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Second Annual Cass Mergers and Acquisitions Research Centre Conference Report

22 August 2017

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Robert Dam, *"Merger Activity, Stock Prices, and Measuring Gains from M&A"* (with **Benjamin Bennett**)

Robert Dam presented a paper which develops a model incorporating acquisition probabilities and expected deal premiums and estimates the "embedded merger premiums" at both the firm and aggregate levels. At the firm and M&A-event level, 10% of a typical firm's value is attributable to the anticipation of its possible acquisition. This implies one-third of the observed premium is already embedded before takeover runup and extant M&A event studies underestimate the gains from mergers. The empirical results show observed premiums are strongly negatively correlated with the predicted takeover probability. At the aggregate level, 10% of total market capitalisation can be attributed to the option value of takeovers. In addition, M&A activity could inform the expectation for future deals and increased deal anticipation embeds more of the future gains into current prices. In contrast to existing literature which states the link from prices to mergers, this channel builds up the causality from M&A activity to stock market.

The discussant, **Andrey Golubov**, noted that the negative relationship between the observed premium and takeover probability could be affected by the way that premium is measured. For instance, the current measure of premium as offer price to target price might not work because higher takeover probability raises the target price and thus leads to a lower premium. He suggested replacing the measurement of those not influenced by anticipation. He also noted that the merger premium reflects part of market return and suggested computing market return excluding target firms. The audience questioned the status of target firms as the results are based on public targets and asked how much the premiums will be to private targets.

Jie Yang: *"Tapping into Financial Synergies: Alleviating Financial Constraints through Acquisitions"* (with **Rohan Williamson**)

Previous empirical studies focused on the measurement and cross-sectional difference of financial constraints. Given the level of financing constraint of a firm, **Jie Yang**, presented a paper which studies the role of M&A in alleviating financial constraints. Compared to unconstrained acquirers, financially constrained firms could use the undervalued stock to fund their acquisitions. By using propensity score-matching in the difference-in-difference setting, the paper finds that constrained acquirers become less constrained post-acquisition and the results are strong for diversifying acquisitions. Taking the withdrawn acquisition as the placebo test, there is no evidence of alleviation of constraints. Following acquisition, constrained acquirers raise more debt and increase investment. Finally, the paper demonstrates that constrained acquirers experience larger announcement returns.

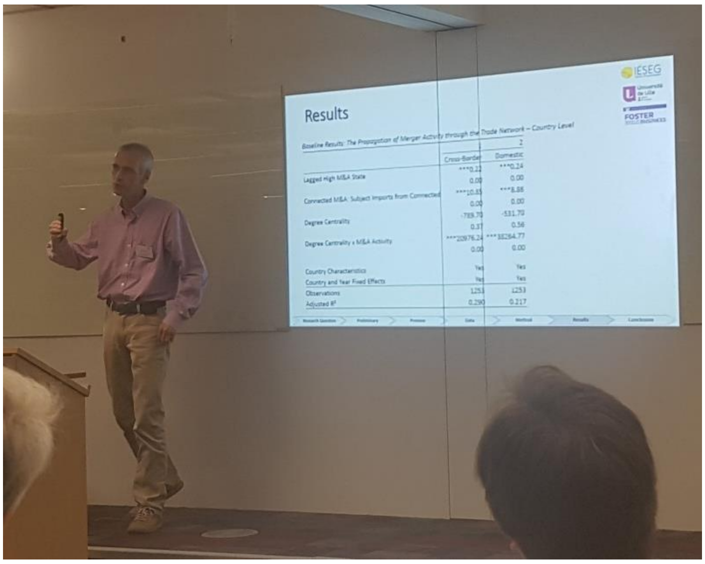
In his discussion, **Rui Silva** asked what is new to the literature and suggested exploring the selection questions further such as which/when firms are acquiring/acquired and what are other alternatives to alleviate financial constraints. He questioned whether the propensity score-matching is correct because the paper compares a combination of acquirer and target to the control group "potential acquiring" firm post-acquisition. He noted the difficulty in identification and suggested extending the placebo test on withdrawn acquisitions further. He also asked whether synergies should be measured in combined returns as this paper adopts acquirers' announcement as evidence as synergy. The audience asked if there were other reasons instead of financial constraints driving the post-merger results and how a constrained acquirer could convince the target by paying the stock.

Brandon Julio: *"A BIT Goes a Long Way: Bilateral Investment Treaties and Cross-border Mergers"* (with **Vineet Bhagwat**, and **Jonathan Brogaard**)

Brandon Julio presented a paper which examines whether Bilateral Investment Treaties (BITs) act as a substitute for high enforcement of contracts and property rights and remove impediments to foreign investment. To measure the flow of capital from one country to another, the paper uses cross-border M&A instead of foreign direct investment. On average, BITs lead to higher volume and likelihood of cross-border mergers between signatory countries. The increasing capital flows are mainly from developed countries to developing countries and the result sheds light on the Lucas Paradox. The effects of the BIT signing are stronger for smaller countries and countries with medium levels of political risk. After the signing of BITs, total announcement returns increase and target firms gain a larger share of merger announcement return post-BIT.

