Fifth Annual Mergers and Acquisitions Research Centre Conference Report

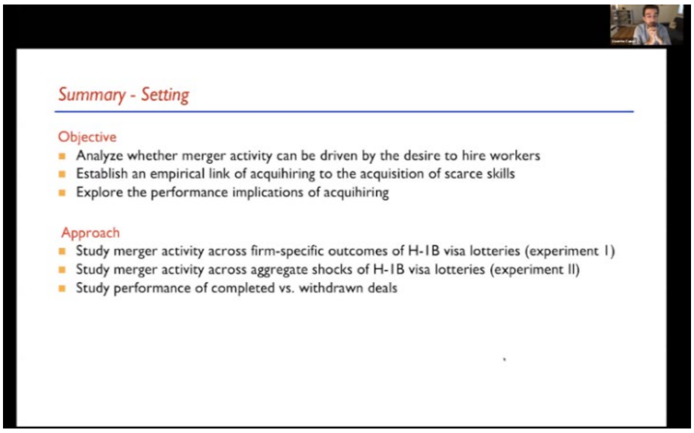
28th- 29th June 2021

Bayes Business School (formerly Cass), Virtual

Session 1:

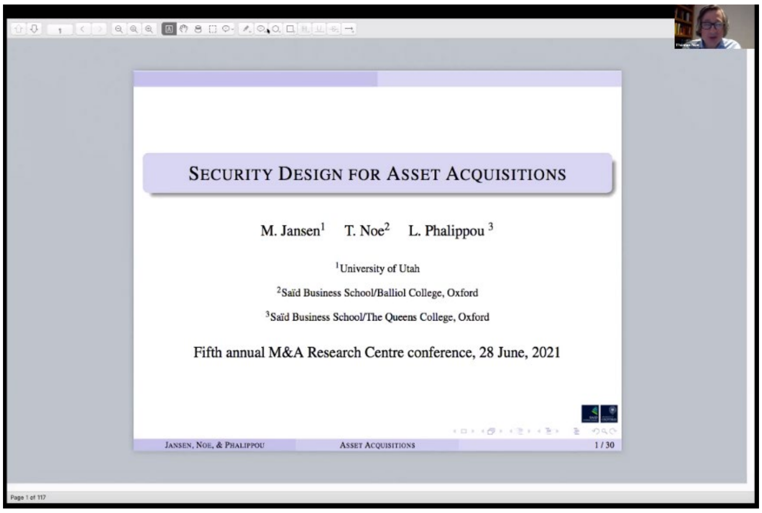
Shenje Hshieh: *Hiring high-skilled labor through mergers and acquisitions* (with **Feng Zhang**, and **Jun Chen**)

Firms recruit high-skilled labor through traditional means may find the process slow and inefficient, especially when skilled workers are in short supply and have non-compete agreements with their existing employers. In fact, many firms have resorted to "acquihiring," the practice of hiring skilled workers from other firms through mergers and acquisitions (M&As). By using two natural experiments based on H-1B visa lotteries and a drastic cut in the annual H-1B visa quota, **Shenje Hshieh** presented a paper which shows that firms respond to shortages in high-skilled workers by acquiring target firms that have these workers. Their paper also shows that the desire for the target's skilled labour is an important driver of these acquisitions. Furthermore, acquirer performance improves after acquihiring. Finally, he suggested that skilled labour is an important driver of M&A decisions and M&As are an effective means of obtaining skilled labour besides direct recruiting from the labour market.

