Corporate Governance and Acquisitions: Acquirer Wealth Effects in the Netherlands

Abe de Jong, Marieke van der Poel and Michiel Wolfswinkel

ERIM REPORT SERIES *RESEARCH IN MANAGEMENT*	
ERIM Report Series reference number	ERS-2007-016-F&A
Publication	January 2007
Number of pages	48
Persistent paper URL	
Email address corresponding author	ajong@rsm.nl
Address	Erasmus Research Institute of Management (ERIM) RSM Erasmus University / Erasmus School of Economics Erasmus Universiteit Rotterdam P.O.Box 1738 3000 DR Rotterdam, The Netherlands Phone: + 31 10 408 1182 Fax: + 31 10 408 9640 Email: info@erim.eur.nl Internet: www.erim.eur.nl

Bibliographic data and classifications of all the ERIM reports are also available on the ERIM website: www.erim.eur.nl

ERASMUS RESEARCH INSTITUTE OF MANAGEMENT

REPORT SERIES

RESEARCH IN MANAGEMENT

ABSTRACT AND KEYWORDS	
Abstract	We examine 865 acquisitions by Dutch industrial firms over the period 1993–2004. Theoretical work based on principal–agent problems predicts that managers of exchange-listed corporations may pursue acquisitions even when these do not add value for the shareholders. Corporate governance structures serve to constrain managers in their acquisition activity. In this chapter we measure the shareholder wealth effects of acquisitions and the factors that determine these wealth effects, including the governance characteristics of corporations. Firms in the Netherlands are interesting from the perspective of corporate governance, because the managerial board has a relatively strong position vis-à-vis shareholders. Several takeover defenses commonly used in the Netherlands not only limit shareholder influence during takeover battles, but also in absence of such fights. On the other hand, ownership is relatively concentrated, which may provide shareholders with the incentives and power to monitor the management. The average abnormal stock return following acquisition announcements is 1.1%, which is a significant positive effect. There is only a significant negative impact of the so-called structured regime, a situation where several shareholder rights are delegated to the supervisory board. This result suggests that governance improves acquisition decisions.
Free Keywords	Mergers & acquisitions, Corporate governance, The Netherlands, Event study
Availability	
Classifications	

Corporate Governance and Acquisitions: Acquirer Wealth Effects in the Netherlands

Abe de Jong
RSM Erasmus University

Marieke van der Poel
RSM Erasmus University

Michiel Wolfswinkel
ENECO Energie NV and RSM Erasmus University

January 2007

Corresponding author: Abe de Jong, Department of Financial Management, Room T9-53 P.O. Box 1738, 3000 DR Rotterdam, The Netherlands. Phone: +31 10 408 1022, Fax: +31 10 408 9017, Email: ajong@rsm.nl. Opinions expressed in this article represent the authors' strictly personal views and opinions and cannot in any way be construed as statements or views of ENECO Energie NV.

1. Introduction

This chapter examines acquirer wealth effects around acquisition announcements by Dutch firms. In the Netherlands the market for corporate control is virtually absent. Dutch firms can use several types of defense mechanisms as a protection against hostile takeovers and as a restriction of shareholders' influence. As a result, shielded by defense mechanisms, Dutch managers can exercise more discretion in their corporate investment decisions than their counterparts in Anglo-Saxon countries.

Several studies examine acquirer wealth effects of US firms during the days around their acquisition announcements. The evidence of these studies is mixed. Some studies find zero or positive shareholder returns around acquisition announcements (e.g., Morck, Shleifer and Vishny, 1990; Lang, Stulz and Walkling, 1991; Moeller, Schlingemann and Stulz 2004, 2005; Masulis, Wang and Xie, 2006), whereas other studies find negative returns (e.g., Franks, Harris and Titman, 1991; Mulherin and Boone, 2000; Andrade, Mitchell and Stafford, 2001). When taking the change in dollar value into account, the results of Moeller, Schlingemann and Stulz (2004, 2005) suggest that overall shareholders lose money. In the 1980s shareholders lost a total of $7 billion, while in the period 1991-2001 the loss amounts to $216 billion. Strikingly, in 1998-2001 period dollar returns add up to a loss of $240 billion, which is mainly the result of a small number of large losses by firms with high market valuations. The acquisition literature knows a few studies on shareholder wealth effects of European acquiring firms. The studies on European acquisitions find on average positive shareholder returns for acquiring firms (Goergen and Renneboog, 2004; Martynova and Renneboog, 2006).

Even though several studies find on average positive returns around acquisition announcements, the percentage of shareholders experiencing negative returns is still high. A widely proposed explanation for the negative shareholder returns is agency problems as a result of the separation between ownership and control (Berle and Means, 1932; Jensen and Meckling, 1976). Managers rather make non-value maximizing acquisitions to build their empire than pay out excess cash to shareholders (Jensen, 1986). In other words, by pursuing their own objectives and thereby increasing their own utility rather than maximizing shareholders' wealth, managers invest beyond the optimal size. A possible consequence of this overinvestment problem is that managers overpay for targets that provide private benefits (Morck, Shleifer and Vishny, 1990), such as entrenchment benefits (Shleifer and Vishny, 1989), which result in negative returns for the acquiring firm's shareholders. In a recent contribution to the agency literature Jensen (2005) argues that managers may be motivated to acquire by high stock prices. Agency costs of overvalued equity arise in case managers make poor acquisitions in order to aim to fulfill unrealistic expectations of the stock market.

Adequate corporate governance should diminish agency problems in acquisition decisions. One of the forces that discourage managers from empire building is the market for corporate control in the sense that firms making value-decreasing acquisitions are more likely to be acquired later (Mitchell and Lehn, 1990). However, takeover defenses decrease the probability of being taken over, which could lead to an insulation of managers from the discipline of the market for corporate control (Bebchuk, Coates and Subramanian, 2002; Field and Karpoff, 2002). Previous studies find takeover defenses to negatively influence firm value and long-run stock performance (Gompers, Ishii and Metrick, 2003; Bebchuk, Cohen and Ferrell, 2005). Specifically, Gompers, Ishii and Metrick (2003) construct a governance index, which is a score for the number of

takeover defenses and other anti-shareholder provisions out of a set of 24 provisions. The authors find firms with weaker shareholder rights have a lower firm value, make more acquisitions, are less profitable and have lower sales growth. Bebchuk, Cohen and Ferrell (2005) refine this study by investigating which provisions from the governance index are the main drivers that negatively influence firm value. Their study suggests that just six out of the 24 provisions play a key role in explaining firm value. The six provisions consist of four provisions that limit shareholder voting power – i.e. staggered boards, limits to shareholder amendments of the bylaws, supermajority requirements for mergers and supermajority requirements for charter amendments – and two provisions that prevent hostile takeovers – i.e. poison pills and golden parachute arrangements. Although these studies contribute the negative relation to agency problems, they do not specify the reasons behind the negative impact. Masulis, Wang and Xie (2006) go one step further and examine the impact of takeover defenses of US firms on shareholder returns around acquisition announcements. They find that firms with more anti-takeover defenses exhibit lower shareholder returns around acquisition announcements relative to firms with less defenses. These findings suggest that managers, who are insulated from the market for corporate control by incorporating takeover defenses, are more likely to make non-value maximizing acquisition decisions.

In this chapter, we describe the acquisition activity of Dutch industrial firms and the related wealth effects of the acquiring firms' shareholders for the period from 1993 until 2004. We are especially interested in the impact of corporate governance on shareholders' wealth changes following acquisition announcements by Dutch firms. As Dutch firms deploy several types of defense mechanisms (Kabir, Cantrijn and Jeunink, 1997; De Jong, Kabir, Marra and Röell, 2001; De Jong, DeJong, Mertens and Wasley, 2005; Renneboog and Szilagyi, 2006), managers can exercise more discretion with their acquisition decisions. In particular, firms that reach a certain

size are required to adopt the *structured regime*, as a result of which qualifying firms are obliged to set up a supervisory board. This supervisory board inherits many powers, which are otherwise held by shareholders. Apart from the structured regime, Dutch firms can introduce three types of securities that restrict shareholders' influence on company decisions and act as defense mechanism against hostile takeovers. First, *certificates* through which holders have the same rights as holders of common shares with the exception of voting rights. Second, Dutch firms can install the option to sell *preference shares* to friendly shareholders during takeover threats, which is equivalent to US firms using poison pills as a takeover defense. Third, through *priority shares*, firms can provide friendly shareholders with special rights such as merger approval, new public offerings, nomination of board members, charter amendments and company liquidation. Corhay and Tourani Rad (2000) also examine abnormal returns of acquisition announcements disclosed by Dutch firms, however, focus exclusively on cross-border acquisitions. Besides, the authors do not relate corporate governance characteristics to acquirer's returns. On the contrary, our study relates specific details of the corporate governance mechanisms of acquiring firms with shareholders' wealth of these firms. We expect firms that are well governed to make value enhancing acquisition decisions. We also distinguish between deals in which shareholders experience large losses and deals without such large losses. Moeller, Schlingemann and Stulz (2005) suggest that wealth destructing deals are more likely to take place when managerial discretion plays a larger role. The authors find firms with high valuations to be more likely to make losses of more than one billion dollar when announcing an acquisition. However, they do not provide direct evidence of the impact of corporate governance on the likelihood of these deals. We investigate whether good corporate governance mechanisms prevent firms from performing wealth-destructing acquisitions.