The discussant, **Elizer Fich,** first recommended that key results in dollar magnitude could depict a clearer picture. He wondered if the paper's contribution is enough. Many papers have already investigated the effects of BITs on FDI and they provide evidence similar to that in this paper. Also, there are papers using cross-border M&As to measure FDI and some results overlap with those in this paper. He suggested that the paper needs an angle to distinguish it from the crowded literature. The audience questioned what the completion rate of the deals are before and after the BITs. The audience noticed that BITs are signed by the UK, for example, and other developing countries. The UK does not have BITs with the US although there are high capital flows between two countries. This could lead to bias on the estimated effects of BITs.

Eric de Bodt: *"International Trade and the Propagation of Merger Waves"* (with **M. Farooq Ahmad and Jarrad Harford**)



Eric de Bodt presented a paper investigating how merger activity transmits across countries through trade links. Using a network based analysis technique to examine country (and country-industry) imports/exports and domestic and cross-border mergers, this paper finds evidence of positive correlation between trade networks and M&A networks. The intensity of M&A activity in connected countries has strong explanatory power for the cross-border/domestic M&A activity in the subject country. The results also hold at the country-industry level. Further, the strength of trade links as the channel to amplify the merger waves is time dynamic and is affected by import tariff cuts, Euro adoption, and entry into the EU and EEA or the WTO. The paper also shows that M&A activity in connected countries could predict M&A activity in the subject country and trade flows drive M&A activity and not vice-versa.

Overview of the Results
Cass Business School

In his discussion, **Paolo Volpin** questioned why M&A contagion happens in this case. It seems there is no clear answer for such contagion. Is it trade? Is it cost of capital? Is it relative over/under valuation? Because the paper adopts country-industry-year as the unit of observation, he also asked how the result would be different using industry-year or country-year observation. Further, he had some concerns about the trade-weighted index as the trade could be a proxy for something else such as cultural distance. The audience asked whether the trade flows on the right-hand side of the equation inform the anticipation and drive the valuation of the M&A in the subject country.

Keynote Speech

Michel Driessen: *"The Next Five Years of M&A: Boom or Cooling off"*

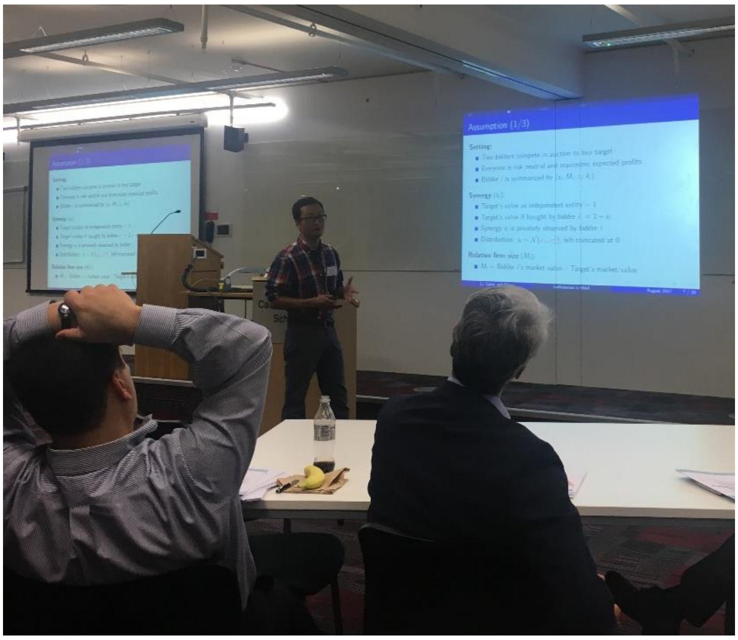
The next 5 years of M&A – Boom or Cooling off?
EY

Michel Driessen opened his speech by providing the outlook for Global M&A activity in 2017. The current M&A wave remains strong as private equity firms stage a return but there is a fall in megadeals and the market is becoming more complex. After Brexit, UK inbound and domestic deal value increased by 3.5% in 2016 but the deal volume declined.

Michel then outlined four key factors impacting M&A in 2017 and beyond. Increased global geopolitical instability makes the M&A activity uncertain. A potential slowdown in global trade flows, increase in protectionism and restrictions in free-movement of employees could put a limit on the M&A market. In addition, he mentioned that increased intervention by governments, for instance, increased antitrust issues in 2017, and newly-established laws and regulations worried M&A practitioners. Although facing the uncertainty mentioned, the UK remains attractive to inbound investment and continues to look abroad to secure entry to new markets. Further, he highlighted the role of the digital revolution in M&A activity.

