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The effects of partial acquisitions on stock performance of target firms

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**THE EFFECTS OF PARTIAL ACQUISITIONS ON STOCK
PERFORMANCE OF TARGET FIRMS**

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Abstract

This study analyzes the returns to target stockholders for partially acquired firms surrounding the acquisition announcements through one year after the announcements. A sample of fifty-three Canadian firms partially acquired by domestic firms from 1993 through 1999 is considered. The examination of the return behaviour found significant positive abnormal returns from event-day $t = - 2$ through $t = + 1$. No significant abnormal returns are realized thereafter. The findings imply that the announcements positively affect the surrounding returns. The lack of significant positive abnormal returns thereafter suggests that the announcement does not have a positive impact on the stockholder returns one year later.

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Chapter One: Introduction

In order to compete more effectively in an increasingly competitive and integrated world economy, corporations merge, acquire, divest and restructure various business activities as part of the re-configuration of their competitive advantage.

Over the last 20 years, acquisitions activity has been one of the chief methods for organizational growth. Whether the goal is improving margins, increasing market share or raising shareholder value, growth is critical. Despite the fact that acquisition success rates are deplorably low, corporations have turned increasingly to acquisitions to fuel their future success. The chief rationalizations offered for taking such a risky strategy are: attempts at organic growth often take too long to achieve greater market share; investment in research and development has proved unfruitful or too expensive; the corporations have identified targets of unique opportunity, or simply they expect to succeed where others have failed (Lynch and Lind, 2002).

Financial economists contend that acquisitions are one part of a market driven mechanism by which resources are reallocated from lower-valued to alternative, higher-valued uses. The process supplements the prevailing competitive forces in markets, in which firms purchase inputs and sell outputs, and stimulates these firms to adapt to changing demands, to respond rapidly to evolving technologies, and to adjust to fluctuating capital market conditions. Most importantly, the market for corporate control of publicly traded corporations unsettles comfortable managerial lives, minimizes the principal-agent problem between shareholders and inefficient or shirking management and eliminates obsolete and less productive processes and organizational structures.

Motives behind Acquisition Activity

Several motives have been offered to explain why acquisition activity takes place. Some of the motives are explained below.

Improved management hypothesis. Some takeovers are motivated by a belief that the acquiring firm's management can better manage the target's resources. The bidder may feel that its management skills are such that the value of the target would rise under its control. This leads the acquirer to pay a value for the target in excess of the target's current stock price.

The improved management argument may have particular validity in cases of large companies making offers for smaller, growing companies. The smaller companies, often led by entrepreneurs, may offer a unique product or service that has sold well and facilitated the rapid growth of the target.

The growing enterprise may find that it needs to oversee a much larger distribution network and may have to adopt a very different marketing philosophy. Many of the decisions that a larger firm has to make require a different set of managerial skills than those that resulted in the dramatic growth of the smaller company. The lack of managerial expertise may be a stumbling block in the growing company and may limit its ability to compete in the broader marketplace. These managerial resources are an asset that the larger firm can offer the target firm (Gaughan, 1996).

Tax motives. Tax gains can be important motives for certain takeovers. A target can become more valuable, for example, if it has transferable tax losses that an acquirer can use to offset income. Other sources of gains can be investment tax credits, which can

also be used to offset income. Moreover, whether the transaction can be structured as a tax-free exchange can be a prime determining factor in whether to go forward with a deal (Gaughan, 1996).

Synergy. The term synergy is often associated with the physical sciences rather than with economics or finance. It refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than what the sum of the two operating independently could account for. For example, a synergistic reaction occurs in chemistry when two chemicals combine to produce a more potent total reaction than the sum of their separate effects. Simply stated, synergy refers to the phenomenon of $2 + 2 = 5$. In acquisitions, this translates into the ability of a corporate combination to be more profitable than the individual profits of the firms that were combined (Gaughan, 1996).

The anticipated existence of synergistic benefits allows firms to incur the expenses of the acquisition process and still be able to afford to give target shareholders a premium for their shares. Synergy may allow the combined firm to appear to have a positive net acquisition value (NAV).

Diversification. By expanding through acquisition of other firms, the acquiring corporation may attempt to achieve some of the benefits that investors receive by diversifying their portfolio of assets. The portfolio theory research literature in finance has attempted to quantify some of the risk-reduction benefits that an investor may enjoy through diversification. This research clearly supports the intuitive belief of investors that “putting all one’s eggs in one basket” is not a wise decision (Gaughan, 1996).

Economic motives. Combinations that result in an increase in market share may have a significant impact on the combined firm's market power. Market power, which is sometimes also referred to as monopoly power, is defined as the ability to set and maintain price above competitive levels. Since in the long run sellers in a competitive industry only earn a normal return and do not earn "economic rent," competitive firms set price equal to marginal cost. Market power refers to the ability to set price in excess of marginal cost (Gaughan, 1996).

Hubris hypothesis of takeovers. An interesting hypothesis regarding takeover motives has been proposed by Roll (1986). He considers the role that hubris, or exaggerated self-confidence of the managers in the acquiring firm, may play in explaining takeovers. The hubris hypothesis implies that chief executive officers (CEOs) seek to acquire firms for their own personal motives and that the pure economic gains to the acquiring firm are not the sole or even the primary motivation in the acquisition.

Roll uses this hypothesis to explain why managers might pay a premium for a firm that the market has already correctly valued. Managers, he states, have superimposed their own valuation over that of an objectively determined market valuation. Roll's position is that the pride of management allows them to believe that their valuation is superior to that of the market.

The famed investor, Warren Buffett, once said that many corporate acquirers think of themselves as beautiful princesses, sure that their kisses can turn toads into handsome princes. The acquirers pay substantial premiums over market value, believing that they can release the imprisoned princes. But, as Buffett said, "We've observed many

kisses but very few miracles” (1981 Berkshire Hathaway Annual Report as cited in Hayward and Hambrick, 1997). With acquirers making record numbers of takeovers at prices far above market levels, the comment Buffett made in 1981 has not lost its relevance for managers and students of organizations today. In fact, more acquisitions were announced in 1995 in U.S. than in any prior calendar year (Hayward and Hambrick, 1997). And between 1976 and 1990, 35,000 corporate acquisitions were completed in U.S., with a combined value of \$ 2.6 trillion (Jensen, 1993). Yet, for all this activity, executives of acquiring companies generally fail to effect acquisition miracles. Acquisitions sometimes yield positive returns for acquirers (Lubatkin, 1987), but generally acquisitions have been found to have a neutral to negative effect on the shareholder wealth of acquiring firms (Berkovitch & Narayanan, 1993; Bradley, Desai, & Kim, 1988; Jarrell, Brickley, & Netter, 1988). Commonly, investors mark down the stock of acquirers following takeovers announcements, indicating their belief that acquiring managers have overpaid (Shleifer & Vishny, 1991). This adverse market reaction is reinforced by findings that acquisitions lead to declines in the acquirer’s longer-term profitability (Fowler & Schmidt, 1988; Ravenscraft & Scherer, 1987) and shareholder returns (Agrawal, Jaffe, & Mandelkar, 1992). Acquisitions are often resold later at a loss (Porter, 1987).

Background of the Problem

Canada is not an exception when it comes to this wave of acquisition activity. Dramatic takeovers have become commonplace and debate about them fills the popular and business press. For example, in 1993 the number of merger and acquisition announcements was 895. In 1999, the number of announcements of mergers and

acquisitions reached 1,230. This represents a 37.43 percent increase within the period. The dollar value of the mergers and acquisitions announcements in 1993 was \$35 billion, whereas in the year 1999 it was \$178 billion.

Financial researchers argue that the goal of the publicly held firm should be to maximize the value of the common stock and that this value maximization rule is unanimously supported by all financial claimants under a variety of conditions (e.g., Ekern & Wilson, 1974; Nielsen, 1976). Profitability or wealth maximization is not only a management goal; it is often the primary reason for organizational existence (Taylor, 2002).