Our findings suggest a minor influence of corporate governance on acquisition announcements in the Netherlands. On average, acquirer returns are 1.1% and the average increase in shareholders' wealth is €18 million. In explaining acquirer returns, we find just one governance variable to be statistically significant, i.e. the structured regime dummy. The regression coefficient suggests 1.0% lower acquirer returns following acquisition announcements of firms that operate under the structured regime as compared to firms that do not operate under such a regime. This is in line with the notion that shareholders have limited power over firm's decisions when these firms adopt a structured regime. We find the same striking result as Moeller, Schlingemann and Stulz (2005) that during 2001 and 2002 average acquirer percentage returns are positive, whereas the total euro wealth effect for shareholders is negative. Consequently, we investigate which firms are more likely to make wealth destructing deals. A binary logit analysis suggests that managers of firms that provide room for exercising discretion in their acquisition decisions are more likely to make deals in which shareholders lose more than €150 million. Specifically, a firm's Tobin's *q*, leverage and firm size increase the probability of making large losses during acquisition announcements. A higher likelihood of making value-destructing acquisitions of firms with more leverage may seem counterintuitive; however, managers of Dutch firms avoid the disciplining role of debt, especially when they overinvest (De Jong, 2002). Therefore, shareholders of firms with high leverage can perceive acquisition announcements as highly risky, which may bring about a stronger negative response resulting in large loss deals. In line with our expectations, a smaller relative size of the executive board and firms that have priority shares are more likely to make value-destructing acquisitions. However, preference shares decreases the likelihood of value-destructing acquisitions.

The structure of this chapter is as follows. Section 2 describes the Dutch situation and previous findings of factors that influence shareholders' wealth effects. Subsequently, Section 3 discusses the research design. Section 4 describes the empirical results and we end the chapter by providing a conclusion in Section 5.

2. Literature review

This section first provides a description of the Dutch setting. Subsequently, we briefly discuss previous studies on the factors that influence shareholder returns around acquisition announcements.

2.1. The Dutch situation

The basis of Dutch corporate law is the shareholder-controlled firm with a management board and supervisory board. Shareholders' rights consist of electing members of the management board and supervisory board, formally approving dividend policy and the annual accounts. Shareholders are also allowed to vote on major decisions, such as mergers and acquisitions. However, firms that are incorporated within the Netherlands are able to severely restrict the power of shareholders in four ways.[1]

Firms with a book value of shareholders' equity of at least €11.4 million, with more than 100 persons employed within the Netherlands and the legal obligation to set up a works council are required to adopt the structured regime. These firms are obliged to set up a supervisory board that takes over several powers from shareholders, including the authority over major decisions, the election of the management and supervisory board and the establishment and approval of annual accounts. It is important to note that shareholders retain their right to vote on mergers and

acquisitions. Multinationals with more than half of its employees abroad are exempted from the requirement of adopting a structured regime. However, they can operate under this regime on a voluntary basis which is applied by most multinationals.

Apart from the structured regime, firms can implement three types of securities that restrict shareholders' influence on company decisions and act as takeover defenses. First, Dutch firms can set up a trust office that holds the firm's shares and issues certificates to the investors. Although certificate holders retain their dividend rights, they can freely trade their certificates and attend the General Meeting of Shareholders. However, they cannot vote. The trust office takes over all voting rights and is normally friendly to the incumbent managers. In practice, certificates enable managers to pursue their own objectives and provide a defense against firms that are willing to acquire the firm. Second, when firms experience a takeover threat, they can sell preference shares to friendly shareholders or a trust office. The main purpose of preference shares is to change the balance of power between shareholders as preference shares carry full voting rights, even though they may not be fully paid-up. The shareholders have to pay 25% of the nominal value upfront and the maximum amount of preference shares that can be issued is 50% or 100% of the current outstanding nominal capital. To be able to issue preference shares without shareholders' consent, firms set up a trust office with an option on these shares. Third, Dutch firms may have priority shares that carry special rights, such as merger approval, new public offerings, nomination of board members, charter amendments and company liquidation, to friendly shareholders as takeover defense. As shareholders' power with firms are severely restricted and Dutch firms widely implement these takeover defenses, the provisions of Euronext Amsterdam since 1989 allow firms to only use two types out of the latter three takeover defenses.

The use of these takeover defenses has implications for firm value. Consistent with previous research on takeover defenses, De Jong, DeJong, Mertens and Wasley (2005) find all four takeover defense mechanisms to be negatively related to firm performance, measured by Tobin's *q*. A possible reason for the lower Tobin's *q* is the minor influence shareholders can exert on firms' decisions. De Jong, Mertens and Roosenboom (2004) provide evidence that the use of certificates, priority shares and the adoption of a structured regime decreases the probability that shareholders vote against proposals during General Meetings of Shareholders. On the other hand, their results show a positive relation between the use of preference shares and the probability of votes against proposals. Renneboog and Szilagyi (2006) also show that shareholders of Dutch firms have a weak position, as they find that firms adopting the structured regime and firms that use preference shares relax their dividend policy.

Other noticeable governance characteristics of Dutch firms include ownership structure, cross-listings in the US and UK and the low disciplining impact of leverage. First, the ownership structure of Dutch firms is relatively concentrated (Kabir, Cantrijn and Jeunink, 1997; De Jong, Kabir, Marra and Röell, 2001), while the voting rights in Dutch firms are more concentrated than ownership rights. This unequal distribution is due to the takeover mechanisms in which blocks of shares are controlled by trust offices (De Jong, Kabir, Marra and Röell, 2001). Furthermore, Dutch firms with a less concentrated ownership structure are more likely to adopt takeover defenses (Kabir, Cantrijn and Jeunink, 1997). Many Dutch firms have a cross-listing in the US, the UK or in both countries. In our sample, this holds for 32% of the firms. By means of a cross-listing in one of these two countries, firms can bond themselves in terms of legal liability exposure and reputation (Coffee Jr, 1999, 2002). In other words, a cross-listing in the US or UK leaves less room for discretionary behavior (De Jong, Mertens and Van der Poel, 2006). Leverage

is another device to discipline managers to make value-maximizing decisions (Jensen, 1986). However, De Jong (2002) finds that this does not apply for managers of Dutch firms. The author provides evidence that in case managers are most likely to overinvest, they avoid the disciplining role of debt.

2.2. Acquirer wealth effects around acquisition announcements

As previously mentioned, studies on the shareholder wealth effects of acquiring firms directly around acquisition announcements provide mixed results. These wealth effects depend on firm and deal specific characteristics.

According to Jensen (1986), managers rather make non value-maximizing acquisitions than pay out excess cash to shareholders. In line with this overinvestment hypothesis, Lang, Stulz and Walkling (1989) and Servaes (1991) show that acquisitions by firms with a low Tobin's *q* negatively influence shareholders' wealth. Besides, as firms with a low Tobin's *q* are not likely to have positive net present value projects, the probability that managers of these firms make non value-maximizing acquisitions increases when having enough free cash flow (Jensen, 1986). Lang, Stulz and Walkling (1991) provide empirical evidence that is consistent with this theory. Bidders with a high Tobin's *q* increase shareholders' wealth when acquiring low *q* targets (Lang, Stulz and Walkling, 1989; Servaes, 1991). These studies interpret high *q* firms as well managed firms that acquire poorly managed firms (i.e. low *q* firms).

A recent theory by Jensen (2005) is based on observed acquisition behavior of highly valued firms (i.e. high *q* firms). In these firms agency problems due to overvalued equity bring about more managerial discretion, increasing the probability of bad acquisitions when firms have run

out of good ones. Jensen's argument is that in case the stock market attaches unrealistic high stock prices to firms, managers will under normal business practice not be able to deliver the performance implies by the pricing. This leads to 'managerial heroin', i.e. using the overvalued equity to make long run value-destroying acquisitions.

According to financial economic theory, the disciplining role of leverage has a positive impact on the acquirer returns (Maloney, McCormick and Mitchell, 1993). Debt serves as a monitoring device, providing less leeway for managers in making acquisition decisions (Jensen, 1986). Hence, leverage increases the probability of value enhancing acquisitions. Moeller, Schlingemann and Stulz (2004) find that firm size is negatively associated with shareholder returns of acquisition announcements. The authors relate the size effect with the difference of deal (e.g. equity/cash payment, private/public target) and firm characteristics (e.g. Tobin's *q* and leverage) between small and large firms.

In terms of deal characteristics, previous studies find that US firms that fully finance their acquisitions with cash experience higher abnormal returns than equity financed deals (e.g., Servaes, 1991; Franks, Harris and Titman, 1991; Moeller, Schlingemann and Stulz, 2004). Acquiring firms finance with equity to force target shareholders in sharing the risk that the price for the target was too high (Hansen, 1987). An alternative explanation is that the acquiring firms are overvalued and aim to decrease their overvaluation by acquiring less overvalued targets with cheap equity (Shleifer and Vishny, 2003). However, Goergen and Renneboog (2004) show opposite results for European firms. Acquirer returns of European firms that pay with equity are higher than that of European firms that pay with cash. The returns for both payment methods are significantly positive. A possible explanation for this opposite result is that European firms

acquire private firms more often, which is in line with US evidence that equity payments with the acquisition of private firms yield positive abnormal returns, whereas equity payments with the acquisition of public firms yield negative abnormal returns (Chang, 1998; Moeller, Schlingemann and Stulz, 2004). Overall, firms experience a positive shareholders' reaction in case they announce an acquisition of a private firm and a negative shareholders' reaction in case of a public firm in both the US and in Europe (Moeller, Schlingemann and Stulz, 2004; Martynova and Renneboog, 2006).

More diversified firms trade at a discount, due to amongst others inefficient investment and cross-subsidization (Berger and Ofek, 1995; Rajan, Servaes and Zingales, 2000; Scharfstein and Stein, 2000). As a result, diversifying acquisitions negatively contribute to shareholders' wealth. This negative impact applies to US firms (Morck, Shleifer and Vishny, 1990), European firms (Martynova and Renneboog, 2006) and, more specifically, to Dutch firms (Corhay and Tourani Rad, 2000). Global diversification seems to have a similar impact on acquisitions as industrial diversification. In particular, the excess value of more globally diversified firms is smaller than less globally diversified firms (Denis, Denis and Yost, 2002). Besides, cross-border acquisitions provides lower abnormal returns than domestic acquisitions in the US (Moeller and Schlingemann, 2005). The impact of cross-border deals by European firms provides mixed results. Consistent with results for US firms, Martynova and Renneboog (2006) find larger acquirer returns for domestic acquisition announcements relative to cross-border announcements for a sample of 2,419 European acquisitions. However, Goergen and Renneboog (2004) examine the returns of 228 acquisitions with a value of at least 100 million dollars and find the opposite result. The latter results are mainly driven by UK acquirers. In contrast to Continental Europe, the UK knows a highly active market for corporate control and has a high degree of shareholder

protection (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1998). Corhay and Tourani Rad (2000) examine cross-border acquisitions by Dutch firms and find small average positive abnormal returns for acquisitions in Western Europe (1.44% for 11 days around the announcement) and the US (0.25% for 5 days after the announcement and 4.83% for 91 days around the announcement), but no significant abnormal returns for acquisitions in Eastern Europe.

