PRACTICE MAKES PERFECT

THE REWARDS OF ACQUIRING EXPERIENCE

A study of takeover activity suggests that companies making multiple acquisitions become more skilled in choosing targets and experience a rising success rate. HAMISH I. CARLISLE explains how markets react to acquisition programs and highlights the implications for investor returns.

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Australian and overseas studies into the wealth effects arising from corporate takeovers suggest that abnormal returns from the target firm around the announcement date are positive and significant. However, the benefits accruing to acquiring firms are less clear. Takeover announcements have not been found to have a consistently beneficial impact on the shareholder wealth of acquiring firms at either the time of announcement or after acquisition, which raises questions about the merits of takeover activity. Studies which have examined acquirer returns generally draw inferences based on the abnormal stock performance surrounding specific acquisitions or announcement dates.

Two features are apparent from a review of prior evidence and theory. First, Schipper and Thompson (1983) and Malatesta and Thompson (1985) showed that it is conceivable the market capitalises future acquisitions before they are formally announced. This helps explain the often insignificant share-price reaction of acquiring firms at the announcement date. Second, Holderness and Sheehan (1985) and Casey, Dodd and Dolan (1987) found evidence suggesting that experienced acquirers have superior skills in target selection and/or asset management and are able to extract more value, or at least retain more value, from a takeover. While the role of multiple acquirers or, as they are often termed, "corporate raiders", has been examined, this paper re-examines the issue by focusing on successive acquisitions. The paper examines takeover announcements across subsequent acquisitions within an acquisitions program.

The theoretical model used is based on three key assumptions:
- acquirer skills improve with each subsequent acquisition;
- the probability of the offer being successful increases with each subsequent acquisition; and
- market expectations become more refined with each subsequent acquisition.

Some of the empirical implications of the model are then examined by observing abnormal returns over the period leading up to the takeover announcements. It is found that, after adjusting for market movements and company-specific risk, a portfolio consisting of acquisitions which occur early in an acquisitions program performs poorly when compared with a portfolio consisting of acquisitions which occur in the later stages of a program.

THE MODEL

The model makes three key assumptions about the wealth effects of corporate takeovers in an acquisitions program. First, assume that the probability of an offer being successful increases as the number of previous successful offers increases. This assumption is consistent with previously documented evidence suggesting multiple acquirers have a higher chance of success than one-off bidders. If the share-price reaction at the time of announcement is determined by the probability of success, and the expected gains from the acquisition are positive, then this assumption implies...
that the gains accruing to acquiring firms on the announcement of a takeover offer are likely to be relatively lower for an inexperienced acquirer.

The second assumption of the model relates to the way in which the total gains from an acquisition are distributed between the bidder and the target firms. More specifically, assume that the proportion of the total gains that are distributed to the bidder increases with subsequent acquisitions. This is consistent with the notion that raiders have superior skills in target selection and/or asset management. The implication of this assumption is that the gains accruing to acquiring firms in the early stages of an acquisitions program are likely to be relatively smaller than those in the later stages of the program.

The third assumption concerns the extent to which the sharemarket has capitalised the takeover announcement before the offer was actually announced. As a company becomes known to the market as a frequent acquirer we would expect investors to anticipate future offers. Such anticipation implies that the major effect on shareholders' wealth should be observed early in a program of acquisitions and, as uncertainty is resolved, should decrease with successive takeovers. This assumption suggests that the magnitude of the abnormal gains accruing to acquiring firms are likely to be larger in the early stages of an acquisitions program irrespective of whether these gains are positive or negative. In other words, an offer early in the program is more likely to be unanticipated; hence the share-price reaction, in terms of abnormal returns, is likely to be relatively larger when compared with takeover announcements in the later stages of the program.

The first two assumptions suggest that the expected gains associated with making the offer are likely to be small and perhaps negative. The assumptions suggest that as the acquisitions program proceeds, acquirer skills improve and the probability of success increases. This then implies that the expected gains associated with making the offer are likely to increase.