Management literature amply reported the discouraging results of many acquisitions. There have been widespread warnings of the erosion of shareholder value and the serious socio-economic costs associated with many acquisitions. In an excellent summary article "Do deals deliver on post merger performance?" (Note: mergers and acquisitions used synonymously) Alexandra Reed Lajoux and J. Fred Weston (as cited in Lynch and Lind, 2002), argue that the longer-term effects of mergers show impairment of value (measured by share price and other indicators) for a variety of identifiable reasons, including inexperience, lack of strategic purpose, use of overvalued stock as a payment mode, and poor post-merger integration. The research, they argue, also shows that companies avoiding these traps perform better than their peers, both acquiring and non-acquiring.

The acquisition wave has also resulted in some firms investing in other firms by buying a certain percent of shares, but less than 100 percent, making them part owners in

such firms. These investing firms have found it strategic not to fully acquire these firms. This raises the related question. How do partial acquisitions affect target firms?

The Research Statement

This study undertakes an investigation of Canadian firms partially acquired by domestic firms. The research statement is: The Effects of Partial Acquisition on Stock Performance of Target Firms.

The Research Purpose

The purpose of this research study is to investigate how a partial acquisition affects the stock price performance of a target firm.

The Research Objectives

The objectives of this study are:

1. To investigate the returns to target shareholders surrounding the partial acquisition announcements dates.
2. To investigate the stock performance of target firms one year subsequent to the partial acquisition.

Significance of the Study

Studies, mostly from the U.S., have analyzed the impact of acquisitions on management turnovers and post merger/acquisition performance of the acquiring firms. The existing literature, however, on partial acquisition is limited. This study is important because not only will it contribute to the body of literature on acquisition activity, but it

also anticipated that it will shed some light on how partial acquisitions affect the stock performance of target firms, more specifically, the shareholder values.

Literature Review

Market for Corporate Control

In the early 1960s, academics coined the phrase “market for corporate control” to describe the market for buying and selling companies, as opposed to the market for products and services. This market for control over companies, their assets, and the opportunity to generate value from them has been very active, to say the least. The pace of acquisition seems unrelenting. In 1988, according to Fortune magazine (as cited in Copeland, Koller, & Murrin, 1990), the top fifty deals in the U.S. totaled \$ 111.8 billion, a new record. This booming market occurred despite the stock market crash in late 1987, which might have scared off potential acquirers, especially heavily leveraged ones.

While at any given time different explanations can be offered for acquisition activity, ranging from rising stock prices to a “cheap” dollar, more fundamental forces are usually at work. Currently they suggest that a relatively high level of activity in the market for corporate control will persist. Three of the most important forces are described next.

Changes in capital markets. The capital markets have changed dramatically, to the point where enormous volumes of funds are available to back acquisitions. Institutional money has flooded into leveraged-buyout funds in search of high returns. The high yield-bond market is large and active. Banks are eager to finance acquisitions since they earn high fees and spreads on this business at a time when many of their other,

more traditional activities are marginally profitable at best. Foreign banks are eager to crack markets (Copeland, Koller, & Murrin, 1990).

Shareholder activism. At the same that funding for takeovers has become more available, shareholders are becoming impatient with managements who do not focus on value creation--and they are doing something about it. Even though a legal fiction has always existed that shareholders are owners of corporations, the reality was quite different, until recently. If a shareholder did not like the performance of a company, he or she was wasting time attending its annual shareholders' meeting. Stock owners basically voted with their feet, selling their shares rather than getting involved in proxy battles at the annual meeting. In fact, shareholders were such a docile lot that those who did make proposals to be voted on at the annual meeting were treated like errant children or labeled gadflies (Copeland, Koller, & Murrin, 1990).

That is changing dramatically. Not only has the proportion of stock owned by large investors grown rapidly, but investors are also increasingly ready to intervene directly when management is underperforming. Funds managers who are evaluated annually on the basis of the amount by which their investment returns exceed the performance of the market, face enormous pressures. Consequently, they are more willing to have their voices heard if they disagree with management's actions and performance.

Ineffective takeover defenses. Obviously, the wave of takeovers and restructurings have not gone unnoticed by corporate managements and other groups. In an effort to fend off unwanted suitors, managements and their advisors have developed a

wide range of defensive mechanisms. These include supermajority provisions, staggered boards, and poison pills. In addition, “antiraider” statutes aimed at protecting companies against hostile takeovers have been adopted in some parts of U.S. Not surprisingly, these steps have generated intense controversy and even greater demand for legal talent with expertise in acquisitions. They have succeeded in preventing the more questionable--and one could argue abusive--tactics, especially the two-tier, front-end-loaded takeover (Copeland, Koller, & Murrin, 1990).

What these steps have not succeeded in doing is stopping the determined bidder. Most investment bankers and lawyers seem to agree that no permanent defense can be made against a well-financed, all-cash bid that exceeds the next-best offer on the table. Poison pills have a spotty track record when put to the test in the courts. Restrictive statutes are being challenged vigorously and successfully by well-heeled bidders. High bids that attract a substantial majority of outstanding shares in tender offers are often not subject to the restrictive provisions in statutes, anyway. Additionally, proxy contests can be used as an alternative avenue of attack to overcome blockages put in place by sitting directors, ultimately by removing the directors or calling special shareholders’ meetings to amend the bylaws directly. And federal government has taken a more laissez-faire attitude toward antitrust enforcement, so that once-potent deterrent has been weakened. Legal maneuvers and obstacles certainly make takeovers more expensive and time-consuming, but they do not stop them.

In this market for corporate control, acquisition activity takes place to replace inefficient management that fails to maximize firm value [see, for example, Choi (1993), Copeland, Koller, & Murrin (1990), Dahya & Powell (1998), Ikenberry & Lakonishok

(1993), Martin & McConnell (1991), and Morck, Shleifer, & Vishny (1989)]. Most of the literature regarding acquisitions and the impact on management has come from the U.S. The studies of Agrawal and Walking (1994), Denis and Denis (1995), and Martin and McConnell (1991) provide strong support for the takeovers being of a disciplinary nature. These studies report poor pre-bid performance and high top management turnover once the takeover has been completed. Walsh and Ellwood (1991) study the relationship between pre-merger performance of the target and post-acquisition turnover of top management. The findings show a turnover of 61% for target management and 34% for the non-acquired control sample. Dahya and Powell (1998) find in a sample of 92 target firms; 47 percent experienced a change in the top executive category following a successful takeover. Kennedy and Limmack (1996) find a significant increase in the rate of target firm CEO turnover following the takeover. They argue that most of these CEOs are from firms with poor pre-bid price performance. This supports the theory that takeovers act as a disciplinary mechanism on non-wealth maximizing CEOs. Likewise, a partial acquisition takes place to give an initial warning to target management and to directly place a monitoring mechanism through which the behaviour of the target managers can be controlled.

Board of Directors as a Mechanism of Managerial Control

The separation of ownership and control first discussed by Berle and Means (1932) creates many situations in which the interests of managers and owners may not coincide. For example, in the last ten years, a considerable amount of evidence has documented the prevalence of managerial behaviour that does not serve the interests of investors, particularly shareholders. Most of this evidence comes from the capital market

in the form of “event” studies. The idea is that if the stock price falls when managers announce a particular action, then this action must serve the interests of managers rather than those of the shareholders. While in some circumstances this inference is not justified because the managerial action, while serving the interests of shareholders, inadvertently conveys to the market some unrelated bad news about the firm (Shleifer & Vishny, 1986a), in general such event study analysis is fairly compelling. It has surely become the most common empirical methodology of corporate governance and finance [see, Fama, Fisher, Jensen, & Roll (1969) for the first event study].

In his free cash flow theory, Jensen (1986) argues that managers choose to reinvest the free cash rather than return it to investors. Jensen uses the example of the oil industry, where in the mid-1980s integrated oil producers spent roughly \$ 20 per barrel to explore for new oil reserves (and thus maintain their oil exploration activities), rather than return their profits to shareholders or even buy proven oil reserves that sold in the marketplace for around \$ 6 per barrel. McConnell and Muscarella (1986) look more generally at announcement effects of investment projects of oil and other firms, and find negative returns on such announcements in the oil industry, although not in others. The study of investment announcements is complicated by the fact that managers in general are not obligated to make such announcements, and hence those that they do make are likely to be better news than the average one. Still, the managers in the oil industry announce even the bad news.