3. Research design

This section first discusses the data selection procedure, followed by a description of variables that we use for the analysis. Finally, we will describe our empirical models.

3.1. Dataset

Our data collection starts with all Dutch exchange-listed firms over the period 1993-2004. We focus on industrial firms, i.e. we exclude financial and service companies. In total, we study the acquisition announcements of 90 firms. For each firm we search the electronic version of the Dutch financial daily, *Het Financieele Dagblad*. We retrieve all newspaper articles with the company names in the title or the body of the text and manually identify articles with the initial announcements of acquisitions. In total, we include 865 acquisition announcements by 64 firms.

For the 64 firms (in 312 firm years) we collect financial and corporate governance characteristics from several sources. We obtain stock and index returns from Datastream. Financial data is obtained from the REACH database (Review and Analysis of Companies in Holland by Bureau Van Dijk) and *Handboek Nederlandse Beursfondsen*. Board and ownership data is taken from the *Handboek Nederlandse Beursfondsen*, *Jaarboek Nederlandse Ondernemingen* and yearly

overviews of WMZ notifications in *Het Financieele Dagblad*.[2] Takeover defenses and cross-listings are taken from the *Effectengids*, a yearly guide with all exchange-listed securities in Amsterdam. The information on the application of the structured regime is obtained from the Monitoring Report 1997 and firm's annual reports. In order for a firm-year to be included we require that data is available for all items.

3.2. Variables definition

This section defines the firm and deal variables that we use in our empirical analysis. The Tobin's *q* is the market value of the firm divided by the replacement value of the assets as calculated in De Jong, DeJong, Mertens and Wasley (2005). In the Netherlands, firms base the value of their assets either on its replacement value or on its historical costs. In case of the replacement value, no change was necessary. In case of historical costs, we adjust this value towards its replacement value. We measure free cash flow similar to Lehn and Poulsen (1989), i.e. operating income before depreciation minus total income taxes plus deferred taxes from the previous year to the current year minus gross interest expense on debt minus dividends paid divided by book value of total assets. The return on assets is calculated as the firm's operating profits standardized by the book value of total assets. Leverage is total debt divided by the book value of total assets and firm size is the natural log of a firm's book value of total assets. The relative size of the board is the number of executive board members divided by the total number of board members (i.e. both executive and supervisory board members). The percentage of block shareholdings is the percentage of shares held in a block outside the firm. A blockholding is defined as a stake of at least 5%. Insider ownership is the percentage blockholdings by insiders, supervisory and executive board members. We define a dummy that takes on the value of one for firms with a cross-listing in the US or the UK, and zero otherwise. To control for takeover defenses, we define

four dummy variables that take on the value of one if the firm has preference shares, if the firm has priority shares, if the firm has certificates and if the firm operates under the restricted regime. To examine the overall impact of takeover defenses, we also define a takeover defense index, which aggregates all four takeover defense dummies.

In terms of the deal characteristics, we construct a dummy for deals in which firms use equity in their payments. Note that mixed payments (i.e. both cash and equity) are also included in this dummy. Furthermore, we define a dummy for observations in which we know that the target is listed. Acquisitions are classified as diversifying and focus shifting, based on the description of the announcement in the newspaper. The relative size of the acquisition is calculated twofold. If firms disclose the transaction value, we calculate the relative size as the transaction value divided by the market capitalization of the acquirer. However, if the transaction value is not available, the relative size is the ratio of target sales to acquirer sales.

3.3. Market reaction model

We measure the acquirer's cumulative abnormal returns (CAR) around acquisition announcements using the abnormal returns generated by a market model as described by MacKinlay (1997). Our estimation window runs from day -120 to day -20. We aggregate the abnormal returns over a period of five days, starting two days prior to the acquisition announcement until two days after the acquisition announcement. Apart from the percentage returns, we also calculate the euro wealth effects by multiplying the five days CAR by the beginning of the year's market value of the acquirer's equity.

Next, we investigate the determinants of the aggregated acquirer returns by means of an ordinary least squares (OLS) regression in which we explain the five days CAR by the acquirer Tobin's *q*, free cash flows, return on assets, leverage, ln(size), a dummy for equity payment, a dummy for listed target, a dummy for diversifying acquisition, a dummy for domestic target, a dummy for European target, a dummy for US target, relative size of the acquisition, relative size of the executive board, block shareholders, insider ownership, a dummy for cross-listing US/UK, a dummy for priority shares, a dummy for preference shares, a dummy for certificates and a dummy for restricted regime. The model incorporates year fixed effects and industry fixed effects, based on five major industry groups according to two-digit SIC industry codes. All regression *p*-values are based on White's heteroskedasticity corrected standard errors.

3.4. Wealth destructing deals model

We classify acquisitions as wealth destructing if shareholders lose more than 150 million euros during the acquisition announcement. To investigate what type of firms make wealth destructing acquisition announcements, we estimate the following binary logit regression, in which we explain whether the deal is wealth destructing by the acquirer Tobin's *q*, free cash flows, return on assets, leverage, ln(size), a dummy for equity payment, a dummy for listed target, a dummy for diversifying acquisition, a dummy for domestic target, a dummy for European target, a dummy for US target, relative size of the acquisition, relative size of the executive board, block shareholders, insider ownership, a dummy for cross-listing US/UK, a dummy for priority shares, a dummy for preference shares, a dummy for certificates and a dummy for restricted regime. The model incorporates year fixed effects and industry fixed effects, based on five major industry groups according to two-digit SIC industry codes. All regression *p*-values are based on Huber/White's heteroskedasticity corrected standard errors.

4. Results

This section first provides a description of the sample. Statistics of firm and deal variables and the features of shareholders' wealth change around acquisition announcements will be discussed. Subsequently, we examine the factors that influence shareholders' wealth change and conclude with an analysis of deals with which shareholders lose more than €150 million.

4.1. Sample description

As previously mentioned, our dataset consists of 312 firm years in which 64 firms announce 865 acquisitions. Table 1 panel A shows more detailed information about the characteristics of these firm years.

- Insert Table 1 about here –

Our sample represents the larger industrial firms within the Netherlands, with an average market capitalization of 3.08 billion euros. They show good performance, as the average return on assets is 33.6% and the average Tobin's *q* is 1.548. However, the return on assets exhibits a large variation across the sample as its standard deviation is relatively high. The mean free cash flow is positive, indicating that firms are able to spend internal funds on additional investments. With an average of 27.9%, the leverage of Dutch firms is low as compared to US firms. In terms of corporate governance, the board consists for 63.8% of executives. Specifically, the median number of executive board members is six, whereas the median number of supervisory board members is just three. The data on blockholders confirm the concentrated ownership structure within the Netherlands. The largest outside blockholder owns on average 17% of the firm. Taking into account all blockholders, the average ownership is 29.1%. Although the median percentage

insider ownership is zero, the average is 5.8%. Furthermore, 31.7% of the sample firms have a cross-listing in the US and or in the UK, suggesting that managers of these firms exercise less discretion in their decisions (De Jong, Mertens and Van der Poel, 2006). Takeover defense mechanisms in the Netherlands severely restrict shareholders' power within the firm. Consistent with previous studies about the Dutch governance situation, the results indicate that Dutch firms widely implement takeover defenses in terms of priority shares (43.3%), preferred shares (67.3%), certificates (37.2%) and the adoption of the structured regime (67.9%). Aggregating all takeover defenses within a firm, the median Dutch firm adopts two out of the four mechanisms.

Panel B of Table 1 provides the deal characteristics of our sample. Firms release the transaction value of their deals only 152 out of the 865 times. These 152 deals show an average transaction value of 521 million euros. The median is only one sixth of the average value, which implies that the dataset includes some very large deals. Besides, the transaction value varies considerably as the standard deviation is relatively high. This also applies for the transaction value relative to the acquiring firm's market capitalization and the ratio of target to acquirer sales. The results also show that Dutch firms acquire public firms in 7.2% of all acquisitions. Compared to the sample of European firms in Martynova and Renneboog (2006), in which 36.8% of all acquisitions concern listed targets, this percentage is rather low. Furthermore, firms announce a diversifying deal in 20.5% of the sample and a shift in focus in 4.9% of the sample. The high percentage of diversifying acquisition announcements is remarkable, as previous studies find diversifying acquisitions to be value-decreasing (Morck, Shleifer and Vishny, 1990; Corhay and Tourani Rad, 2000; Martynova and Renneboog, 2006). Firms finance their target with a combination of cash and equity in 3.6% of our sample. In 5.9% of the acquisitions, firms announce to pay with equity. Note that this percentage also includes the mixed payments. The low percentage may be caused

by the low amount of listed target firms. In 19.1% of the acquisitions, firms announce to finance their deal with cash. In all other cases, firms do not disclose how they finance their target. In line with Corhay and Tourani Rad (2000), Dutch firms know a strong international orientation. They make domestic acquisitions only in 24% of all sample deals, whereas in 44.5% of the deals the target comes from another European country and in 19.2% of the deals the target is located in the US.[3]

To get an impression about the shareholders' wealth effects around acquisition announcements, Table 2 provides statistics of the percentage abnormal returns (panel A) and the euro wealth transfers (panel B) for different event windows.

- Insert Table 2 about here –

Panel A of the table shows significantly positive abnormal returns around acquisition announcements for four out of the six event periods, indicating that acquisitions in the Netherlands on average enhance shareholder wealth. During the five days around the acquisition announcement, shareholders experience a significant increase of 1.07% in their returns. The share price does not experience a significant change from 20 days until 3 days prior to the acquisition announcement and 3 days until 20 days after the announcement, suggesting that the information about the acquisition is discounted into the market price immediately around the release of the information.

