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What happens in acquisitions? Evidence from brand ownership changes and advertising investment

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ABSTRACT

We study advertising at the brand level in a sample of corporate acquisitions. New owners display an elevated propensity to sharply cut advertising in acquired brands. This behavior is most pronounced in private equity transactions. When a buyer's existing brands overlap with the acquired brands, aggregate advertising spending on the merged portfolio of brands tends to shift downward. Sharp advertising cuts are more likely to be observed when the old owner of the assets was investing at an elevated level and when the new owner has displayed past restraint in their investment spending activities. Combined buyer and seller abnormal returns are more positive in deals characterized by post-acquisition cuts in advertising, suggesting that these cuts often represent efficiency-enhancing cost savings.

1. Introduction

What happens to purchased assets after they are acquired? This is a surprisingly difficult question to answer, as information on acquired assets becomes opaque after the acquired assets are consolidated into a merged organization. Consequently, much of the past evidence on what happens subsequent in an acquisition is indirect. In this paper, we provide direct evidence on some of the consequences of acquisitions by studying a specific type of investment that is available at a very micro level, brand-level advertising. While advertising decisions are important economic choices in their own right, the availability of rich data on these decisions may also provide us with more general insights into post-acquisition spending and investment decisions. The data we exploit is available not only for domestic public firms, but also for private firms and foreign firms. Consequently, we are able to track advertising investment behavior as assets (i.e., brands) move across different types of owners.

We find that acquisitions present natural opportunities for significant cost cutting behavior, at least in the case of advertising spending. In particular, new owners display an elevated tendency to sharply cut advertising in acquired brands. While this pattern is evident throughout our sample of acquisitions, it is particularly evident in the case of acquisitions made by private equity acquirers. This finding is consistent with the earlier evidence of Kaplan (1989) and suggests that private equity organizations specialize in cost cutting activities.

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Turning to other owner characteristics, we find that cuts in brand advertising are particularly elevated in cases in which the buyer's brands and the acquired brands have substantial overlap. This finding suggests that some acquisitions are associated with efficient cost savings that arise from overlapping activities. Large advertising cuts are also more likely if the old owner of the brand was generally investing at a high level and/or if the buyer displays a restrained propensity to invest. This finding suggests that some acquisitions undertaken by public firms may create value by transferring brands to an owner with a more restrained spending style. Complementing these findings, we find that combined buyer/seller deal announcement returns are more positive in deals associated with post-acquisition cuts in advertising spending.

Taken as a whole, our evidence supports the hypothesis that corporate control activity has a real effect on how assets are managed, and control events present an opportunity for efficient cost savings by new owners who are in a position to exploit these savings opportunities. Our results are consistent with some of these savings opportunities arising because of new ownership by firms that specialize in efficient cost cutting, notably private equity firms and public firms with restrained investment styles. Additional savings opportunities appear to arise because of efficiencies that are specifically made possible by combining assets under common ownership, most notably cases in which the assets have substantial overlap. These findings complement studies of changes in plant efficiency following control changes (e.g., Maksimovic and Phillips (2001), Schoar (2002)), as efficiency changes can be thought of as the net effect of various operational changes implemented by a new owner. Our study provides direct evidence that some of these operational changes are likely related to investment decisions.

The rest of the paper is organized as follows. In Section 2, we review the related literature and outline our empirical strategy. In Section 3, we detail our sample construction and describe the sample. In Section 4, we present our main results on post-acquisition advertising policies. Section 5 concludes.

2. Background and empirical strategy

2.1. Value creation and the market for corporate assets

A large body of existing evidence suggests that many acquisitions are associated with increases in market value.[1] In particular, in full firm acquisitions, combined buyer and target announcement returns are on average positive (e.g., Bradley et al., 1988)). In partial firm acquisitions, seller and buyer returns both tend to be positive (e.g., Alexander et al., 1984; Hite et al., 1987; Jain, 1985). Operating performance after acquisitions also often displays improvement, at least on some dimensions (e.g., Healy et al., 1992). However, given the consolidated nature of accounting information for merged entities and the various special charges and adjustments associated with merger accounting (restatements, merger charges, etc.), it can be difficult to ascertain whether changes in operating performance are directly related to the economic performance of the acquired assets.[2]

Complementing this firm-level evidence, several researchers have attempted to look further inside the firm by studying plant-level efficiency. This evidence indicates that acquired plants often experience increases in productivity under new ownership (e.g., Maksimovic and Phillips, 2001, 2008; McGuckin and Nguyen, 1995)). However, there is also some evidence that purchasers exhibit a post-acquisition decline in the productivity of their existing plants (e.g., Schoar, 2002). These studies provide important evidence indicating that acquisitions can lead to real changes in efficiency of acquired and existing assets. In our analysis we provide evidence on some of the types of decisions that may underlie these efficiency changes.

2.2. Cost savings and changes in control

Several interesting studies suggest that some of the value gain associated with acquisitions is specifically related to the exploitation of cost savings opportunities. In particular, Houston et al. (2001) and Bernile (2004) report that combined bidder plus target merger announcement returns are closely related to management's estimates of projected cost savings. This leads to the natural question of what types of acquisitions give rise to these savings opportunities.

The literature suggests two leading channels though which cost savings may arise in acquisitions. First, the work of Jensen (1986) suggests that target firm managers may tend to overinvest in their firms because of agency problems and a managerial preference for growth. If this is the case, new owners may create value by curbing this overspending. Prior evidence suggests that some acquisitions by private equity firms are driven by this motive (e.g., Kaplan, 1989; Muscarella and Vetsuypens, 1990; Smith, 1990), suggesting that these firms specialize in efficient cost cutting activities.[3] Presumably some acquisitions by public buyers may also be motivated by these concerns.

Another important hypothesized channel for cost savings in acquisitions arises from the possibility of cutting spending in overlapping activities and exploiting economies of scale by bringing similar assets under common ownership. Consistent with the presence of these savings opportunities, the evidence in Healy et al. (1992) and Houston and Ryngaert (1994) suggests that acquisition value gains tend to be larger when there is substantial overlap between a buyer's assets and the purchased assets.

[1] For surveys of this evidence, see Jensen and Ruback (1983), Jarrell et al. (1988) and Andrade et al. (2001). A recent study by Netter et al. (2011) demonstrates that this literature often substantially oversamples domestic deals between public firms. Our unique data source does not suffer from this sampling bias.

[2] For a lucid discussion of some of the difficulties in measuring performance and asset-level decisions subsequent to acquisitions, see Kaplan (2006). See also Ghosh (2001) for a discussion of benchmarking issues after acquisitions and Mulherin and Boone (2000) for additional evidence on synergy gains arising from changes in asset ownership.

[3] For a related theory of this behavior, see Cuny and Talmor (2007). More generally, there is evidence that private entities involved in acquisitions are associated with larger value gains than in purely public deals (e.g., Chang, 1998; DeAngelo et al., 1984; Fuller et al., 2002; Lehn and Poulsen, 1989).