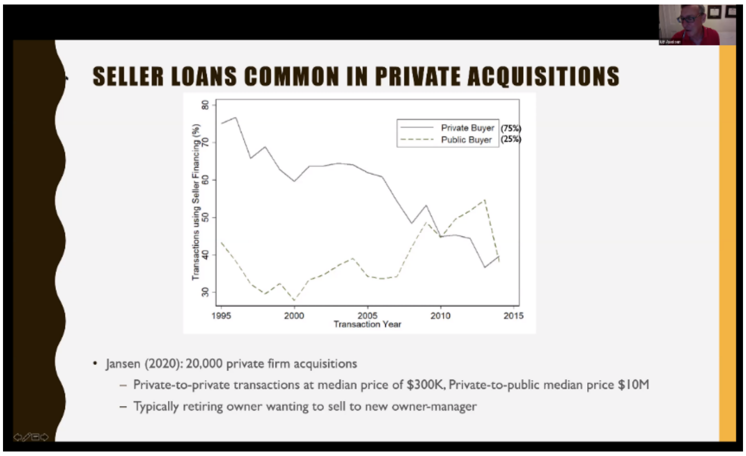


In his discussion, **Vicente Cuñat**, first challenged the identification strategy that H1B visa variation is rich, random but complicated. He pointed out that the results are mainly driven by small firms. He argued that focusing on human capital alone is too restrictive from the perspective of M&A, and he suggested to include patent results to understand capabilities of the company more comprehensively. Moreover, he challenged the performance measurement and recommended to use raw returns to measure M&A performance rather than ROA which is easily affected by other firm characteristics (for example, leverage where firm's leverage is easily to be changed through M&A process). Finally, he argued that there may be other potential reasons why firms with more H1B visas will acquire other firms with more H1B visas. For example, such acquisitions may be driven by similar technologies.

Thomas Noe: "*Security design for the acquisition of private firms*" (with **Mark Jansen** and **Ludovic Phalippou**)

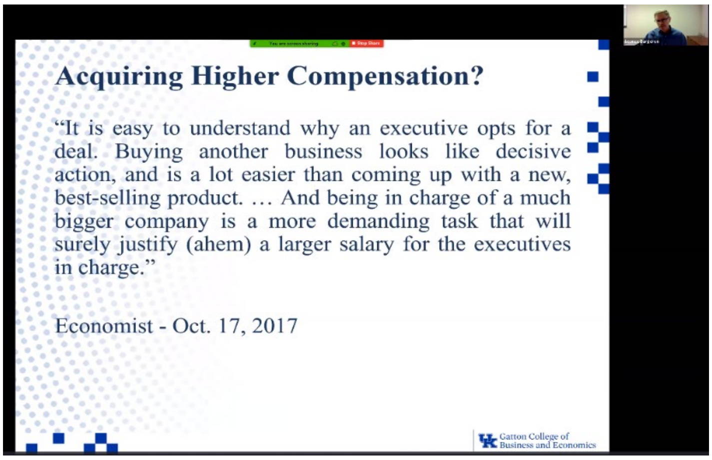


Acquisitions targeting companies with a single principal owner (e.g., subsidiaries of public firms and most private firms) have increased over time and have become more prominent than the acquisitions of public firms. These acquisitions are frequently motivated by the acquirer's expectation to increase the value of the target. **Thomas Noe** presented a security design model in which a potential acquirer approaches a firm with a value-add plan. Based on three assumptions: (1) the acquirer's capability to add value depends on characteristics of the asset acquired; (2) the current asset owner has superior information about these characteristics; and (3) the acquirer is more confident than the seller about her ability to add value if the seller's assets are compatible with the acquirer's plan, the paper shows that even when acquirers are not liquidity-constrained or limited to certain security designs, optimal offers always take the form of combined cash and non-recourse debt. The paper also finds that the debt is usually junior, secured solely by the asset acquired, and issued by the owner of the firm. The result is consistent with the preponderance of seller debt financing in the acquisitions of privately held firms and subsidiaries of public firms. This phenomenon does not appear to have an alternative explanation that is grounded in direct applications of extant theoretical models to asset acquisitions.

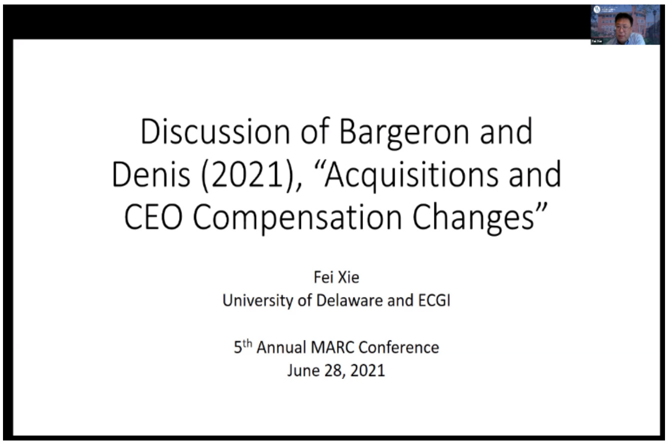


In his discussion, **Ulf Axelson**, suggested for a more general theory paper. He argued that this is an applied theory paper explaining the phenomenon that it is optimal for acquirer to use debt and cash as the package. However, he expressed his hesitations whether this theory fits current empirical phenomenon and he challenged the contribution of the theory. He advised to include more evidence on whether cash and debt payment is also common for non-financial constrained firms as well. Moreover, he also argued that explaining two phenomena with two separate frictions may have limited contribution. Finally, he recommended to provide more results for the specific interaction between seller information and value adds.