In the last decade, the top five publicly-traded companies have moved from the traditional energy industry to the high technology industry. Digital disruption, which brings in big data and analytics, internet of things, augmented/virtual reality and artificial intelligence, influences all aspects of the value chain from product development to customer interaction. Digital innovation also results in convergence of sectors and diversification of deal strategy. For example, Apple not only participates in the retail and consumer sector but also steps into the artificial intelligence sector. The types of deals are broadened from pure acquisition to more diversified strategies including joint ventures, partnerships and alliances. Michel concluded his talk by emphasising that the way we do business is changing but transactions will continue.

Wenyu Wang: *“Inefficiencies and Externalities from Opportunistic Acquirers”* (with **Di Li** and **Lucian A. Taylor**)



Quantifying stock misevaluation, M&A synergy and inefficiency from acquirers’ opportunistic behaviours is challenging. **Wenyu Wang** presented a paper which develops a model of M&A contests to overcome these challenges, quantify the potential inefficiency and estimate the model’s parameters using simulated method of moments (SMM). The paper documents that the aggregate inefficiency from opportunistic acquirers is modest. In 7% of the deals, an overvalued bidder crowds out a bidder with a higher synergy. In these inefficient deals, the average synergy loss is equal to 9% of the target’s value and, as a result, average loss across all deals is 0.63%. However, the inefficiency is large for certain deals and it is larger in deals where misvaluation is more likely. The paper also finds that misvaluation imposes larger externalities across acquirers and makes the payment of cash more valuable.

In his discussion, **Enrique Schroth** first suggested considering the addition of moments such as the mean and variance of the offer premium which are more informative about the parameters. He questioned how the merger arbitrage by hedge funds could distort the actual acquirers’ CAR away from the model and recommended fixing or discussing merger arbitrage in a more detailed manner. He also suggested adding a caveat to inefficiency measures. The audience asked what the role of cash-rich acquirers would be. The audience was also curious about externalities because this will be transferred from undervalued acquirers to the target but not to the third party overvalued acquirers.

Mihir N. Mehta: *“Political Influence and Merger Antitrust Reviews”* (With **Suraj Srinivasan** and **Wanli Zhao**)

Mihir N. Mehta presented a paper examining whether M&A parties in the constituencies of politicians serving on U.S. Congressional Judiciary Committees are more likely to receive favourable antitrust outcomes. The paper documents that when acquirers have judiciary committee representation, antitrust reviews result in fewer obstacles and reviews are completed more quickly. By contrast, when targets have judiciary committee representation, antitrust reviews result in more obstacles, reviews are completed more slowly and results vary with the target’s favourability towards the merger. To address the causality, the paper exploits judiciary committee member departure turnover cases and a falsification test using powerful politicians with no jurisdiction over antitrust regulators. Why do politicians influence regulators? The paper finds that this could be due to lobbying, contributions and prior business connections but not concerns about voter job losses.

The discussant, **Sudi Sudarsanam**, asked what the exact relationship is between the Judiciary Committee and the Federal Trade Commission (FTC) and whether Senators and House representatives have enough incentives. Why not use the state Attornies General? He then called into question how independent the FTC review process is. He also questioned the appropriateness of the proxies for political influence and the demand for FTC review. He suggested that the paper should go deeper into the merger review process to clarify how influence is channelled to the investigative agencies.

Kai Li: *"Product Market Dynamics and Mergers and Acquisitions: Insights from the USPTO Trademark Data"* (With **Po-Hsuan Hsu**, **Yunan Liu** and **Hong Wu**)

Firms merge to obtain synergies and synergy stems from efficiency improvement or market power. **Kai Li** presented a paper employing the trademark data from the USPTO to shed light on how product market competition affects M&A activities and how acquisitions affect product lines. The paper documents that firms with more, newer and faster-growing trademarks are more likely to be acquirers. Firms with overlapping product lines as measured by trademark similarity are more likely to be merged and these deals are associated with high combined announcement returns. Post-merger, greater trademark similarity leads to more cancelled trademarks for targets as well as fewer newly registered trademarks for acquirers. Also, it is related to lower cost of goods sold, lower advertising expenses, higher return on sales and larger market shares.

In his discussion, **François Derrien** asked what the difference would be were the analysis to be conducted at the product market classes and industry levels. He also suggested that there could be alternative interpretations of the trademark cancellation results. For example, if post-acquisition, a target's product lines re-focused toward those of the acquirer, could this lead to the economies of scale. Also, product lines that are different from those of the acquirer could be dropped. As for post-acquisition operating efficiency, are they stronger after cancellation of competing trademarks at the target firm? Are these acquisitions good or bad? He also raised a question about the endogeneity of the acquisitions because unobserved factors explain participation in the acquisition and outcome variables.