The announcement selection problem does not arise in the case of a particular kind of investment, namely acquisitions, since almost all acquisitions of public companies are publicly announced. Some of the clearest evidence on agency problems

therefore comes from acquisition announcements. Many studies show that bidder returns on the announcement of acquisitions are often negative [Roll (1986) surveys this evidence]. Finally, Lang, Stulz, and Walkling (1991) find that bidder returns are the lowest among firms with low Tobin's Qs and high cash flows. Their result supports Jensen's (1986) version of agency theory, in which the worst agency problems occur in firms with poor investment opportunities and excess cash. In sum, quite a bit of evidence points to the dominance of managerial rather than shareholder motives in firms' acquisition decisions.

Even clearer evidence of agency problems is revealed by the studies that focus on managers directly threatened with the loss of private benefits of control. These are the studies of management resistance to takeovers, which are now too numerous to survey completely. Managerial resistance to value-increasing takeovers is less likely when top managers have a direct financial interest in the deal going through via share ownership or golden parachutes, or when top managers are more likely to keep their jobs. Another set of studies finds that, when managers take anti-takeover actions, shareholders lose. For example, DeAngelo and Rice (1983) and Jarrell and Poulsen (1988) find that public announcements of certain anti-takeover amendments to corporate charters, such as super-majority provisions requiring more than 50 percent of the votes to change corporate boards, reduce shareholder wealth. Ryngaert (1988) and Malatesta and Walkling (1988) find that, for firms who have experienced challenges to management control, the adoption of poison pills--which are devices to make takeovers extremely costly without target management's consent--also reduce shareholder wealth. Comment and Schwert (1995), however, question the event study evidence given the higher frequency of takeovers

among firms with poison pills in place. Taken as a whole, the evidence suggests that managers resist takeovers to protect their private benefits of control rather than to serve shareholders.

Some of the evidence on agency costs is less direct, but perhaps as compelling. In one of the most macabre event studies ever performed, Johnson, Magee, Nagarajan, and Newman (1985) find that sudden executive deaths--in plane crashes or from heart attacks--are often accompanied by increases in share prices of the companies these executives managed. The price increases are the largest for some major conglomerates, whose founders built vast empires without returning much to investors. A plausible interpretation of this evidence is that the flow of benefits of control diminishes after the deaths of powerful managers.

There is also a great deal of evidence that control is valued, which would not be the case if controlling managers (or shareholders) received the same benefits as the other investors. Barclay and Holderness (1989, 1992) find that, in the U.S., large blocks of equity trade at a substantial premium to the post-trade price of minority shares, indicating that the buyers of the blocks that may have a controlling influence receive special benefits. Several studies compare the prices of shares with identical dividend rights, but differential voting rights. DeAngelo and DeAngelo (1985), and Lease, McConnell, and Mikkelsen (1983, 1984), all show that, in the U.S., shares with superior voting rights trade at a premium. On average, this premium is very small, but it rises sharply in situations where control over firms is contested, indicating yet again that controlling management teams earn benefits that are not available to minority investors.

Agency theory is based on the notion that the delegation of managerial responsibilities by principals (owners) to agents (managers) requires the presence of mechanisms that either align the interests of principals and agents (such as stock ownership plans and performance contingent compensation) or monitor the performance of managers to ensure that they use their knowledge and the firm's resources to generate the highest possible return for principals. A better solution is to grant a manager a highly contingent, long-term incentive contract *ex ante* to align his or her interests with those of investors. While in some future contingencies the marginal value of the personal benefits of control may exceed the marginal value of the manager's contingent compensation, such instances will be relatively rare if the incentive component of pay is substantial. In this way, incentive contracts can induce the manager to act in investors' interests without encouraging blackmail. When the optimal compensation contract cannot be achieved or managers are reluctant to bear greater risks, owners must create or utilize existing mechanisms to monitor managerial action (Fama, 1980).

The primary monitoring mechanism available to organizational owners is the board of directors. The board of directors is considered an important internal corporate control mechanism (Fama, 1980; Fama & Jensen, 1983). A number of authors have supported this reasoning, for example, Boyd (1994) and Zald (1969), who argue that the board of directors is probably the most effective mechanism for both influencing and controlling top management decisions so as to ensure that shareholder interests are protected. In short, the board helps align ownership interests with top management and hence performs the monitoring that shareholders expect (Walsh & Seward, 1990). Among other things, the directors are responsible for evaluating the chief executive

officer (CEO) and other top-executives, determining the level and structure of top-executive compensation, and replacing poorly performing CEOs.

To perform this function effectively, the board of directors must assume the task of extracting information about the true managerial performance of the firm from noisy and sometimes disguised or misleading financial performance measures. Both accounting and market-based measures are likely to be relatively useful indicators, though both of these measures may be determined in part by factors beyond the control of the firm's managers, such as, industry and economy factors. Furthermore, these measures are likely to be prone to the influence of managerial inputs and outputs, which themselves may provide indicative information on managerial performance (Joskow & Rose, as cited in Dahya & Powell, 1998). In the U.S. and the U.K., managerial performance is maintained (and agency problems limited) by the complementary intervention of both internal and external control mechanisms (Franks & Mayer, 1996). These mechanisms include: (1) monitoring and exerting an influence on control through the team of executive and non-executive directors on the board (Coughlan & Schmidt, 1985; Weisbach, 1988); (2) the managerial labour market (Fama, 1980); (3) product market competition (Hart, as cited in Dahya & Powell, 1998); and (4) the market for corporate control (Jensen, as cited in Dahya & Powell, 1998).

The Failure of Internal Control Mechanisms

The internal control mechanisms of corporations operate through the board of directors, who generally maintain the power to hire and fire top management. There is, however, considerable controversy about the role of the board of directors in this governance process. Fama and Jensen (1983) and Fama (1980) view the board as an

important internal mechanism for disciplining incumbent management. Mace (1986), however, questions the importance of the board and non-executive directors as monitors.

The importance of internal control mechanisms has increased in the U.S., due partially to legal and regulatory developments, which have curtailed activity in the market for corporate control (see, Jensen 1991). Furthermore, in the U.K., a re-emphasis on the importance of good internal management controls followed the publication of the Cadbury Report (1992) (as cited in Dahya & Powell, 1998) on corporate governance. There is, however, little empirical evidence on the effectiveness of internal control mechanisms in generating improvements in firm performance. Denis and Denis (1995) note that, if internal control mechanisms are effective, then there should be a greater incidence of top management changes in poorly performing companies and improvements in firm performance following changes in management. Warner, Watts, and Wruck (1988) and Coughlan and Schmidt (1985) document that top management change is inversely related to prior share price performance. Weisbach (1988) documents a stronger relationship between price and top management change for firms with a greater percentage of non-executive directors on the board. These findings are consistent with the boards acting as an important mechanism for disciplining poorly performing managers.

When the internal processes for change in large corporations are too slow and costly to implement the required management changes, the market for corporate control quickly responds. Morck et al. (1989) find that takeovers tend to be directed at poorly performing industries. In such cases, the takeover seems to provide an efficient alternative to removing unresponsive managers when the board is reluctant or unable to remove managers. Other constraints on managerial activity, such as competition in the

product or managerial labour markets, may encourage managers to behave in firm value maximizing ways. However, when these mechanisms fail, the market for corporate control may serve as a “court of last resort.”

Takeovers as a Mechanism of Managerial Control

A great deal of theory and evidence supports the idea that takeovers address governance problems (Jensen, 1988; Manne, 1965; Scharfstein, 1988). The most important point is that takeovers typically increase the combined value of the target and acquiring firm, indicating that profits are expected to increase afterwards (Jensen & Ruback, 1983). Moreover, takeover targets are often poorly performing firms (Morck, Shleifer, & Vishny, 1988, 1989; Palepu, 1985), and their managers are removed once takeover succeeds. Jensen (1986, 1988) argues that takeovers can solve the free cash flow problem, since they usually lead to distribution of the firm’s profits to investors over time. Takeovers are widely interpreted as the critical corporate governance mechanism in the U. S., without which managerial discretion cannot be effectively controlled (Easterbrook & Fischel, 1991; Jensen, 1993).