Panel B provides the abnormal euro returns around acquisition announcements. Shareholders experience an average significant increase in their wealth of €17.89 million during the five days

around an acquisition announcement. Wealth changes in the other event windows are not significantly different from zero. Note that the standard deviation of the euro returns are extremely large, suggesting both large gains and losses for shareholders of acquiring firms. The extreme values provide support for this suggestion. For instance, the minimum value for the five days window indicates a loss of about €2.7 billion and the maximum value indicates a gain of about €1.8 billion. The extreme values of the other event windows are even larger.

As Table 2 suggests that most of the announcement returns occur during the five days around the acquisition announcement, Figure 1 provides the average development of the share price over the forty days around the announcement and Figure 2 shows the distribution of the cumulative abnormal returns over the five days event window.

- Insert Figure 1 and 2 about here –

Figure 1 shows a slight price run-up prior to the acquisition announcement, which does not differ significantly from zero. The sharp increase in average abnormal returns starts at two days prior to the announcement day and lasts for about five days. Afterwards, the cumulative abnormal returns remain relatively stable around the 1.2%. Figure 2 shows that the distribution of the cumulative abnormal returns appears to be normally distributed. Besides, acquisition announcements are more often value increasing than value decreasing. The results further show that the distribution of abnormal returns is somewhat skewed towards positive returns.

When disclosing a planned acquisition, firms usually provide reasons why they take over another firm. As the motivation behind acquisitions is important information for the market, table 3 lists the stated motivations, the frequency of these motivations and the related acquirer returns.

- Insert Table 3 about here –

We categorize the motives into seven groups; 1) cost reduction, 2) geographic expansion, 3) broadening the firm's product line, 4) increasing the firm's market share, 5) diversification, 6) another motive, which do not belong to the first five groups, and 7) no motive provided. The most common motives are an increase in market share that occurs in 37% of all announcements and geographic expansion that occurs in 17% of all announcements. Both motives yield significantly positive abnormal returns (1.21% and 1.19%, respectively), indicating that these types of acquisitions are value enhancing for shareholders. The acquisitions in which firms can reduce their costs in the form of economies of scale or access to low wage labor also provides positive abnormal returns (1.32%). A remarkable result is that shareholders respond positively to diversifying reasons, while previous studies find diversifying acquisitions to be negatively related with the market reaction. The abnormal returns are 1.56%, which is the highest percentage compared to all other reasons. Note that in 3% of all acquisition announcements, firms state that the prime motive to acquire a firm is to diversify, whereas 20.5% of all acquisitions are diversifying acquisitions. Furthermore, firms do not provide a motive for their acquisition in 27% of the sample, yet the abnormal returns are significantly positive. The data do not show a significant response to firms that aim to broaden their product line or give another motive. The main conclusion from Table 3 is that the stated motive does seem to explain the acquirer's wealth change, as shareholders respond significantly to some of the stated motives and not to others.

The market response and total wealth effects around acquisitions depend on the period in which the acquisition takes place (Harford, 2005; Moeller, Schlingemann and Stulz, 2005). In particular, the abnormal returns are higher at the beginning of merger waves than later during the merger wave. Table 4 presents the percentage abnormal returns and the euro wealth effects per year. A more visual overview can be drawn from Figure 3.

- Insert Table 4 and Figure 3 about here –

The results indicate that during the first half of the nineties, several value decreasing acquisitions take place. Though not statistically significant, the years 1994 and 1995 show zero and small negative abnormal returns and large negative wealth effects for the shareholders. During these years, the least amount of positive reactions to acquisition announcements occur. Afterwards, shareholders experience an increase in their wealth, with 1999 as most successful year. In that year, the total wealth gain due to acquisition announcements is €7.7 billion and the average abnormal return is 2.2%. The economic downturn started halfway 2000. The consequences of this downturn appear in 2001, which shows a decrease in the number of acquisitions. The total wealth losses are €660.2 million and €4.7 million in the year after. Strikingly, the average abnormal returns are positive during these years. These results suggest that, consistent with Moeller, Schlingemann and Stulz (2004, 2005), the negative wealth effects are a result of a few extremely large losses. Moeller, Schlingemann and Stulz (2005) argue that managers of highly valued firms can exercise more discretion and hence, are more likely to make value-destroying acquisitions. Firm size can also drive the results (Moeller, Schlingemann and Stulz, 2004). Acquisitions by small firms are generally value enhancing, but the euro gains are small as well. On the contrary,

larger firms make larger acquisitions that can result in large euro losses. Both effects together can result in positive returns and negative wealth effects at the same time. In Section 4.3, we examine the value-destructing deals into more detail. Finally, in the last two years of our sample the number of acquisitions is still low, yet the acquisition announcements that take place do yield positive abnormal returns.

4.2. Explaining wealth effects

So far, we discussed the characteristics and abnormal returns of our sample of acquisition announcements by means of a univariate analysis. This section discusses the factors that influence shareholders' wealth around an acquisition announcement. Table 5 shows the results of four ordinary least squares regressions with the five days abnormal returns as the dependent variable.

- Insert Table 5 about here –

Consistent with Moeller, Schlingemann and Stulz (2004), the first regression indicates that larger firms are more likely to make value reducing acquisitions. Furthermore, firms that finance their deal with equity experience 2.2% higher abnormal returns than firms that do not use equity as payment. Although this result is not in line with previous research on US firms, Goergen and Renneboog (2004) find similar results for European firms. A possible explanation for the positive relation is the high amount of private targets that get acquired. The results further show that the target's country of origin does not influence shareholders' wealth. None of the country dummies is significant. Firm and deal characteristics that do not influence acquirer returns are the firm's

Tobin's *q*, free cash flow, return on assets, leverage, whether the target is listed and whether the deal is diversifying.

The size of the target relative to the acquirer firm size is an indication for the impact of the deal for the acquiring firm. Unfortunately, few firms disclose the price they pay for the target (152 out of 865) and we do not know the target sales of all deals (555). To examine the impact of the deal size, we construct the variable 'relative size of acquisition' in which we set the value to the relative price paid, calculated as price paid for the target divided by the market value of the acquirer firm's equity. If this value is not available, we take the ratio of target sales to acquirer sales. Regression 2 of Table 5 includes the relative size of the acquisition. We find the relative size to be positively related with acquirer returns, suggesting that larger acquisitions are more likely to be firm value enhancing. Another effect of including this relative size is that the equity payment dummy loses its significance, which may a result of the smaller sample size. However, when running regression 1 with the same observations as regression 2 (results are not tabulated), the equity payment dummy remains significant, implying that the dummy is an artifact of the relative size of an acquisition. Firms that acquire relatively large targets are more likely not to have enough cash available, increasing the probability to pay with equity. A comparison between the R-squared of regression 1 (with 644 observations) and regression 2 implies a significant increase in explanatory power (p=0.000).

To examine the impact of corporate governance on shareholders' wealth around acquisition announcements, Regression 3 includes the variables relative size of the board, percentage of block shareholders, percentage insider ownership, a dummy for being cross-listed in the US or UK and the takeover defense index. We expect a better governance structure within a firm to

bring about less discretion for managers, resulting in higher abnormal returns. The results suggest a marginal impact of corporate governance on firm's decisions as only the coefficient for takeover defense index is significant. In line with Masulis, Wang and Xie (2006) and in line with our expectations, the coefficient is negative. *Ceteris paribus*, for each implemented takeover defense mechanism, shareholders' wealth decreases with 0.4%. To investigate which of the takeover defense mechanisms drive the negative effect, we include the four defense dummies in regression 4. The restricted regime dummy appears to mainly drive the takeover defense effect. In particular, the abnormal returns around acquisition announcements are 1.0% lower for firms that have adopted a structured regime as compared to firms that have not adopted such a regime. Comparing the 1.0% with the average of 1.07% abnormal returns for the whole sample, the impact of a structured regime is high.

4.3. Which firms make wealth-destructing deals?

As previously mentioned, our results suggest that a small number of acquisitions drive down the total shareholders' wealth around acquisition announcements. In this section, we investigate whether firm and deal characteristics differ for wealth-destructing deals versus non-wealth destructing deals. In particular, we expect these wealth-destructing deals to occur in firms where managers are able to exercise discretion and make acquisitions that maximize their own utility. Corporate governance should prevent managers from making large loss deals. Moeller, Schlingemann and Stulz (2005) examine wealth-destructing deals with a loss of at least $1 billion disclosed by US firms. We focus on deals with losses of more than €150 million, because our sample exclusively consists of Dutch firms that are on average smaller than US firms and we aim to construct a sample that is large enough to draw robust conclusions.[4] From our sample of 865 acquisition announcements, 80 acquisitions announced by 9 firms are wealth-destructing. The

total wealth destruction of these 80 acquisition announcements is €38 billion. Table 6 presents descriptives and mean comparisons of the sample with and without these wealth-destructing deals.