The third assumption suggests that the extent to which a forthcoming takeover offer is expected by the market is a positive function of previous acquisitions. In other words, an announcement early in the program is more likely to be unanticipated; hence the share-price reaction, in terms of abnormal returns, is likely to be relatively larger when compared with takeover announcements in the later stages of the program.

DATA AND METHOD

The study covers the period January 1977 to December 1992. For the period January 1977 to June 1985 the Centre for Independent Studies (CIS) takeover file was used as the data source. The file contains details of all takeovers reported by the Sydney Stock Exchange's publications Current Offers and Takeover Offers over the relevant period. For the period July 1985 to December 1992 the Corporate Adviser takeover files were utilised. These two data sources give a total of more than 2,000 takeover offers.

The definition of an acquisitions program is subjective, but for the purposes of this paper a firm was defined to have started an acquisitions program if it met the following criteria. First, the firm had not been involved in a takeover offer in the five years preceding its first acquisition. Second, the firm must have made at least three successful bids for different targets in the following five years.

For methodological reasons, the firm had to be listed on the Australian Stock Exchange and sufficient price data had to be available over the takeover period. Under these criteria the sample was exhaustive and consisted of 26 firms. The subsequent acquisition programs of these firms (a total of 92 acquisitions) were analysed.

The market's reaction to a takeover offer was measured using weekly stock return data to compute excess stockholder returns. These price relatives were adjusted for both dividends and capitalisation changes. The weekly excess return for security i was estimated by

\[ E_{it} = R_{it} - \alpha_i - \beta_i R_{mt} \]

where

- \( t \) = week measured relative to an event,
- \( E_{it} \) = excess return on security i for week t,
- \( R_{it} \) = return on security i during week t,
- \( \alpha_i \) = the weekly alpha of security i,
- \( \beta_i \) = the beta of security i,
- \( R_{mt} \) = the return on the market index for week t.

The market model coefficients were estimated using monthly share-price data adjusted for dividends and capitalisation changes and are based on the period commencing 40 months before the offer announcement to four months before the offer announcement. This period dis-continues at the beginning of the weekly event window. The market model parameters were re-estimated before each subsequent acquisition and the Statex Actuaries Accumulation Index was used to estimate the return on the market.

Individual security excess returns were then calculated and grouped into portfolios according to the acquisition number in each firm's program. Specifically, two portfolios were formed; the first portfolio consisted of first and second acquisitions and the second consisted of third and
The size of the losses following takeover announcements (i.e., around negative 12 percent in total) when it is considered that this represents the extraordinary market reaction to the former portfolio are even larger than the returns accruing to acquiring firm shareholders are significantly less positive. Nonetheless, as a means to further understanding the nature of these returns, the portfolios were further divided into four groups constituting first, second, third, and fourth and subsequent acquisitions. These results are shown graphically in Figure 2 and presented in Table 2. The results are largely consistent with those presented earlier and, while this approach is not statistically robust, it does suggest a general trend. That is, the APIs are increasing with successive acquisitions.

To establish whether this trend results in significant positive abnormal returns, however, remains an issue for future research.

The third assumption of the model implied that the extent to which a forthcoming offer is anticipated by the market, or capitalised, is a positive function of the firm. These findings suggest that the announcements came as no surprise to the market regardless of whether the

<table>
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<tr>
<th>Table 1: Summary of Abnormal Returns over Weekly Event Window</th>
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<tr>
<td><strong>1-week return</strong></td>
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<tr>
<td><strong>(week 0)</strong></td>
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<tr>
<td>Abnormal returns for all acquisitions</td>
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<td></td>
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<td>Abnormal returns for first and second acquisitions</td>
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<td></td>
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<tr>
<td>Abnormal returns for third and subsequent acquisitions</td>
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* Significantly different from zero at the 1% level.
acquirer had a history involving successful takeovers. The results do, however, highlight the importance of the pre-announcement period when dealing with acquiring firms.

In summary, the results are consistent with the notion that raiders have superior skills in target selection and/or asset management but offer only limited support for the notion that acquisition programs are capitalised before the announcement of individual takeover offers.