The theory that underlies the functioning of the market for corporate control can be traced back to Manne (1965), who was the first to articulate the workings of a market for corporate control. Manne views the takeover as a useful mechanism for encouraging managers to pursue shareholder wealth maximization strategies. According to Manne, corporate control is a valuable asset actively traded on a market. The operation of this market depends upon the link between a firm's share price and the performance of its management. Poor performance relative to some benchmark causes a firm's share price to

fall below its value under efficient management, allowing a transfer of control by encouraging takeover bids from prospective new management teams. In fact, bringing in more responsible management may benefit a variety of corporate constituencies as it signals that the corporation will henceforth be run in a more efficient fashion (Waverman, 1991). The nature of the bid, hostile or friendly, depends upon the expected source of gains from the takeover. If the takeover is primarily motivated to discipline poor managers, shareholders will benefit because new managers will invoke shareholder wealth-maximizing strategies. A second view advances the notion that gains are created through the various forms of synergy generated through the combination of target and acquirer firms. Morck et al. (as cited in Dahya & Powell, 1998) show that friendly takeovers are more likely to be motivated by synergy, whereas hostile takeovers are more likely to be aimed at disciplining poorly performing top management.

Basically, friendly takeovers are when the bidding company's proposal receives a positive reaction from the target's board of directors, which in turn will go out and recommend the offer to the shareholders. Hostile takeovers are when the board of directors of the target company tries to fight off the bid and in turn will go out to the shareholders and recommend that they do not accept the bidder's offer. With respect to the acquisition and the type of bid, management of the bidder and target would be affected differently. The bidding company managers may have new opportunities to enhance the firm's competitive advantage, operational efficiency and financial performance. Managers of bidding companies may also have increased job security. On the other hand the management of the target may find difficulties adapting to the new company's culture and staff. Also the managers of the target companies in acquisitions

may lose power and status. Theory suggests that the motivation of the acquisition will decide the fate of acquired company managers. A disciplinary (hostile) takeover, with the belief in an inefficient target management, will by definition result in a high managerial turnover. In contrast the acquiring management is in a far safer position. Once the takeover is complete, one of the evident rewards is an increase in firm size. Remuneration is positively linked with the size of the firm, regardless of post-acquisition performance. Perhaps this managerial self-interest serves as one of the main motivations in the market for corporate control.

Dahya and Powell (1998) argue that many regard the threat of takeover, operationalized through the capital markets, as one of the key factors in maintaining good managerial control. Many regard this control as the single most important external factor in encouraging good managerial performance. Advocates of this view suggest that other mechanisms of managerial control, such as internal board controls, the managerial labour market, and product market competition, are ineffective in encouraging the efficient management of corporations, for example, Grossman and Hart (1980). According to Jensen (as cited in Dahya & Powell, 1998), when other mechanisms fail to influence managerial performance, the external market for corporate control comes into play and acts as a “court of last resort.”

Theory of Signalling

According to Grossman & Hart (1981), an acquirer may possess special information about the target company that indicates the potential value of the target exceeds the existing value. The acquirer can extract gains by acquiring the target and revising managerial decisions. Although small investors may not be able to obtain such

special information, investors that are in a position to be large shareholders (such as potential acquirers) have an incentive to develop and capitalize on the information, because they can extract gains on all the shares that they acquire.

Shareholders who monitor a bid by a potential acquirer recognize that the acquirer possesses special information not known to the general public and tend to revise upward their valuation of the target. Grossman and Hart argue that the job of monitoring the firm will therefore be left to a potentially large shareholder, such as a prospective bidder. One role of a potential bidder is to discover whether a firm is being run inefficiently and, if it is, to take it over and replace the current management by more efficient management. They refer to this role as an allocational bid but state that a bidder can also extract gains by engaging in an acquisitional bid, whereby the bidder has special information that may enable the target firm to improve its performance even with its existing management. Grossman and Hart suggest that allocational bids are not necessarily distinguishable from acquisitional bids.

Halpern (1983) supports the theory of Grossman and Hart by suggesting that the bidder has information about the target firm that is not available to other participants in the market, and not reflected in the current share price of the target. The information may be that the target shares are undervalued based on publicly available information or there are more efficient operating strategies that could be used by the target's management. According to Halpern, therefore, the announcement of an acquisition bid should be a signal to the market place and the asymmetry in information should be ameliorated.

Partial Corporate Acquisitions

Partial ownership of one corporation by another allows the acquirer to exert some control or influence over its acquisition. In some cases the acquiring firm discloses that the purchase of shares is solely for investment purposes, while in other cases the acquiring firm indicates that an attempt to acquire control of the target firm is under consideration. It is obvious that the motives for acquiring shares in rival companies and participating in various forms of co-operation may be complex and case-specific.

According to von der Fehr et al. (as cited in Amundsen & Bergman, 2002) three types of motives can be distinguished, namely:

- I. Expected synergies, for example, cost reduction through sales co-operation. All acquisitions are predicated on making more (profit) from two entities than they would make alone.
- II. Financial considerations, for example, investment of funds into other companies as a part of the company's management of financial assets.
- III. Learning, for example, to get information from the other company on how to deal with a certain production process.

However, all of the investments represent a potentially important change in the security ownership structure of the target firm.

Mikkelsen and Ruback (1985) find that the share prices of both the acquiring and the target firms increase in response to the initial disclosure of the investment position. Such investments initiate a process that may end with a completed takeover; a completed

takeover by another firm; a repurchase of the investment position by the target firm (target repurchase); or a sale of shares in the market or to a third party. In some cases, none of these outcome events follow the initial investment.

In a passive partial ownership, a company owning a share of another company has no direct influence on the production decisions of that company. The company can, however, indirectly influence the profit of the other company (and thereby its own proceeds) via the price effect that its own production decisions give rise to. Hence with a passive ownership arrangement the capacity decisions of a company should be based not only on the direct effect on its own profit, but also on the indirect effect of those decisions on the profit of the companies in which it owns shares. It is a well established result that Cournot oligopolists with passive equity interests in other companies act less competitively in the sense of reducing output and thus increasing prices (Bolle & Guth, 1992; Bresnahan & Salop, 1986; Reynolds & Snapp, 1986).

In an active partial ownership, an arrangement is made in which production decisions of the owning firm and some of its potential competitors are coordinated. This may take place in a situation where the firm in question possesses sufficiently large ownership shares in other firms to be able to exercise at least some control over their production decisions. It may also take place if the firm has external owners that have important shares in some of the other competing firms. In this case the firms involved may coordinate their production decisions so as to benefit their common owners. For this case, however, there exists no obvious equilibrium concept for co-ordination of production decisions (von der Fehr et al. as cited in Amundsen & Bergman, 2002).

The partial owner may be more effective than widely dispersed shareholders in monitoring the acquired firm's management, reducing agency costs to the benefit of all shareholders. Alternatively, the partial owners may transfer wealth from remaining target shareholders by coopting the firm's management to influence the terms of inter-corporate transactions in its favour.

In a partial acquisition, transactions between the partial acquirer and target affect the share values of remaining target shareholders after the event. In contrast, with a complete takeover the relationship between the acquiring and target firm shareholders is terminated after the latter group receives some portion of the expected gains through merger premium. The complexity of inter-corporate transactions, combined with the random nature of stock market movements, contributes to the difficulty in determining their impact on the performance of partially owned firms.

Studies of the price effects of mergers by Mandelker (1974), Ellert (1976), and Langetieg (as cited in Madden, 1981) have found statistically significant positive abnormal returns to the shareholders of target firms in the months preceding the effective dates of completed mergers. Halpern (as cited in Madden, 1981) and Franks, Broyles, and Hecht (1977) found that the market began to anticipate mergers in the two or three months preceding the announcements. These studies have shown that the shareholders of the acquired firms received much larger returns than the shareholders of the acquiring firms.