- Insert Table 6 about here –

Panel A provides the firm characteristics. Consistent with Moeller, Schlingemann and Stulz (2005), firms that make value-destroying acquisitions are larger (market capitalization of €12.0 billion vs. €1.5 billion) and have a higher Tobin's *q* (2.067 vs. 1.459). The higher Tobin's *q* is in line with the arguments that a high valuation of firms increases the likelihood of managers to act in their own interest (Jensen, 2005; Moeller, Schlingemann and Stulz, 2005). According to Jensen (1986), managers in firms with excess free cash flows are more likely to make value reducing acquisitions. However, this theory does not apply to wealth-destructing acquisitions, as firm years in which wealth-destructing acquisitions occur do not have significantly more free cash flows. Governance characteristics also provide some significant results. Although both the supervisory board and the executive board are larger in firms with wealth-destructing deals, the relative size of the executive board is smaller (60.4% versus 64.4%). The smaller relative number of executives in the board implies better monitoring and therefore a lower probability to make large losses. Moreover, the percentage of outside blockholders that are other monitoring agents is lower within firm years with wealth-destructing deals (20.7% vs. 30.5%). Insider ownership should increase the incentives of managers to act firm value maximizing and hence not to make large losses around acquisition announcements. Insider ownership of 1.1% for firm years with wealth-destructing acquisitions and of 6.6% for firm years without such deals is evidence that is consistent with this line of reasoning. A remarkable result is that firms making wealth-destructing

deals are more often cross-listed in the US and/or the UK (73.9% vs. 24.4%). A cross-listing is amongst others a bonding mechanism for managers to act value-maximizing (Coffee Jr., 1999, 2002), however, the results suggest the opposite. An alternative explanation comes from the fact that Dutch firms with a cross-listing in the US and/or UK are typically larger. The significant difference may be an artifact of firm size. Another surprising result is the lower amount of takeover defense mechanisms in firm years with value-destructing deals (1.8 vs. 2.2). Distinguishing between the different takeover defense mechanisms gives 21.7% of all firm years with wealth-destructing acquisitions have certificates, 39.1% have adopted the structured regime, 58.7% have preference shares and 65.2% have priority shares. For firm years without the wealth-destructing deals, these percentages are 39.8%, 72.9%, 68.8% and 39.5%, respectively. Therefore, only the relatively high application of priority shares for firm years with wealth-destructing deals as compared to firms without such deals meets our expectations.

Panel B provides the differences in deal characteristics between wealth-destructing deals and non wealth-destructing deals. As wealth-destructing deals have a large impact on the euro value of firms, we expect the transaction value for these deals to be larger as well. The table shows a higher transaction value for value-destructing deals, yet the difference is not statistically significant. This also applies for the transaction value standardized by the market value of equity of the acquirer. Unexpectedly, the ratio of target sales to acquirer sales, which is also a proxy for the size of the deal, is smaller for value-destroying deals (3.8% vs. 9.9%). Moeller, Schlingemann and Stulz (2005) suggest that the absolute change of returns around acquisition announcements reflect both the net present value of the acquisition itself and the information that is revealed about the firm by announcing an acquisition. The large loss deals may be a reflection of the information about the firm beyond the acquisition announcement. Furthermore, targets of value-

destructing deals are more often listed (15% vs. 6.4%) and located in the US (30% vs. 18.1%). In contrast to Moeller, Schlingemann and Stulz (2005), we find less equity payments in wealth-destructing deals. In particular, 1.3% of the wealth-destructing deals are financed with equity, whereas this is 6.4% for non wealth-destructing deals (this is 0% vs. 3.9% for mixed payment methods).

Now that we know the characteristics of firms announcing wealth-destructing deals and the characteristics of such a deal itself, we aim to predict the likelihood that a wealth-destructing acquisition occurs. In a logit regression with exclusively a dummy for the firm being in its highest valuation year, Moeller, Schlingemann and Stulz (2005) find that firms make wealth destructing deals when their valuation is high. This result is consistent with the arguments of Jensen (2005), who reasons that a high valuation of firms increases the likelihood of managers to act in their own interest. Apart from the Tobin's *q*, we include additional firm, governance and deal variables in the regression in which the dependent variable that takes on the value of one if the deal is value-destructing and zero otherwise. We are particularly interested in whether good corporate governance structures provide more protection for shareholders.

- Insert Table 7 about here –

With a McFadden *R*-squared of 35.68%, the model can reasonably predict the likelihood that firms make value-destructing acquisitions. The significantly positive Tobin's *q* is in line with the theory that managers of highly valued firms are more likely to make value decreasing decisions. Leverage shows a significantly positive coefficient, suggesting that firms with more leverage are more likely to make value-decreasing acquisitions in spite of the fact that leverage acts as a

monitoring device (Jensen, 1986). As De Jong (2002) argues that Dutch managers are not disciplined by leverage, shareholders can perceive acquisition announcements of firms with high leverage as highly risky and hence respond negatively to the announcement. Furthermore, larger firms are also more likely to make wealth-destructing deals. This result is consistent with Moeller, Schlingemann and Stulz (2004), who find a size effect in explaining acquirer returns around acquisition announcements. As larger firms make larger deals, they are also more likely to make larger losses. The governance variables suggest that the relative size of the board, priority shares and preference shares influence the likelihood of a wealth-destructing deal. In line with our expectations, a larger proportion of executives on the board give the executives more possibilities to exercise discretion, increasing the probability to make value-destroying acquisitions. Furthermore, firms with priority shares, providing friendly shareholders with special rights such as merger approval, are better protected against takeover defenses and therefore more likely to make wealth-destructing deals. On the other hand, preference shares, another takeover defense mechanism, negatively influence the probability of wealth-destructing acquisitions. The other governance variables – i.e. block shareholders, insider ownership, being cross-listed in the US or UK, certificates and structured regime – do not show a significant impact. Free cash flows, return on assets and none of the deal characteristics influence the probability of value-destructing deals either. In sum, the significant coefficients of firms' Tobin's *q*, leverage and size imply that managers exercise discretion in their acquisition decisions resulting in a higher probability of making wealth-destructing acquisitions. Corporate governance does have an effect on acquirer wealth gains in acquisitions; however, the results suggest a rather minor effect.

5. Conclusion

This chapter provides an extensive description of the acquisition market within the Netherlands for the period starting in 1993 until 2004. We investigate the change in shareholders' wealth during the days around acquisition announcements and the impact of a firm's governance structure on shareholders' wealth change. From an international perspective, the Netherlands provides an interesting setting, as the market for corporate control is virtually absent. Dutch firms can implement four types of defense mechanisms – priority shares, preference shares, certificates, adoption of structured regime – that severely restrict shareholders' power. Limited shareholder power leaves much room for managers to exercise discretion in their acquisition decisions. We examine shareholders' wealth change in terms of the percentage abnormal returns and the absolute euro change.

We investigate a sample of 865 acquisitions in the period 1993-2004 and find that, even though shareholders have limited power, their average wealth increases around acquisition announcements. We also find that an adequate corporate governance structure has a minor influence on acquisition announcements. In explaining acquirer returns, only one governance factor provides significant results. Specifically, firms that adopt the structured regime have lower acquirer returns, which is in line with managers exercising discretion when shareholders' power is low.

In addition to returns expressed as the corrected percentage stock price change, we also measure the changes in the market values of the firm's equity in euros. We find the same striking result as Moeller, Schlingemann and Stulz (2005) that during 2001 and 2002 average acquirer returns are positive, whereas the total euro wealth effect for shareholders is negative. In order to shed light

on this counter-intuitive finding, we examine which firms are more likely to announce deals that result in a wealth loss of more than €150 million. Our results indicate that high *q* firms, firms with high leverage and larger firms are more likely to make value-destructing acquisitions. The finding that high *q* firms are dominantly present among the group of wealth destructing companies is in line with Jensen's (2005) prediction of agency problems resulting from overvalued equity. The positive impact of leverage on the likelihood of managers to announce value-destructing deals is in line with the results of De Jong (2002), who finds Dutch managers to avoid the disciplining role of leverage, especially when they overinvest. Once more, the results on explaining the likelihood of wealth destructing deals suggest a minor impact of corporate governance. A smaller relative amount of executive board members and firms that do not have priority shares decrease the likelihood of value-destructing acquisitions.

References

Andrade, G., M. L. Mitchell, and E. Stafford, 2001. New evidence and perspectives on mergers. Journal of Economic Perspectives 15, 103-120.

Bebchuk, L., J. C. Coates, and G. Subramanian, 2002. The powerful antitakover force of staggerd boards: Theory, evidence, and policy. Stanford Law Review 54, 887-951.

Bebchuk, L., A. Cohen, and A. Ferrell, 2005. What matters in corporate governance? Unpublished working paper. Harvard Law School, Boston.

Berger, P. G., and E. Ofek, 1995. Diversification's effect on firm value. Journal of Financial Economics 37, 39-65.

Berle, A. A. J., and G. C. Means, 1932. The modern corporation and private property. Macmillan, New York.

Chang, S., 1998. Takeovers of privately held targets, methods of payment, and bidder returns. The Journal of Finance 53, 773-784.

Coffee Jr., J. C., 1999. The future as history: The prospects for global convergence in corporate governance and its implications. Northwestern University Law Review 93, 641-708.

Coffee Jr., J. C., 2002. Racing towards the top?: The impact of cross-listings and stock market competition on international corporate governance. Columbia Law Review 102, 1757-1831.

Corhay, A., and A. Tourani Rad, 2000. International acquisitions and shareholder wealth: Evidence from the Netherlands. International Review of Financial Analysis 9, 163-174.

De Jong, A., 2002. The disciplining role of leverage in Dutch firms. European Finance Review 6, 31-62.

De Jong, A., D. V. DeJong, G. M. H. Mertens, and C. E. Wasley, 2005. The role of self-regulation in corporate governance: Evidence and implications from The Netherlands. Journal of Corporate Finance 11, 473-503.

De Jong, A., R. Kabir, T. Marra, and A. Röell, 2001. Ownership and control in the Netherlands. In: The control of corporate Europe, ed.: Fabrizio Barca, and Marco Becht (Oxford University Press, New York).188-206

De Jong, A., G. M. H. Mertens, and P. Roosenboom, 2004. Shareholders' voting at general meetings: Evidence from the Netherlands. Unpublished working paper. RSM Erasmus University, Rotterdam.

De Jong, A., G. M. H. Mertens, and M. Van der Poel, 2006. The impact of managerial discretion on management earnings forecasts. Unpublished working paper. RSM Erasmus University, Rotterdam

Denis, D. J., D. K. Denis, and K. Yost, 2002. Global diversification, industrial diversification, and firm value. The Journal of Finance 57, 1951-1979.

Field, L. C., and J. M. Karpoff, 2002. Takeover defenses of IPO firms. The Journal of Finance 57, 1857-1889.

Franks, J., R. Harris, and S. Titman, 1991. The postmerger share-price performance of acquiring firms. Journal of Financial Economics 29, 81-96.

Goergen, M., and L. Renneboog, 2004. Shareholder wealth effects of European domestic and cross-border takeover bids. European Financial Management 10, 9-45.

