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Ownership structure, family control, and acquisition decisions

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ABSTRACT

We investigate how ownership and family control influence the decision to take part in M&As as an acquirer or as an acquired company in a sample of 777 large Continental European companies in the period 1998–2008. We find that ownership is negatively correlated with the probability of launching a takeover bid, and family firms are less likely to make acquisitions, especially when the stake held by the family is not large enough to assure the persistence of family control. On the passive side of M&A deals, the effect of the largest shareholders' ownership on the decision to accept an acquisition proposal depends non-linearly on the voting rights they hold, and family control reduces the probability of being acquired by an unrelated party. We do not find evidence that family-controlled firms destroy wealth when they acquire other companies. Finally, we document that ownership and family control, while being negatively correlated with M&A activity, are not negatively correlated with growth in firm size.

1. Introduction

The research on mergers and acquisitions (M&As) has uncovered several factors that explain their occurrence and affect how they take place. Examples include synergies (Andrade et al., 2001), managerial empire building (Jensen, 1986; Morck et al., 1990), managerial hubris or overconfidence (Malmendier and Tate, 2008; Roll, 1986), and bidder overvaluation (Shleifer and Vishny, 2003). The ownership structure of a firm, which shapes the decision maker's incentives, also influences the decision to make acquisitions (or to accept takeover offers). For instance, the empire-building argument should be far more relevant to bidding firms with dispersed ownership and entrenched managers than to firms in which the ultimate decision maker owns a sizeable stake. The role played by ownership structure and family control in M&As, which has been neglected in empirical research since the early contribution of Holderness and Sheehan (1988), has become the object of recent papers studying the U.S. market (Basu et al., 2009; Bauguess and Stegemoller, 2008; Klasa, 2007) and the Canadian market (Ben-Amar and André, 2006).

We analyze the relation between ownership and M&As in the different corporate ownership and institutional environment of Continental Europe. We study 777 publicly listed non-financial companies over the period 1998–2008 with total assets above US $250 million at the beginning of the period. While the literature usually studies samples of companies that have been involved in acquisitions as either bidders or targets, we select a closed sample of companies in order to observe their behavior both as bidders and as targets. Six out of 10 of our sample firms (478 out of 777) made at least one acquisition, with a total of 2275 acquisitions launched. We also find that over a third (291) of firms received a takeover offer.

We find that the size of the voting rights held by the largest shareholder is negatively related to the propensity to acquire and that family firms are less likely to make acquisitions, after controlling for all other relevant factors. Family firms are particularly reluctant to make acquisitions when the stake held by the family is not large enough to guarantee control after the transaction.

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We also examine the behavior of our sample firms as targets. The influence of the largest shareholder's ownership on the decision to accept an acquisition proposal depends non-linearly on the voting rights they hold. For levels of ownership below 20%, the likelihood of acceptance of a takeover increases with the amount of voting rights; for levels of ownership between 20% and 50%, no relation between the two variables is found; and, finally, for levels beyond 50%, the relation becomes negative, except for buyouts by the largest shareholder. Family control reduces the probability of being acquired by an unrelated party.

We proceed then to analyze whether the influence of ownership structure on the propensity to acquire is associated with a different acquisition performance, as measured by cumulative abnormal returns (CARs) around the announcement of the takeover deal. We do not find evidence that ownership and family control affect acquisition performance.

Finally, we check whether the low propensity to acquire is a consequence of the financial constraints faced by family firms, which could lead them to choose lower-growth strategies and therefore forgo investment opportunities that would be taken absent family control, or the consequence of a strict aversion against external growth via takeovers. The evidence from our sample companies suggests the latter is true, since family firms do not experience a slower growth rate than non-family firms in the period we cover.