Franks (as cited in Madden, 1981) showed that the gains to the shareholders of acquired corporations in which the acquiring corporations purchased shares prior to a bid announcement were far smaller than the gains to the shareholders of acquired

corporations, which were not subject to pre-bid share purchases. This result suggests that the gains to merger participants are partly realized prior to any formal public announcement of a merger proposal.

Studies of the price effects of tender offers by Kummer and Hoffmeister (1978) and Dodd and Ruback (as cited in Madden, 1981) have found large positive abnormal returns to the shareholders of the acquired companies in the announcement months and in the immediately preceding months.

Holderness and Sheehan (1985) find that firms partially acquired by raiders experienced significantly positive abnormal returns on the announcement of the raider's filing of the 13-D. Because raiders tend to be active rather than passive investors, the effect on the target firm can be attributed to active monitoring. Their results suggest investors may value the presence of a large stakeholder that is likely to serve as an active monitor. Spencer, Akhigbe, and Madura (1997) document that firms that had been partially acquired commonly engage in acquisitions and divestitures after the partial acquisition, and that these investment decisions affect the performance of the partial acquirer.

Noting that managers of firms with widely dispersed ownership may have more discretion than those of firms with large minority blockholders (Berle & Means, 1932), “managerialism” theories (Baumol, 1959), Williamson (1964) suggest that management-controlled firms are less profitable than their owner-controlled counterparts. A long-standing proposition in the economic theory of organization holds that corporate managers, isolated from owners and shielded from the vagaries of the marketplace, pursue goals, which may be inconsistent with the profit-maximizing interests of the firm's

shareholders. The conflict of interest between owners and managers, characterized as the separation of ownership from control by Berle and Means (1932), is usually couched in a value-enhancing context: the competing goals of owners and managers misalign corporate interests and may result in less than optimal share price performance. Empirical research provides weak support for the presence of managerialism and indicates that minority-block shareholders do have an impact on firm performance. Substantial evidence documents that large stakeholders can influence a firm's financial decisions. For example, Shleifer and Vishny (1986b), and others, suggest methods by which stakeholders impose influence on firms and find large shareholders can help monitor firms.

Jensen and Meckling (1976) and Grossman and Hart (1980) develop models in which the interests of various classes of equity claimants do not coincide. Jensen and Meckling (1976) theorize that the threat of takeover or the presence of a large minority shareholder may effectively discipline managers, reducing agency costs of widely dispersed outside ownership. The literature suggests that the dispersion of ownership among a large number of shareholders in large corporations will bring about the separation of ownership and control, providing temptation for managers to pursue their own interests rather than those of shareholders (Fama & Jensen, 1983; Jensen & Meckling, 1976). Alchian and Demsetz (1972) and Jensen and Meckling (1976) argue that in a dispersed ownership structure individual investors will refrain from investing in managerial monitoring because the private costs of monitoring exceed the incremental benefit to the monitor.

The most direct way to align cash flow and control rights of outside investors is to concentrate share holdings. This can mean one or several investors in the firm have substantial minority ownership stakes, such as 10 or 20 percent. A substantial minority shareholder has the incentive to collect information and monitor the management, thereby avoiding the traditional free rider problem. He also has enough voting control to put pressure on the management in some cases, or perhaps even to oust the management through a proxy fight or a takeover (Demsetz, 1983; Shleifer & Vishny, 1986b). In the more extreme cases, large shareholders have outright control of the firms and their management with 51 or more percent ownership. Large shareholders thus address the agency problem in that they both have a general interest in profit maximization, and enough control over the assets of the firm to have their interests respected. The cost to concentrated owners of increased monitoring may be more than offset by the benefits they receive (Park, Nelson, & Torabzadeh, 2000).

The actions of a partial acquirer are similar to an institutional investor that invests a large amount of funds in a particular firm. Like that institutional investor, the partial acquirer is more motivated than most individual investors to monitor the firm in which it has invested because it has a large stake in that firm. However, the position of the partial acquirer differs from the position of the institutional investor in that it may consider fully acquiring the firm to merge that business with its own. Thus, the future prospects of the partial acquirer (and therefore its value) can be affected by the financing policies of the firm in which it has invested. Though supporting the performance implications of managerialism theories, agency theory also implies a divergence of goals among outside and inside equity holders. Grossman and Hart's solution to the "free-rider" problem is to

allow “corporate raiders” to “dilute” the claims of remaining minority shareholders after a takeover. The resulting increase in takeover activity would lead to a more efficient allocation of capital, but would also create two classes of equity claimants.

In addition to monitoring the actions of management, corporate partial owners may attempt to coopt target firm managers through the implied threat of a complete takeover. In so doing, they may seek “intercorporate perquisites”. For example, Shleifer and Vishny (1986b) suggest that partial corporate acquirers may advocate a high dividend payout policy to take advantage of the intercorporate dividend exclusion rule, thereby diluting the claims of other shareholders. “Product market” benefits, such as favourable terms for intercorporate products, fixed asset and technology sales, allocation of risk through research and development activities, and division of distribution channels or marketing activities may also be sought. Partial acquirers may also escape antitrust scrutiny that could be prompted by a complete takeover.

Management literature has reported the discouraging results of many acquisitions. There have been widespread warnings of the erosion of shareholder value and the serious socio-economic costs associated with many acquisitions. In an excellent summary article "Do deals deliver on post merger performance?" (Note: mergers and acquisitions used synonymously) Alexandra Reed Lajoux and J. Fred Weston (as cited in Lynch & Lind, 2002), argue that the longer-term effects of mergers show impairment of value (measured by share price and other indicators) for a variety of identifiable reasons, including inexperience, lack of strategic purpose, use of overvalued stock as a payment mode, and poor post-merger integration. The research, they argue, also shows that companies avoiding these traps perform better than their peers, both acquiring and non-acquiring.

In Mercer Management Consulting's analysis (as cited in Lynch & Lind, 2002) of the period 1990 to 1996, nearly half of acquisitions studied actually had a damaging impact on shareholder value. For example, Price Waterhouse Coopers (as cited in Lynch & Lind, 2002) found that two-thirds of buyers' stock dropped appreciably on announcement of a major acquisition, and that more than one-third of these losers still lagged the levels of peer companies a year later.

Rosenstein and Rush (1990) examine the stock return performance of 51 firms, which had been partially held prior to and during the period from 1980 through 1984. They find that risk-adjusted monthly stock returns of these firms were significantly lower than those of matched control firms. This finding leads them to conclude that partial acquirers are successful in using their control to transfer wealth from the remaining target shareholders by influencing the terms of inter-corporate transactions in favour of the acquiring firms.

Schipper and Smith (1986) examine the equity carve-out, in which a parent firm makes a public offering of some portion of a wholly owned subsidiary, creating the reverse of a partial acquisition. They find positive abnormal returns for parent firms, noting that virtually all other studies of the issuance of equity result in negative announcement date returns.

Chapter Two: Research Methodology

Data & Sample

Partial acquisitions are reported whenever the investment results in ownership of at least 5 percent of the firm of concern. The partial acquisitions are identified from the Canadian Directories of Mergers and Acquisitions from 1993 through 1999, along with other information such as the number of shares purchased, price of the investment, method of payment used, the total amount of shares held by the partial acquirer, the four-digit Standard Industrial Classification code (SIC), status of the acquisition--completed or pending, domestic activity, and the initial announcement date of partial acquisitions.