Gompers, P. A., J. L. Ishii, and A. Metrick, 2003. Corporate governance and equity prices. Quarterly Journal of Economics 118, 107-155.

Hansen, R. G., 1987. A theory for the choice of exchange medium in mergers and acquisitions. The Journal of Business 60, 75-95.

Harford, J., 2005. What drives merger waves? Journal of Financial Economics 77, 529-560.

Jensen, M. C., 1986. Agency costs of free cash flow, corporate finance, and takeovers. The American Economic Review 76, 323-329.

Jensen, M. C., 2005. Agency costs of overvalued equity. Financial Management 34, 5-19.

Jensen, M. C., and W. H. Meckling, 1976. Theory of the firm: Managerial behavior, agency cost and ownership structure. Journal of Financial Economics 3, 305-360.

Kabir, R., D. Cantrijn, and A. Jeunink, 1997. Takeover defenses, ownership structure and stock returns in the Netherlands: An empirical analysis. Strategic Management Journal 18, 97-109.

La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. W. Vishny, 1998. Law and finance. Journal of Political Economy 106, 1113-1155.

Lang, L. H. P., R. M. Stulz, and R. A. Walkling, 1989. Managerial performance, Tobin's *q*, and the gains from successful tender offers. Journal of Financial Economics 24, 137-154.

Lang, L. H. P., R. M. Stulz, and R. A. Walkling, 1991. A test of the free cash flow hypothesis. Journal of Financial Economics 29, 315-335.

Lehn, K., and A. Poulsen, 1989. Free cash flow and stockholder gains in going private transactions. The Journal of Finance 44, 771-787.

MacKinlay, A. G., 1997. Event studies in economics and finance. Journal of Economic Literature 35, 13-39.

Maloney, M. T., R. E. McCormick, and M. L. Mitchell, 1993. Managerial decisions making and capital structure. The Journal of Business 66, 189-217.

Martynova, M., and L. Renneboog, 2006. Mergers and acquisitions in Europe. In: Advances in corporate finance and asset pricing, ed.: Luc Renneboog (Elsevier, Amsterdam).16-75

Masulis, R. W., C. Wang, and F. Xie, 2006. Corporate governance and acquirer returns. Unpublished working paper. Vanderbilt University, Nashville.

Mitchell, M. L., and K. Lehn, 1990. Do bad bidders become good targets? The Journal of Political Economy 98, 372-398.

Moeller, S. B., and F. P. Schlingemann, 2005. Global diversification and bidder gains: A comparison between cross-border and domestic acquisitions. Journal of Banking & Finance 29, 533-564.

Moeller, S. B., F. P. Schlingemann, and R. M. Stulz, 2004. Firm size and the gains from acquisitions. Journal of Financial Economics 73, 201-228.

Moeller, S. B., F. P. Schlingemann, and R. M. Stulz, 2005. Wealth destruction on a massive scale? A study of acquiring-firm returns in the recent merger wave. The Journal of Finance 60, 757-782.

Morck, R., A. Shleifer, and R. W. Vishny, 1990. Do managerial objectives drive bad acquisitions? The Journal of Finance 45, 31-48.

Mulherin, H. J., and A. L. Boone, 2000. Comparing acquisitions and divestitures. Journal of Corporate Finance 6, 117-139.

Rajan, R., H. Servaes, and L. Zingales, 2000. The cost of diversity: The diversification discount and inefficient investment. The Journal of Finance 55, 35-80.

Renneboog, L., and P. G. Szilagyi, 2006. How relevant is dividend policy under low shareholder protection? Unpublished working paper. Tilburg University, Tilburg.

Scharfstein, D. S., and J. C. Stein, 2000. The dark side of internal capital markets: Divisional rent-seeking in inefficient investment. The Journal of Finance 55, 2537-2564.

Servaes, H., 1991. Tobin's *q* and the gains from takeovers. The Journal of Finance 46, 409-419.

Shleifer, A., and R. W. Vishny, 1989. Management entrenchment: The case of manager-specific investments. Journal of Financial Economics 25, 123-139.

Shleifer, A., and R. W. Vishny, 2003. Stock market driven acquisitions. Journal of Financial Economics 70, 295-311.

Table 1: Descriptive statistics of acquirer and deal characteristics

The table presents the means, medians, standard deviations and the number of observations of firm and deal variables. The market capitalization is the beginning of the year market value of equity. The return on assets is calculated as operating profits standardized by book value of total assets. We measure the Tobin's *q* as the ratio of a firm's market value to replacement value of assets as calculated in De Jong, DeJong, Mertens and Wasley (2005). We calculate free cash flow as in Lehn and Poulsen (1989). Leverage is total debt divided by book value of total assets. The relative size of the board is the number of executive board members divided by total number of board members. The takeover index is the aggregate value of all four takeover defense dummies (i.e. priority shares, preference shares, certificates and structured regime). The transaction value is the amount paid for the target.

Panel A: Acquirer characteristics at a firm year level

	all deals			
	Mean	Median	St.dev.	N
Financial characteristics				
Market capitalization (€ thousands)	3,081,620	593,857	7,776,843	312
Return on assets	0.336	0.108	3.737	312
Tobin's *q*	1.548	1.344	0.769	312
Free cash flow/total assets	0.032	0.034	0.035	312
Leverage	0.279	0.245	0.188	312
Governance characteristics				
Number of supervisory board members	3.510	3.000	1.645	312
Number of executive board members	6.048	6.000	2.205	312
Relative size of executive board	0.638	0.636	0.108	312
Percentage largest outside blockholder	0.170	0.090	0.182	312
Total percentage outside blockholders	0.291	0.225	0.237	312
Total percentage inside blockholders	0.058	0.000	0.141	312
Dummy cross listing US and/or UK	0.317	0.000	0.466	312
Takeover defense index	2.157	2.000	1.007	312
Dummy priority shares	0.433	0.000	0.496	312
Dummy preference shares	0.673	1.000	0.470	312
Dummy certificates	0.372	0.000	0.484	312
Dummy structured regime	0.679	1.000	0.467	312

Panel B: Deal characteristics at a deal level

	all deals			
	Mean	Median	St.dev.	N
Transaction value (€ thousands)	520,761	90,756	1,201,059	152
Transaction value/market capitalization	0.136	0.031	0.255	152
Sales target/sales acquirer	0.094	0.015	0.291	555
Dummy listed target	0.072	0.000	0.259	865
Dummy diversifying acquisition	0.205	0.000	0.404	865
Dummy focus shifting acquisition	0.049	0.000	0.215	865
Dummy payment in cash and equity	0.036	0.000	0.186	865
Dummy payment in equity	0.059	0.000	0.236	865
Dummy payment in cash	0.191	0.000	0.393	865
Dummy domestic acquisition	0.240	0.000	0.428	865
Dummy European acquisition (excluding NL)	0.445	0.000	0.497	865
Dummy US acquisition	0.192	0.000	0.394	865

Table 2: Acquirer returns around acquisition announcements for different event windows

This table presents the descriptive statistics of the percentage abnormal returns and the wealth transfer in millions of euros for different event windows. The acquisition announcement day is day zero. Abnormal returns are calculated by using the market model as described in MacKinlay (1997), with the estimation window running from day -120 to day -20. We aggregate the abnormal returns for the different event windows. The euro wealth transfer is the cumulative abnormal returns for the event window times the acquirer's market capitalization at the beginning of the fiscal year. The table shows *, ** and *** for values that are significantly different from zero at a 10%, 5% and 1% level, respectively.

Panel A: Descriptives of the market reaction to acquisition announcements for different event windows

	Event window					
	[-20, 20]	[-10, 10]	[-5, 5]	[-2,2]	[-20,-3]	[3,20]
Mean	1.30% ***	0.96% ***	1.13% ***	1.07% ***	0.08%	0.15%
Minimum	-55.76%	-68.33%	-36.09%	-22.48%	-66.47%	-39.07%
25%	-6.16%	-3.97%	-2.63%	-1.45%	-4.31%	-3.85%
Median	1.00%	0.45%	0.54%	0.61%	-0.16%	-0.15%
75%	7.29%	5.40%	4.43%	3.31%	4.37%	4.16%
Maximum	68.22%	71.17%	40.39%	39.27%	32.57%	50.23%
Standard deviation	12.42%	9.04%	6.78%	4.95%	7.86%	7.69%
N	865	865	865	865	865	865

Panel B: Descriptives of the wealth transfer in € millions around acquisition announcements for different event windows

	Event window					
	[-20, 20]	[-10, 10]	[-5, 5]	[-2,2]	[-20,-3]	[3,20]
Mean	23.04	1.89	6.57	17.89 *	-28.70	33.84
Minimum	-9,040.49	-6,377.08	-5,144.17	-2,726.24	-6,545.32	-3,646.44
25%	-66.75	-55.36	-41.87	-20.13	-51.37	-54.05
Median	3.05	1.49	1.49	2.22	-0.37	-0.42
75%	87.75	52.87	51.62	37.06	53.80	47.92
Maximum	16,146.15	9,302.80	3,717.78	1,790.41	7,199.73	11,871.74
Standard deviation	1,033.73	665.18	482.74	294.73	673.89	839.78
N	865	865	865	865	865	865

Table 3: Stated motives for acquisitions and the related abnormal returns

This table presents the frequency of acquirers' motives for the acquisition as disclosed in their acquisition announcements. Cost reduction consists of economies of scale, synergy, efficiency and access to low wage labor. The table also provides the average cumulative abnormal returns over five days surrounding the acquisition announcements per stated motive. The table shows *, ** and *** for CAR values that are significantly different from zero at a 10%, 5% and 1% level, respectively.

Stated motives for acquisitions	**Number**	**Percentage**	**CAR**	
Cost reduction	60	7%	1.32%	*
Geographic expansion	150	17%	1.19%	***
Broadening product line	61	7%	0.93%	
Increasing market share	321	37%	1.21%	***
Diversification/vertical integration	22	3%	1.56%	*
Other motive	19	2%	0.86%	
No motive	232	27%	0.74%	**
Total	865	100%	1.07%	***

Table 4: The characteristics of shareholders' wealth effects per year

The table shows descriptives of the cumulative abnormal returns over five days surrounding acquisition announcements and the related euro wealth effects per year. The euro wealth effects are the cumulative abnormal returns for the event window times the acquirer's market capitalization at the beginning of the fiscal year. The table shows *, ** and *** for values that are significantly different from zero at a 10%, 5% and 1% level, respectively.