The contribution of our paper can be assessed as follows. The role that ownership and family control exert in passive takeovers is largely expected, since both previous literature and casual evidence suggest that a dominant long-term shareholder does not easily relinquish its position by accepting a merger or a takeover proposal, especially if it is a family in control since generations. Conversely, the influence that ownership and family control may have on both the probability of active takeovers and their wealth effects is less obvious, and has been previously analyzed only in Bauguess and Stegemoller (2008) for the U.S. market. While the study we undertake is in many respects comparable to theirs, the results we find in a different context, Continental Europe, are partially different. While we confirm that family control decreases the probability that a company will engage in active takeovers, we do not find any evidence that family firms destroy value when they acquire other companies in our European sample.

This finding adds to a literature that offers more benign evidence for family control in Europe (Barontini and Caprio, 2006; Maury, 2006; Sraer and Thesmar, 2007) than in the United States (Anderson and Reeb, 2003; Miller et al., 2007; Villalonga and Amit, 2006). Such evidence gives rise to the conjecture that the different legal and institutional environment makes family control more value efficient in Europe, which is directly tested by Franks et al. (2010), who conclude that in Continental European insider-dominated systems family ownership is a powerful and persistent arrangement.

Further original evidence in our paper supports this interpretation. We find that family-controlled listed companies can engage in takeovers significantly less than non-family companies without negatively affecting their growth. This finding complements the evidence in Franks et al. (2010), who find that in “outsider systems,” such as in the United Kingdom, family control has a lower survival rate in industries with high M&A intensity, while in “insider systems” this does not happen.

The paper is structured as follows. We develop hypotheses in Section 2. Section 3 defines ownership and family control, describes the sample, and presents some descriptive statistics. We examine the propensity to acquire in Section 4 and investigate which firms are more likely to be acquired in Section 5. Acquisition performance is analyzed in Section 6. Section 7 analyzes the relation between ownership and growth, and Section 8 performs robustness tests. We present our conclusions in Section 9.

2. Hypotheses and predictions derived from the prior literature

A large body of research suggests that firms can benefit from the monitoring effort of large shareholders when it comes to M&A activity. In fact, managers in widely held firms often make acquisitions to create empires and maximize their utility (Jensen, 1986; Morck et al., 1990) and/or because of their overconfidence (Malmendier and Tate, 2008; Roll, 1986). Furthermore, managers may pursue size-increasing acquisitions as a device to defend themselves from unwanted disciplinary takeovers (Gorton et al., 2009).

These acquisitions, especially when aimed at buying publicly listed firms, often result in a loss of value for the bidding firm (Andrade et al., 2001). Powerful, large shareholders have often both the power and incentives to prevent these non-value-enhancing proposals made by managers. Since we expect that deal proposals will be scrutinized more in firms with large shareholders than in widely held firms, the probability of making an acquisition should decrease as the voting rights held by the largest shareholder increase. There can be, however, a dark side of ownership, since a large shareholder could collude with managers in sharing the private benefits arising from acquisitions, which would reverse the previous conclusions. Claessens et al. (2002) show that the prevalence of negative effects of large shareholders on performance is positively related to the presence of control-enhancing devices, such as pyramids and dual class share structures, which are employed in many European companies to create a divergence between the amount of voting rights and cash flow rights held, the so-called wedge (Faccio and Lang, 2002). When the wedge is high, the largest shareholder has more incentives to collude with managers in sharing the private benefits arising from acquisitions, to the detriment of minority shareholders. For this reason, we expect that the wedge between voting and cash flow rights held by the largest shareholders is positively related to the likelihood of acquisitions.

As far as the decision to accept a takeover offer is concerned, we observe that, on the one hand, self-interested managers are likely to resist value-enhancing proposals that would force them out of their positions and deprive them of the related private benefits. Large shareholders may also counter such resistance and persuade the board to accept value-enhancing proposals, increasing the number of takeovers (Shleifer and Vishny, 1986). On the other hand, the same entrenched managers may look with too much favor at takeovers proposals (especially mergers) that offer them good future employment opportunities or large severance payments. This would make takeovers more frequent without large shareholders, who would likely act against such deals. Another reason why takeovers could be less frequent in the presence of a powerful, large shareholder is, once again, that that shareholder could