The following guidelines are used to form the sample size. First, to ensure that the partial acquisitions are large enough to have a discernible effect on the stock price of the target firm, the acquisition must represent at least 5 percent of the target's firm outstanding common shares. Second, because I wish to assess partial ownership, the total ownership of the partial acquirer must be less than 100 percent of the target firm's common shares. Third, the stock price data of the target firm must be available in the Toronto Stock Exchange database. Fourth, the targets in which the same acquirer increased its stake once or more by buying additional common shares within the period under consideration are excluded from the final sample. This is done in order to get a clear picture of the initial announcement effects on the target firm's stock price performance. Fifth, only publicly traded firms are considered for the final sample. Sixth, the target in which the status of the acquisition is indicated as pending, that is, not completed, has also been excluded from the final sample size. Seventh, both the target and the partial acquirer must be Canadian firms. And lastly, targets in which the

acquisition resulted in total or completed acquisition have also been excluded from the final sample.

A total of 53 firms are finally selected for this study. The sample represents firms from all sectors of the Canadian economy: Pipelines, Metals and Minerals, Paper and Forest Products, Gold and Silver, Real Estate, Industrial Products, Consumer Products, Oil and Gas, Financial Services, Merchandising, Communications and Media, Utilities, and Transportation and Environmental Services.

Table 1

Sample Characteristics

	<u>Method of Payment</u>			<u>SIC</u>		<u>Percent Ownership</u>	
	Cash	Stock	Not Disclosed	Same	Not the Same	>50%	<50%
No. of Firms	35	13	5	38	15	4	49

Method

To investigate the impact of partial acquisition on stock prices, the standard-event study methodology is used. For each firm, daily security returns are calculated for a period of 300 days prior to the initial announcement date through 5 days after the announcement date. Daily market returns, using the Toronto Stock Exchange (TSE) database, are calculated for the same period.

The risk-adjusted average abnormal return (AAR_t) for each day of the event period t ($t = - 5$ to $t = + 5$) is calculated using the market model taken from Brown and Warner (1985).

$$AAR_t = \frac{1}{M} \sum_{j=1}^M (R_{jt} - \alpha_j - \beta_j R_{dt}) \quad (1)$$

where,

M = The number of firms.

R_{jt} = The daily rate of return for the common stock of firm j in day t .

R_{dt} = The daily rate of return for the TSE database in day t .

α_j β_j = The ordinary least squares estimates of the market model parameters which are calculated over the period $t = - 300$ to $t = - 6$ relative to the announcement day, $t = 0$.

The daily average abnormal returns are summed over the event period to obtain cumulative average daily returns (CAR_T). The expected values of AAR_t and CAR_T should be zero in the absence of abnormal common stock price movements. Significant deviations from zero are, therefore, attributable to the partial acquisition announcement. The observed values of AAR_t and CAR_T will be tested for significant differences from zero using standardized t-tests.

The test statistics for AAR_t are obtained based on the average standardized return ($ASAR_t$), where

$$ASAR_t = \frac{1}{M} \sum_{j=1}^M \frac{(R_{jt} - \alpha_j - \beta_j R_{dt})}{S_{jt}} \quad (2)$$

S_{jt} is defined as

$$S_{jt} = \left[1 + \frac{1}{295} + \frac{\left(R_{dt} - \bar{R}_d \right)^2 \sum_{j=1}^{-6} U_{jt}^2}{\sum_{j=1}^{-6} \left(R_{dt} - \bar{R}_d \right)^2} \frac{-300}{295 - 2} \right]^{\frac{1}{2}} \quad (3)$$

where \bar{R}_d is the mean daily return in the estimation period and \hat{U}_{jt} is the residual return for common stock j in day t of the estimation period. The t-statistics for AAR_t is, therefore, defined as

$$t_{AAR_t} = \sqrt{\frac{293M}{291}} ASAR_t \quad (4)$$

The t-statistics for CAR_T is obtained by

$$t_{CAR_T} = \frac{1}{\sqrt{T}} \sum_{t=1}^T t_{AAR_t} \quad (5)$$

where T is the number of event days over which the t_{AAR} is summed.

Results

I used the standard-event methodology to investigate the impact of partial acquisition on the returns to target shareholders surrounding the announcements dates and one year subsequent to the partial acquisition.

Overall Findings

The average abnormal returns (AAR) and cumulative abnormal returns (CAR), along with their corresponding t-statistics, for the target firms are presented in Table 2.

As shown in Table 2, the AAR for the target firms in the event-day $t = -2$ is + 1.19 ($t_{AAR-2} = 2.94$). The return is significantly different from zero at conventional level. In the event-day $t = -1$ the AAR for the target firms is + 2.11 percent ($t_{AAR-1} = 3.97$). This return is also significantly different from zero at conventional level. On the announcement day $t = 0$, the AAR is + 12.93 percent ($t_{AAR0} = 14.86$). The rate is also significantly different from zero at any conventional level. In the event-day $t = +1$, the targets also registered a significant AAR of + 1.99 ($t_{AAR+1} = 3.58$). From the event-day $t = -2$ through $t = +1$, the target shareholders realized a significant CAR of +18.22 percent. The announcement effect is gone from event-day $t = +2$. No statistically significant AAR is observed thereafter. Over the entire event period, the stockholders of the target firms realized a significant CAR of + 18.67 percent. Using the maximum and minimum values, I found no outliers in the data. I removed these values from the data one at a time to find out how their removal affects the statistical significance of the abnormal returns. The removal of the maximum and minimum values from the data did not change the statistical significance of the abnormal returns.

Table 2

Daily Average Abnormal Returns (AAR) and Cumulative Average Returns (CAR) for target firms with corresponding t-statistics for the event period

Event Day	AAR%	t _{AAR}	CAR%	t _{CAR}
- 5	0.40264	-0.00075	0.40264	-0.00075
- 4	0.03028	1.53442	0.43291	1.08447
- 3	-0.18768	1.16918	0.24523	1.56049
- 2	1.18645	2.94368*	1.43168	2.82327*
- 1	2.11012	3.97439*	3.54180	4.30261**
0	12.92792	14.86477**	16.46972	9.99624**
+ 1	1.99233	3.58281*	18.46205	10.60890**
+ 2	0.10889	0.27646	18.57093	10.02146**
+ 3	-0.65786	-1.29087	17.91307	9.01803**
+ 4	0.49074	0.95253	18.40381	8.85647**
+ 5	0.26827	0.78552	18.67207	8.68116**

* Significant beyond .05 level.

** Significant beyond .01 level.

The average abnormal returns (AAR) and cumulative abnormal returns (CAR), along with their corresponding t-statistics for target firms, from post announcement day t = + 2 to t = + 252 are presented in Table 3.

As shown in Table 3, the CAR remained insignificant from post announcement day t = + 2 to t = + 252. The CAR remained small, mostly negative over the period. The small positive and mostly negative values of t_{CAR} revealed no statistically significant AAR in the next individual post announcement days. Over the entire period, the stockholders of the target firms realized an insignificant CAR of – 14.47. No outliers are found in the data.

Table 3

Daily Average Abnormal Returns (AAR) and Cumulative Average Returns (CAR) at selected post announcement days for target firms with corresponding t-statistics from $t = + 2$ to $t = + 252$

Post Announcement Day	AAR%	t_{AAR}	CAR%	t_{CAR}
+ 2, + 25	0.02415	0.17944	2.31542	0.98573
+ 2, + 50	-0.63250	-1.32121	2.08799	0.49103
+ 2, + 75	0.04007	0.33101	0.89425	-0.03798
+ 2, + 100	0.00477	-0.40645	-0.97617	-0.70972
+ 2, + 125	-0.11528	-0.29043	-3.33784	-1.14983
+ 2, + 150	-0.12683	-0.32853	-5.75358	-1.55659
+ 2, + 175	0.08303	0.04360	-7.53536	-1.85591
+ 2, + 200	0.01463	-0.06103	-9.90475	-2.17360
+ 2, + 225	-0.10523	-0.27018	-12.01870	-2.44964
+ 2, + 250	-0.16577	-0.38420	-14.45810	-2.71233
+ 2, + 252	-0.05074	-0.18491	-14.46910	-2.71452

Figure 1 shows the estimated CAR from post announcement day $t = + 2$ to $t = + 252$. The CAR took a dive over the period.