		CAR [-2,2]			**Wealth effects in € millions**		
year	*n*	*Mean*	*Median*	*% positive*	*Total*	*Mean*	*Median*
1993	61	1.42% ***	1.03%	69%	1,075.61	17.63 ***	2.03
1994	83	-0.05%	-0.26%	41%	-1,190.58	-14.34	-2.55
1995	97	0.00%	-0.32%	42%	-1,602.75	-16.52	-2.06
1996	86	1.09% ***	0.73%	59%	749.88	8.72	2.21
1997	89	1.66% ***	0.78%	57%	2,820.43	31.69	1.54
1998	102	0.85%	0.72%	64%	839.57	8.23	3.68
1999	116	2.20% ***	1.93%	61%	7,756.35	66.87 *	5.91
2000	83	1.10% *	1.19%	59%	4,103.12	49.44	11.84
2001	44	1.31% *	1.79%	66%	-660.20	-15.00	4.58
2002	44	0.80%	0.56%	52%	-4.66	-0.11	5.45
2003	27	1.22%	2.34%	59%	468.61	17.36	9.75
2004	33	1.31% ***	1.47%	73%	1,123.02	34.03	3.73
ALL	865	1.07%	0.61%	57%	15,478.40	17.89	2.22

Table 5: Regression analysis of acquirer return around acquisition announcements

The table provides the results of ordinary least squares regressions that explain the abnormal returns during five days around acquisition announcements. All variables in this table are defined in Table 1. All regressions include year and industry dummies. *P*-values are documented in parentheses and based on White's heteroskedasticity corrected standard errors. The table shows *, ** and *** for values that are significantly different from zero at a 10%, 5% and 1% level, respectively.

	(1) Coefficient	(2) Coefficient	(3) Coefficient	(4) Coefficient
Intercept	0.111 ***	0.114 ***	0.106 ***	0.097 ***
	(0.000)	(0.001)	(0.003)	(0.009)
Tobin's *q*	-0.001	-0.004	0.000	0.000
	(0.611)	(0.172)	(0.895)	(0.890)
Free cash flow/total assets	-0.011	0.144	-0.023	-0.003
	(0.915)	(0.209)	(0.822)	(0.973)
Return on assets	0.000	0.000	0.000	0.000
	(0.779)	(0.378)	(0.835)	(0.841)
Leverage	-0.004	0.003	-0.003	0.002
	(0.762)	(0.833)	(0.805)	(0.863)
ln(size)	-0.006 ***	-0.003 **	-0.006 ***	-0.005 ***
	(0.000)	(0.021)	(0.002)	(0.006)
Dummy equity payment	0.022 **	0.000	0.023 **	0.023 **
	(0.044)	(0.964)	(0.035)	(0.033)
Dummy listed target	0.002	-0.010	0.000	0.000
	(0.826)	(0.186)	(0.977)	(0.975)
Dummy diversifying	-0.005	-0.003	-0.005	-0.005
	(0.229)	(0.536)	(0.269)	(0.228)
Dummy Domestic target	-0.002	0.000	0.001	0.001
	(0.752)	(0.962)	(0.839)	(0.807)
Dummy European target, but not Dutch	-0.008	-0.003	-0.006	-0.006
	(0.101)	(0.584)	(0.216)	(0.211)
Dummy US target	-0.001	0.004	0.001	0.001
	(0.822)	(0.562)	(0.930)	(0.931)
Relative size of acquisition		0.058 ***		
		(0.000)		
Relative size of the board			0.013	0.017
			(0.468)	(0.362)
Block shareholders			0.003	0.003
			(0.730)	(0.703)
Insider ownership			-0.011	-0.008
			(0.526)	(0.656)
Dummy cross-listing US or UK			-0.001	-0.003
			(0.767)	(0.486)
Takeover defense index			-0.004 *	
			(0.060)	
Dummy priority shares				-0.005
				(0.241)
Dummy preference shares				0.001
				(0.910)
Dummy certificates				-0.001
				(0.779)
Dummy structured regime				-0.010 *
				(0.086)
Number of observations	865	644	865	865
Adjusted *R*-squared	5.11%	12.03%	4.66%	4.99%

* significant at 10%; ** significant at 5%, *** significant at 1%

Table 6: Differences between wealth-destructing deals and non-wealth-destructing deals

This table presents the means, medians, standard deviations and the number of observations of firm years with wealth-destructing deals and firm years without wealth-destructing deals in panel A. The last two columns show the mean difference and the *p*-value of the mean difference between the two types of firm years. Panel B provides these statistics for wealth-destructing deals and non-wealth-destructing deals. A deal is classified as wealth-destructing when the negative wealth effect is more than €150 million. All variables in this table are defined in Table 1. The table shows *, ** and *** for mean differences that are significantly different from zero at a 10%, 5% and 1% level, respectively.

Panel A: Acquirer characteristics at a firm year level

	Excl. firmyrs with wealth-destructing deals				**Firmyrs with wealth-destructing deals**				**Difference**	
	Mean (1)	Median	St.dev.	N	Mean (2)	Median	St.dev.	N	(1)-(2)	*p* -value
Financial characteristics										
Market capitalization (€ thousands)	1,542,605	423,689	6,037,254	266	11,981,138	8,434,009	10,410,379	46	-10,438,533	***0.000***
Leverage	0.274	0.247	0.187	266	0.310	0.239	0.195	46	-0.036	0.248
Tobin's *q*	1.459	1.302	0.664	266	2.067	1.805	1.081	46	-0.609	***0.000***
Free cash flow/total assets	0.031	0.034	0.036	266	0.039	0.037	0.032	46	-0.007	0.171
Return on assets	0.197	0.107	3.795	266	1.142	0.114	3.300	46	-0.945	0.113
Governance characteristics										
Number of supervisory board members	3.271	3.000	1.588	266	4.891	5.000	1.251	46	-1.621	***0.000***
Number of executive board members	5.801	6.000	2.171	266	7.478	7.000	1.847	46	-1.678	***0.000***
Relative size of executive board	0.644	0.667	0.114	266	0.604	0.600	0.059	46	0.041	***0.018***
Percentage largest outside blockholder	0.171	0.100	0.182	266	0.163	0.090	0.184	46	0.008	0.789
Total percentage outside blockholders	0.305	0.240	0.242	266	0.207	0.150	0.185	46	0.098	***0.009***
Total percentage inside blockholders	0.066	0.000	0.148	266	0.011	0.000	0.074	46	0.055	***0.014***
Dummy cross listing US and/or UK	0.244	0.000	0.431	266	0.739	1.000	0.444	46	-0.495	***0.000***
Takeover defense index	2.211	2.000	1.014	266	1.848	2.000	0.918	46	0.363	***0.018***
Dummy priority shares	0.395	0.000	0.490	266	0.652	1.000	0.482	46	-0.257	***0.001***
Dummy preference shares	0.688	1.000	0.464	266	0.587	1.000	0.498	46	0.101	0.179
Dummy certificates	0.398	0.000	0.491	266	0.217	0.000	0.417	46	0.181	***0.019***
Dummy structured regime	0.729	1.000	0.445	266	0.391	0.000	0.493	46	0.338	***0.000***

Table 6: Differences between wealth destructing deals and non wealth destructing deals (continued)

Panel B: Deal characteristics at a deal level

	Excl. wealth-destructing deals				Wealth-destructing deals				Difference	
	Mean (1)	Median	St.dev.	N	Mean (2)	Median	St.dev.	N	(1)-(2)	*p* -value
Transaction value (€ thousands)	469	70	1,232	130	824	363	968	22	-354	0.138
Transaction value/market capitalization	0.148	0.037	0.271	130	0.068	0.028	0.099	22	0.080	0.176
Sales target/sales acquirer	0.099	0.017	0.300	513	0.038	0.004	0.119	42	0.061	***0.008***
Dummy listed target	0.064	0.000	0.244	785	0.150	0.000	0.359	80	-0.086	***0.004***
Dummy diversifying acquisition	0.201	0.000	0.401	785	0.238	0.000	0.428	80	-0.036	0.470
Dummy focus shifting acquisition	0.048	0.000	0.215	785	0.050	0.000	0.219	80	-0.002	0.951
Dummy payment in equity	0.064	0.000	0.244	785	0.013	0.000	0.112	80	0.051	***0.064***
Dummy payment in cash	0.196	0.000	0.397	785	0.138	0.000	0.347	80	0.059	0.204
Dummy payment in cash and equity	0.039	0.000	0.195	785	0.000	0.000	0.000	80	0.039	***0.070***
Dummy domestic acquisition	0.246	0.000	0.431	785	0.188	0.000	0.393	80	0.058	0.245
Dummy European acquisition (excluding NL)	0.452	0.000	0.498	355	0.375	0.000	0.487	80	0.077	0.186
Dummy US acquisition	0.181	0.000	0.385	142	0.300	0.000	0.461	80	-0.119	***0.010***

Table 7: Regression analysis explaining the likelihood of a wealth-destructing acquisition announcement

The table provides the results of a binary logit regression that explains the likelihood of an acquisition announcement to be wealth destructing. A deal is classified as wealth-destructing when the negative wealth effect is more than €150 million. All variables in this table are defined in Table 1. The regression includes year and industry dummies. *P*-values are documented in parentheses and based on Huber/White's heteroskedasticity corrected standard errors. The table shows *, ** and *** for values that are significantly different from zero at a 10%, 5% and 1% level, respectively.