The implications of the findings relate to the competitiveness of the market for corporate control and the prevalence in this market of multiple acquirers, or corporate raiders.

CONCLUSION

The implications of these findings with regard to corporate raiders and their role in the market for corporate control are substantial. Previous papers indicated an absence of positive abnormal returns accruing to acquiring firm shareholders associated with takeovers.

Early studies examined the effects of various factors including relative size, method of payment and the number of opposing bidders as potential explanations of this phenomenon. Furthermore, recent studies have found that multiple acquirers not only account for a large proportion of all takeover offers but are able to extract more of the value from a corporate acquisition than their non-raiding counterparts.

The results presented in this paper extend these previous findings by documenting that early acquisitions are likely to perform poorly relative to acquisitions undertaken by an experienced acquirer. The paper offers insight into why corporate raiders are able to extract more of the value associated with corporate acquisitions and into why multiple acquisitions are so common.

The evidence suggests that multiple acquirers, on average, create more value for their shareholders after they have gained experience in the takeover market. Further, the evidence explains why samples taken from a population of all types of acquisitions are likely to yield negative abnormal returns around the takeover announcement date. The results can be interpreted as a form of scale economy in acquisitions and would explain the prevalence of a small number of large players in the market for corporate control.

NOTES

1 This research benefited from the comments of various members of the Department of Accounting and Finance at Melbourne University. In particular, the author acknowledges the comments of Kim Sawyer and is indebted to Tim Holderness and Sheehan for access to the Statics Accumulation Index and helpful comments.


6 Formally,

\[ E(g_i | T) = P_i \cdot E(g_i | S) + (1 - P_i) \cdot E(g_i | U) \]

where,

\[ E(g_i) \] is the expected abnormal gain to acquirer of the \( i \)th acquisition,

\( T \) is the event that the offer is announced,

\( P_i \) is the probability of the \( i \)th offer being successful,

\( S \) is the event that the offer is successful,

\( U \) is the event that the offer is unsuccessful.

7 The gains accruing to acquiring firms may be negative if the probability of success is low, reflecting fixed costs associated with making a bid, and/or the acquirer’s skills are undeveloped, reflecting poor target selection and asset management.

8 An offer was classed as successful if it resulted in the acquisition of at least 50 per cent of the voting shares of the target.

9 Daily return data was also used, yielding results that were consistent with those of the weekly data.

10 Market model estimates were also formed using a five-year estimation period. Results are essentially the same.

11 The All Ordinaries Price Index was also employed as an indication of the return on the market. Results are essentially the same.

12 Alpha estimates are converted from monthly estimates to weekly estimates by multiplying them by 7/30.

Table 2: Summary of abnormal returns over weekly event window

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<tr>
<th></th>
<th>1-week return</th>
<th>11-week return</th>
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<tbody>
<tr>
<td></td>
<td>(week 0)</td>
<td>(day -10, 0)</td>
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<tr>
<td>Abnormal returns for all acquisitions</td>
<td>-0.83%</td>
<td>-2.58%</td>
</tr>
<tr>
<td></td>
<td>(-1.54, 69)</td>
<td>(-1.52, 69)</td>
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<td>Abnormal returns for first acquisition</td>
<td>-1.90%</td>
<td>-9.15%</td>
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<td></td>
<td>(-1.65, 22)</td>
<td>(-4.13, 22)</td>
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<td>Abnormal returns for second acquisition</td>
<td>-0.24%</td>
<td>-2.42%</td>
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<tr>
<td></td>
<td>(-0.41, 18)</td>
<td>(-1.10, 18)</td>
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<tr>
<td>Abnormal returns for third acquisition</td>
<td>-1.69%</td>
<td>2.00%</td>
</tr>
<tr>
<td></td>
<td>(-1.73, 14)</td>
<td>(0.18, 14)</td>
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<tr>
<td>Abnormal returns for fourth and subsequent acquisitions</td>
<td>0.84</td>
<td>4.02%</td>
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<tr>
<td></td>
<td>(0.86, 15)</td>
<td>(0.84, 15)</td>
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* Significantly different from zero at the 1% level.