Regression Analyses

Table 4 reports the results of linear regression analysis using cumulative abnormal returns (CAR) for event-day $t = - 2$ to $t = + 1$ as the dependent variable. Panel A of Table 4 reports the values of R^2 and the adjusted R^2 as 0.151 and 0.093 respectively. These values show that there are some other variables that can be used to predict the abnormal returns as the variables used, only help predict a small part of the abnormal returns. Panel B of Table 4 reports the insignificant value ($F = 2.602$) of the regression analysis. Panel C of Table 4 shows that of the three variables analyzed (ownership percent, standard industrial classification (SIC) index, and method of payment), only the method of payment has significant coefficient. The abnormal returns are positively related to the method of payment ($t = 2.783$) used by the partial acquirer.

Table 5 reports the results of the linear regression analysis using cumulative abnormal returns (CAR) for post announcement day $t = + 2$ through day $t = + 252$ as the dependent variable. Panel A of Table 5 reports the values of R^2 and adjusted R^2 as 0.123 and 0.063 respectively. These values show that the three variables used in the regression analysis only help predict a small part of the abnormal returns. Panel B of Table 5 reports the insignificant value ($F = 2.049$) of the regression analysis. Panel C of Table 5 shows that of the same three variables analyzed, only the SIC has significant coefficient. The abnormal returns are positively related to the SIC ($t = 2.138$).

Figure 1

Cumulative Average Returns (CAR) at post announcement days from $t = + 2$ to $t = + 252$

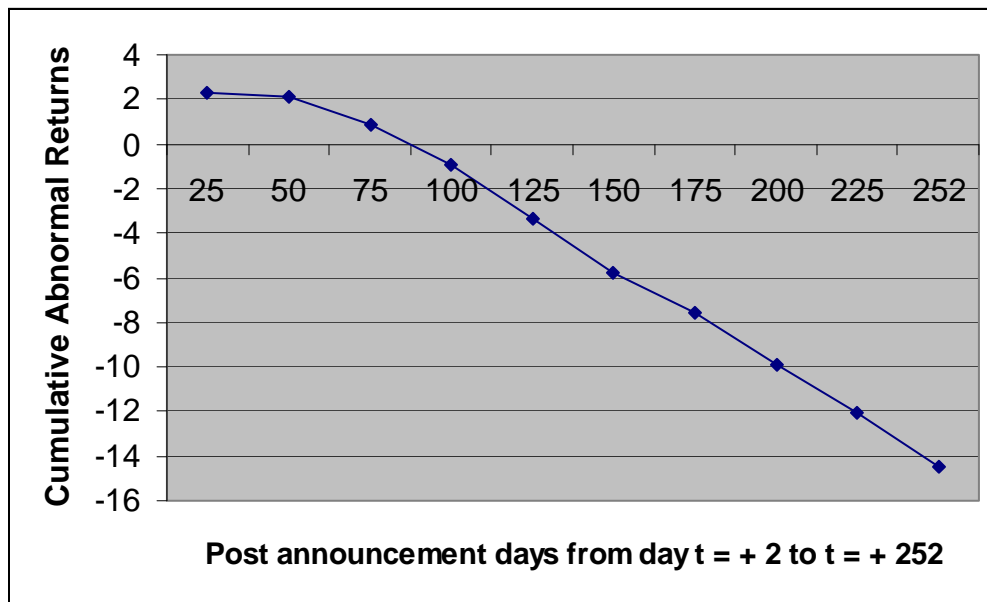


Table 4**Results of Regression of Cumulative Abnormal Returns (CAR) (t = - 2 to t = + 1),****N = 48****Panel A: Model Summary**

R	R ²	Adjusted R ²	Std. Error of the Estimate	Change Statistics				
				R ² Change	F Change	df 1	df 2	Sig. F Change
0.388 ^a	0.151	0.093	0.1592589	0.151	2.602	3	44	0.064

^a. Predictors: (Constant), SIC, Method of Payment, Ownership Percent**Panel B: ANOVA^b**

	Sum of Squares	df	Mean Square	F Statistics	Significance Level
Regression	0.198	3	0.066	2.602	0.064 ^a
Residual	1.116	44	0.025		
Total	1.314	47			

^a. Predictors: (Constant), SIC, Method of Payment, Ownership Percent^b. Dependent Variable: CAR**Panel C: Coefficients**

Variable	Coefficient	t-Statistics	Significance Level
Method of Payment ^a	0.388	2.783	0.008
Ownership Percent	0.006	0.044	0.965
Standard Industrial Classification (SIC) Index ^b	-0.005	-0.037	0.971

^a. 1 if method of payment is cash; 0 otherwise.^b. 1 if SIC is same; 0 otherwise.

Table 5

**Results of Regression of Cumulative Abnormal Returns (CAR) ($t = + 2$ to $t = + 252$),
N = 48**

Panel A: Model Summary

R	R ²	Adjusted R ²	Std. Error of the Estimate
0.350 ^a	0.123	0.063	0.1328023

^a Predictors: (Constant), Method of Payment, SIC, Ownership Percent

Panel B: ANOVA^b

	Sum of Squares	df	Mean Square	F Statistics	Significance Level
Regression	0.108	3	3.614E-02	2.049	0.121 ^a
Residual	0.776	44	1.764E-02		
Total	0.884	47			

^a Predictors: (Constant), SIC, Method of Payment, Ownership Percent

^b Dependent Variable: CAR

Panel C: Coefficients

Variable	Coefficient	t-Statistics	Significance Level
Method of Payment ^a	0.181	1.278	0.208
Ownership Percent	-0.087	-0.606	0.548
Standard Industrial Classification (SIC) Index ^b	0.305	2.138	0.038

^a 1 if method of payment is cash; 0 otherwise.

^b 1 if SIC is same; 0 otherwise.

Discussion

The pattern of AARs and CARs observed are consistent with those reported by previous research. For example, Jabbour, Jalilvand, and Switzer (1998) report significant positive abnormal returns of + 1.06*, + 5.85***, and + 1.27* for event-days $t = -2$, $t = 0$, and $t = +1$, respectively. In this study, however, no significant positive abnormal return is reported in event-day $t = -1$. This may be due to the difference in time periods considered. Jabbour, Jalilvand, and Switzer (1998) used Canadian acquisitions over the period 1985 through 1995 to examine the abnormal returns. In reference to the U.S. experience, Madden (1981) report a significant positive abnormal returns on the announcement month and the immediately preceding month over the 22 months surrounding the announcement month of the acquisition. In the event-month $t = -1$, the $AAR + 0.058$ ($t_{AAR-1} = 3.096$)**. On the announcement month $t = 0$, the $AAR + 0.104$ ($t_{AAR0} = 5.331$)**.

Also, in reference to U.S. experience, Mikkelson and Ruback (1985) find in a sub-sample of firms that had been partially acquired without subsequently being completely taken over or divested, a negative CAR at one-year level to large negative abnormal returns over the thousand-trading-day period following the announcement. Madden (1981) finds an insignificant CAR in post announcement month $t = +10$ after the announcements.

*, ***, show significance levels of 0.05 and 0.001 respectively.

** Null hypothesis rejected at the 0.05 level.

The results of regression analysis using cumulative abnormal returns (CAR) ($t = -2$ to $t = +1$) as the independent variable show that the method of payment ($t = 2.783$) used by the partial acquirer has an impact on the abnormal returns of the targets. The finding is consistent with prior research. For example, in an early study, Wansley, Lane and Yang (1983) analyze returns to U.S. acquired firms involved in 102 cash offers and 87 share offers over the period January 1970 to December 1978. Over the period $(-40, 0)$ days relative to the bid announcement date, firms offered cash earned a significant average cumulative abnormal return (CAR) of 33.54 percent while firms offered shares earned 17.47 percent. Other studies report similar results. For instance, Travlos (1987) finds that U.S. target firms involved in 60 share offers over the period 1972 through 1982 earned a significant average cumulative abnormal return (CAR) of 12.04 percent over the period $(-2, 0)$ days relative to the bid announcement date. Target firms in 100 cash bids earned 17.06 percent over the same event-window.