	Coefficient (*p*-value)	
Intercept	-28.020	***
	(0.000)	
Tobin's *q*	0.995	***
	(0.000)	
Free cash flow/total assets	4.451	
	(0.634)	
Return on assets	0.059	
	(0.393)	
Leverage	3.696	***
	(0.005)	
ln(size)	1.509	***
	(0.000)	
Dummy equity payment	-1.105	
	(0.298)	
Dummy listed target	0.472	
	(0.279)	
Dummy diversifying	0.455	
	(0.194)	
Dummy European target, but not Dutch	0.339	
	(0.452)	
Dummy Domestic target	0.841	
	(0.131)	
Dummy US target	0.329	
	(0.521)	
Relative size of the board	-3.981	*
	(0.079)	
Block shareholders	0.720	
	(0.553)	
Insider ownership	0.986	
	(0.744)	
Dummy cross-listing US or UK	0.700	
	(0.215)	
Dummy priority shares	0.995	*
	(0.056)	
Dummy preference shares	-0.899	*
	(0.072)	
Dummy certificates	0.193	
	(0.715)	
Dummy structured regime	-0.163	
	(0.774)	
Number of observations	865	
McFadden *R*-squared	35.68%	

* significant at 10%; ** significant at 5%, *** significant at 1%

Figure 1: The development of abnormal returns around acquisition announcements

This figure shows the cumulative average abnormal returns of the days around acquisition announcements. The day of the announcement is day zero.

Figure 2: The distribution of abnormal returns

This figure provides the distribution of the five days cumulative abnormal returns around acquisition announcements. The horizontal axis shows the five days cumulative abnormal returns and the vertical axis shows the frequency in which this return occurs.

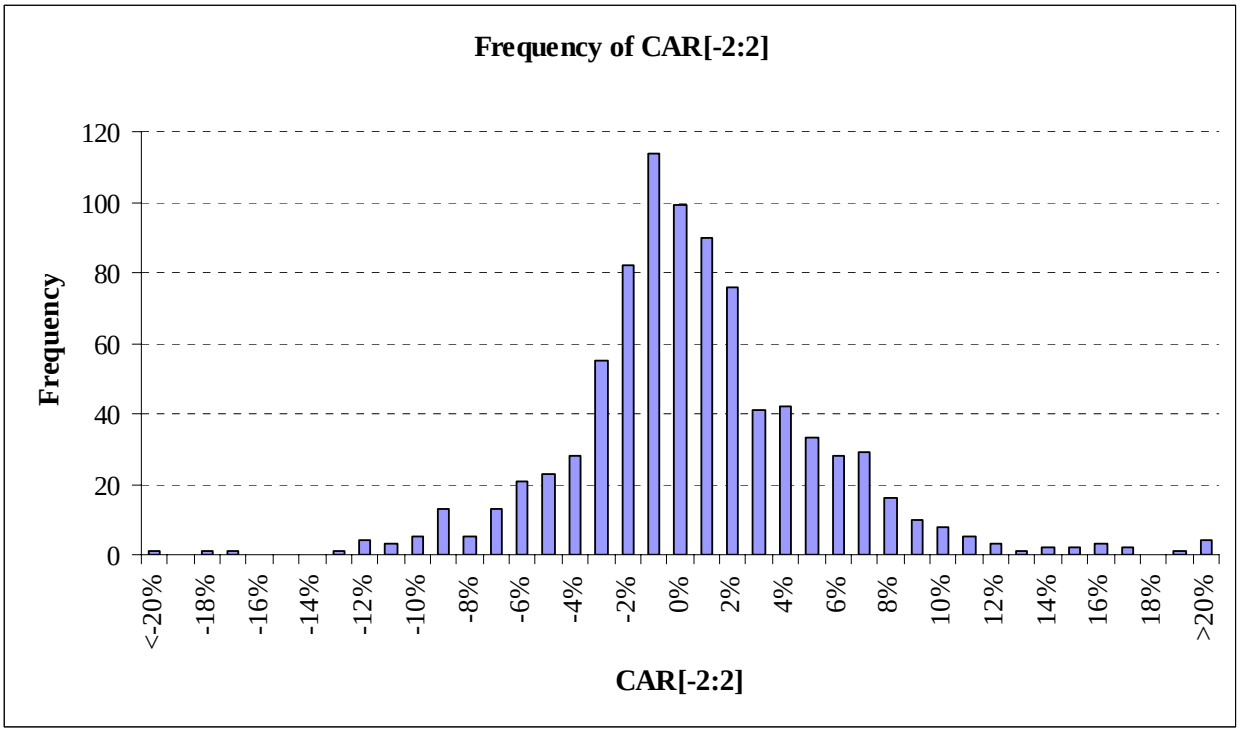
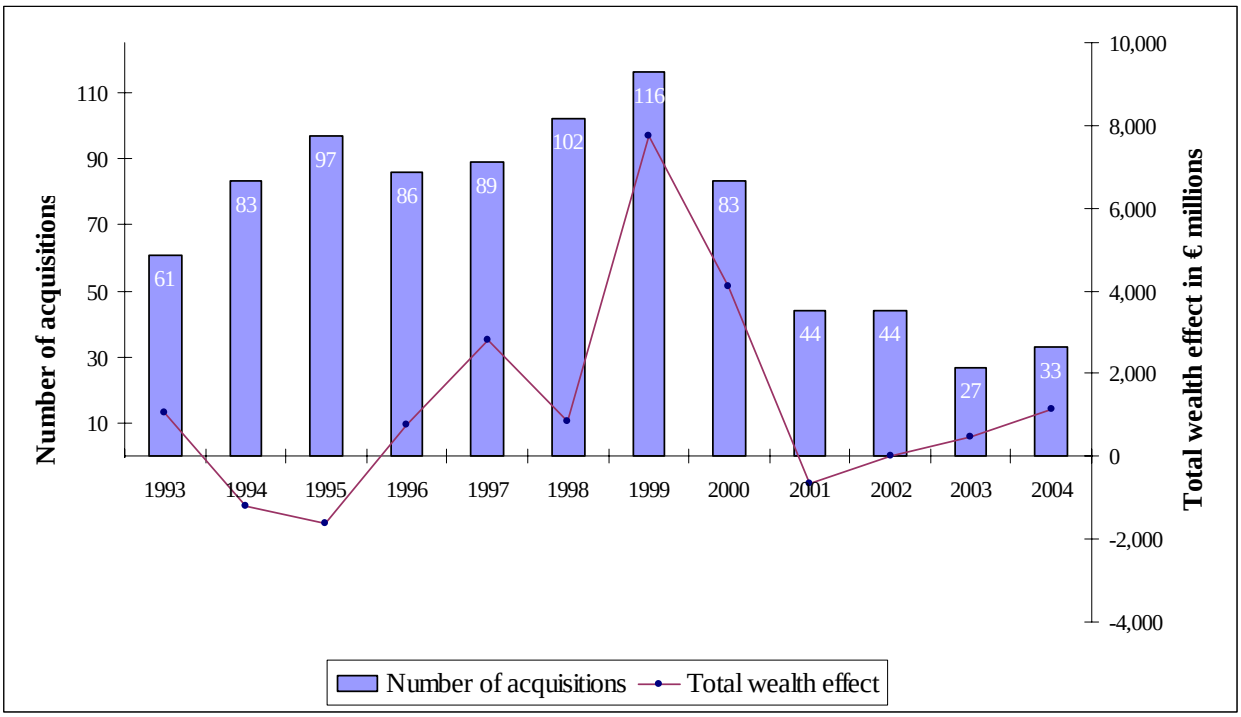


Figure 3: The number of acquisition announcements and the total wealth effects per year

This figure shows the number of acquisitions and the total aggregated wealth effects over five days around acquisition announcements per announcement year. The left vertical axis provides the number of acquisitions, the right vertical axis shows the total wealth effects in millions of euros and the horizontal axis shows the announcement year.



Endnotes

[1] De Jong, Kabir, Marra and Röell (2001) provide an extensive description about the ownership and control of listed firms in the Netherlands.

[2] The 1996 Act on Disclosure of Holdings in Listed Companies, provides that any person, who directly or indirectly, acquires or disposes of an interest in the capital and/or the voting right of public limited liability company incorporated under Dutch law with an official listing on a stock exchange, must give a written notice of such acquisition or disposal, if as a result of such acquisition or disposal the percentage of capital interest or voting rights held by such person falls within another percentage range held by such person prior to the acquisition or disposal. The relevant percentage ranges referred to in the Disclosure of Holdings Act are 0% to 5%; 5% to 10%; 10% to 25%; 25% to 50%; 50% to 66%; and over 66%.

[3] Most of the takeover activity is concentrated in Europe and the US. For example, only 4.1% of the deals concern Asian targets, 1.2% are acquisitions of African firms and 2.7% concern non-US companies from the American continents.

[4] Our sample includes eight deals with shareholders' losses of more than €1 billion.

Publications in the Report Series Research* in Management

ERIM Research Program: "Finance and Accounting"

2007

Revisiting Uncovered Interest Rate Parity: Switching Between UIP and the Random Walk
Ronald Huisman and Ronald Mahieu
ERS-2007-001-F&A
http://hdl.handle.net/1765/8288

Hourly Electricity Prices in Day-Ahead Markets
Ronald Huisman, Christian Huurman and Ronald Mahieu
ERS-2007-002-F&A
http://hdl.handle.net/1765/8289

Do Exchange Rates Move in Line with Uncovered Interest Parity?
Ronald Huisman, Ronald Mahieu and Arjen Mulder
ERS-2007-012-F&A
http://hdl.handle.net/1765/8993

Hedging Exposure to Electricity Price Risk in a Value at Risk Framework
Ronald Huisman, Ronald Mahieu and Felix Schlichter
ERS-2007-013-F&A
http://hdl.handle.net/1765/8995

Corporate Governance and Acquisitions: Acquirer Wealth Effects in the Netherlands
Abe de Jong, Marieke van der Poel and Michiel Wolfswinkel
ERS-2007-016-F&A

---

* A complete overview of the ERIM Report Series Research in Management:
https://ep.eur.nl/handle/1765/1

ERIM Research Programs:
LIS Business Processes, Logistics and Information Systems
ORG Organizing for Performance
MKT Marketing
F&A Finance and Accounting
STR Strategy and Entrepreneurship