Session 2:
Leonce Bargeron: *"Acquisitions and CEO compensation changes"* (with **David Denis**)

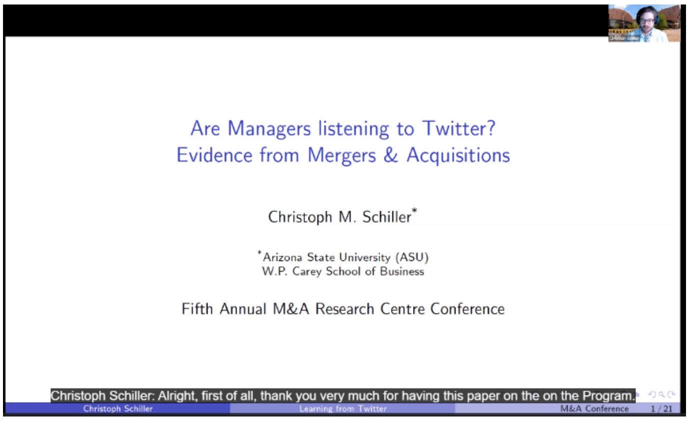


Several prior studies analyse the evolution of CEO compensation around acquisitions and generally report that (1) CEOs benefit from acquisitions, on average, and (2) these benefits are uncorrelated with measures of the quality of the acquisitions. **Leonce Bargeron** presented a paper which re-examines the link between CEO compensation and acquisitions over an extended and more recent sample period (1993-2017) and finds that the positive association between acquisitions and CEO compensation is not consistent over time. The paper reports that increases in CEO compensation following acquisitions are unique to stock-financed deals. Moreover, because the frequency of stock financed deals has dropped sharply over their sample period (1993-2017), acquisition related increases in CEO compensation are significant only in the first half of the sample period. He further announced that the CEO compensation increases in stock financed deals are driven by increases in equity-based compensation, and are concentrated in riskier acquirers, riskier deals, and in acquirers whose CEOs have low exposure to the stock price. These findings support the *Dual Adverse Selection Hypothesis* (DASH), which posits that acquirers use stock to overcome adverse selection in the target firm, while they increase the equity-based compensation of the acquirer CEO to mitigate adverse selection concerns on the part of target shareholders. Finally, empirical results show little support for the hypothesis that acquisition-related increases in CEO compensation are due to entrenched or empire building CEOs.



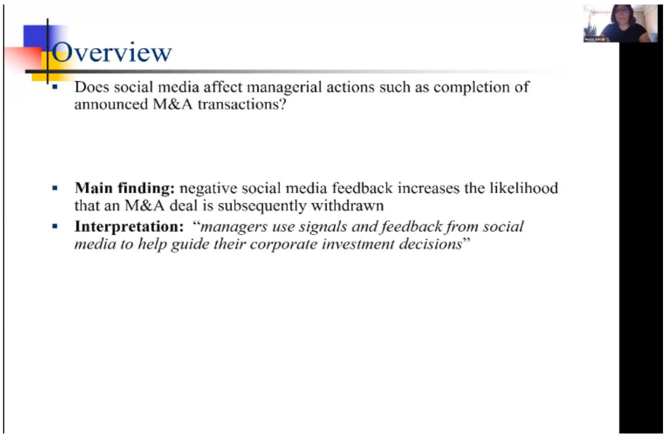
In his discussion, **Fei Xie**, firstly suggested to provide more discussion on whether new equity awards are substitute for parts of CEO compensation or they are purely incremental to total CEO compensation package. He advised to use other measurements to proxy stock payment, for example the percentage of stock in total payment, to test the theory. He then argued to use different sample partition in 2001. Moreover, since some key results are consistent with both agency theory and DASH, he would like to read more explanation on such results. Finally, the authors should interpret the results for event study carefully since it is unclear when the market learns about the change of post-acquisition compensation. Finally, he noted that the authors should consider other governance factors in their paper as well.