The results of regression analysis of cumulative abnormal returns ($t = +2$ to $t = +252$) shows that both the method of payment ($t = 1.278$) and ownership percent ($t = -0.606$) have insignificant coefficients. Based on the theory of market for corporate control, I expected ownership percent to have a positive significant coefficient. This is because ownership percent will not only improve monitoring mechanisms (where control is not attained), but it will also enable the partial acquirers (where the control is attained) to replace the inefficient target management with individuals able to create value. The partial acquirers attain control in the target firms by owning 51 percent or more of their outstanding common shares. The same results, however, show that SIC ($t = 2.138$) is positively related to abnormal returns. I expected the SIC to be related to abnormal

returns. This is because the acquisitions involving companies in the same industry should enable the firms involved to gain synergistic benefits, which in turn should be reflected in the abnormal returns.

Implications, Limitations, and Future Research

Several motives for takeovers have been advanced, for example, poor target company management and synergy. Advocates of the poor target management perspective, which is rooted in agency theory, claim that inefficient, self-serving incumbent managers who fail to maximize stockholder value will be forced out of office by acquirers attempting to extract such value. Literature provides strong support for the takeovers being of a disciplinary nature. Several studies report high top management turnover once the takeover has been completed. Based on this theory of market for corporate control, therefore, we should expect target firms stock performance to improve as a result of these changes in management team and or improved monitoring. The result one year later does not depict or reveal this.

Synergy is another motive offered for takeover activity. The two main types of synergy are operating and financial. Operating synergy refers to the efficiency gains or operating economies that are derived in horizontal or vertical acquisitions. One of the main sources of operating synergy is the cost reduction that occurs as a result of economies of scale-decreases in per-unit costs that result from an increase in the size or scale of a company's operations.

Financial synergy refers to the impact of a corporate acquisition on the costs of capital to the firms involved. If financial synergy exists in a corporate acquisition, the

costs of capital should be lowered. The synergistic benefits are discussed under three scenarios below:

Scenario 1: The synergistic benefits stem from the acquirer's resources. In this first scenario, I assume that opportunities to exploit synergies are associated with the acquirer's resources. The acquirer uses the partial acquisition to redeploy some of its specialized resources in the target's context (Barney, 1988). Therefore, we should expect the target's to reflect the captured part of the synergistic gains in stock returns as a result of this transfer of resources of the acquirer to the target. The result one year later does not depict this.

Scenario 2: The synergistic benefits stem from both the acquirer's and the target's resources. In this second scenario, I assume that opportunities to exploit synergies are associated with both the acquirer's resources and the target's resources. Synergy is generated out of the joint participation of both the parties. Therefore, we should expect synergistic gains reflected in stock returns of the target. The result one year later does not reveal this.

Scenario 3: The synergistic benefits stem from the target's resources. In this third scenario, I assume that opportunities to exploit synergies are associated with the target's resources. Therefore, we should expect the partial acquirers stock returns to improve, thereby increasing their shareholder returns. This might be done at the cost of the return of target shareholders. If this happens, then, we should expect the target's to have a diminishing stock return performance. This is very much possible in situations where the partial acquirer has obtained control in the target. In 92 percent of my sample size, the partial acquirers obtained control in the targets.

This leaves me with the following possible explanations for my results: wealth transfer hypothesis and semi-strong form of efficient market theory. Rosenstein and Rush (1990) find evidence suggesting that corporate partial owners, in general, exert control by coopting target firm management, transferring wealth to their own shareholders but diminishing the stock return performance of their partial acquisitions.

Theory of Market Efficiency

It is generally accepted that an efficient securities market will instantaneously incorporate information into security values. Thus any public information will already be incorporated into security values as soon as it becomes known. The only way to benefit from information is to keep it private or to act upon it before it becomes public. The latter course of action is sometimes called insider trading because it involves buying or selling securities based on information known by insiders of the firms that have issued the securities before this information becomes public. Insider trading is illegal and insider transactions, even if carried out legally, must be reported!

The efficient markets hypothesis or EMH states that securities markets are efficient with respect to public information in the sense that no individual or organization can gain superior profits from using the information; this means that no one can “beat the market”. The notion of efficiency here is that traders move quickly and at low cost to re-value existing securities of a firm to reflect any new information about the likely profitability and future dividend flow of that firm.

Levels of Market Efficiency

The testing of market efficiency has been undertaken from several different points of view, and these became known as levels of market efficiency. Weak form efficiency is defined as the situation where the market was efficient with respect to all historical information available to participants. This information includes historical prices and yields on equity and debt securities. Semi-strong form efficiency is defined as the situation where the market was efficient with respect to all publicly available information, not just past price information. The information set includes anything that could be known by an informed outsider of the firm from published and non-published sources. Strong form efficiency is defined as the situation where the market is efficient with respect to all information, both public and private. The information set includes all published and non-published information known to insiders and outsiders.

From the efficient market theory perspective, I argue that the significant abnormal returns realized from event-day $t = - 2$ to $t = - 1$ are attributable to the buying pressure exerted by the acquiring firm or to the information associated with an increased volume of trading and, on event-day $t = 0$ to $t = + 1$, to the information contained in the announcement itself. The lack of significant abnormal returns thereafter is consistent with the semi-strong form of the efficient market theory. Madden (1981) finds evidence supporting the semi-strong form of the efficient market hypothesis.

In this study, I analyzed the stock performance of Canadian firms one year subsequent to the announcements. Future research should investigate the returns for corporations that have had a corporate partial owner for several years after the announcements matched against a nonpartially owned control group. Such a study should

also investigate the difference in abnormal returns in partial acquisitions involving different methods of payments. The variables I used in the regression analyses helped predict only a small part of the abnormal returns. Future research should, therefore, include more variables that can be used to predict the abnormal returns.

Conclusion

This study had two objectives. First, to investigate the returns to target shareholders surrounding the partial acquisition announcements. Second, to investigate the stock performance of target firms one year subsequent to the partial acquisition. A sample of 53 Canadian firms partially acquired by domestic firms from 1993 through 1999 is considered for this study.

To investigate the impact of partial acquisition on stock prices, I used the standard-event methodology. Consistent with finding using Canadian data, I find statistically significant positive abnormal returns in event-day $t = - 2$, on announcement day $t = 0$, and event-day $t = + 1$. I also find statistically significant positive abnormal return in event-day $t = - 1$. The findings are also consistent to U.S. experience for event-month $t = - 1$ and announcement month $t = 0$. Also, consistent with the U.S. experience is the negative cumulative abnormal return (CAR) at the end of one year subsequent to the announcements.

The regression analysis using cumulative abnormal returns (CAR) for event-day $t = - 2$ to $t = + 1$ as the dependent variable, shows that of the three variables analyzed: ownership percent, standard industrial classification (SIC) index, and method of payment, only the method of payment has significant coefficient. The abnormal returns are

positively related to the method of payment ($t = 2.783$) used by the partial acquirer. This finding is also consistent with prior research.

The second regression analysis using cumulative abnormal returns (CAR) for post announcement day $t = + 2$ through day $t = + 252$ as the dependent variable, shows that of the same three variables analyzed, only the SIC has significant coefficient. The abnormal returns are positively related to the SIC ($t = 2.138$).

These findings suggest that partial acquisitions have positive effect on target shareholders returns surrounding announcement dates. The lack of significant positive abnormal returns thereafter suggests that the announcement does not have a positive impact on the stockholder returns one year later. My results one year subsequent to the acquisitions are inconsistent with what one should expect based on the theory of the market for corporate control. I therefore used the wealth transfer hypothesis and the semi-strong form of market efficiency to try to explain my findings. According to the advocates of the wealth transfer hypothesis, corporate partial owners, in general, exert control by coopting target firm management, transferring wealth to their own shareholders but diminishing the stock return performance of their acquisitions.

From the semi-strong form of market efficiency perspective, I argue that the significant abnormal returns realized from event-day $t = - 2$ to $t = - 1$ are attributable to the buying pressure exerted by the acquiring firm or to the information associated with an increased volume of trading and, on event-day $t = 0$ to $t = + 1$, to the information contained in the announcement itself.

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