Christoph Schiller: *"Are managers listening to Twitter? Evidence from Mergers & Acquisitions"*

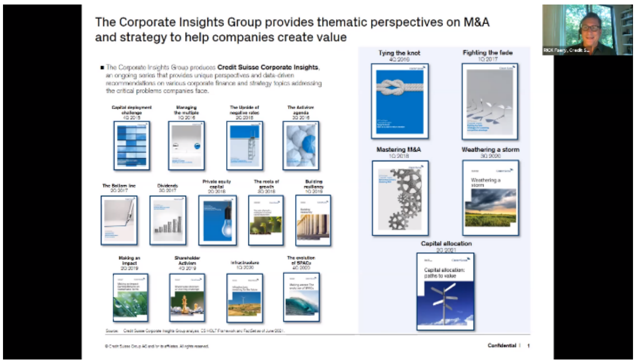


Today, investors share opinions and investment ideas on social media platforms, and firms also use social media to disclose information. Furthermore, companies closely monitor social media postings and sentiment. **Christoph Schiller** presented a paper which studies the feedback effects of social media on corporate investment decisions. Using a comprehensive sample of millions of tweets from a popular social media network, he showed that negative social media feedback around the announcement of a corporate acquisition increases the likelihood of withdrawing the deal, especially (1) when the relevant tweets have a higher prominence and visibility, and (2) when the acquiring firm's stock has low price informativeness. This paper shows that the effect is not subsumed by the announcement returns of the acquiring and target firm or the reaction to the M&A announcement in traditional news media. The paper also provides evidence that managers use feedback from social media as a substitute for other sources of information to help guide their investment decisions.

In her discussion, **Merih Sevilir** first argued that there are many other potential reasons for deal withdrawal, and she suggested to clarify how much percentage of deal withdrawal is due to information provided from Twitter. She suggested to show more evidence on the unique role of social media for deal withdrawal, for example to what extent managers would learn meaningful information from traditional and social media to change their beliefs about the desirability of the deal. She was also concerned about the causality issue in which a high positive correlation between abnormal social media content and withdrawal likelihood does not necessarily imply that managers learn new and significant information from Twitter and use such information to make the withdrawal decision. She advised to explore the ex-ante role of social media in investment decision, for example managers may use information from social media to search for potential targets. Finally, she recommended to compare social media and the traditional one, and provide more explanations on the motivation for studying social media if prior work has already shown traditional media affects investment decisions.



Keynote Speech
Rick Faery: *"Corporate M&A: A proven value creation strategy"*



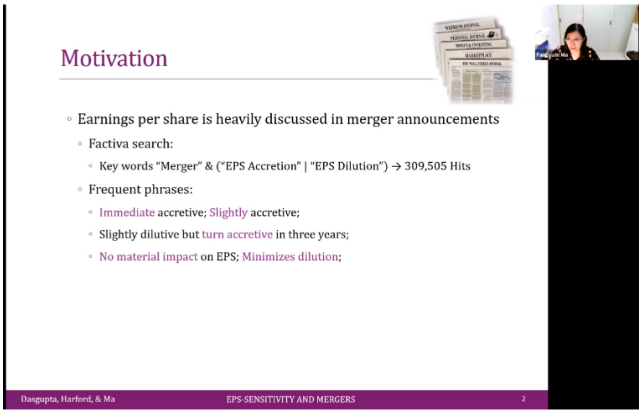
Rick Faery first delivered a brief introduction of himself and the Corporate Insights Groups. He stated that returns on capital is a key driver of market valuation, due to its explanatory power of observed market valuations. Combined with growth, returns on capital explains how and why some companies trade at the highest multiples. He presented several graphs showing that the persistenly high retunrs on capital provides evidence of firm's competitive advantanges. He further explained that corporate lifecycle position is essentially a measure of competitive advantage of the company: in the context of corporate lifecycles, competitive advantage can be defined as the distance between a company's current performance (measure by returns on capital) and the industry long-term performance. Companies with sustainable competitive advantages deliver superior returns to shareholders. He also suggested that firms keep their competitive advantage by investing in organic investment capital expendiure, research and development, operating intangibles and M&A.

Moreover, he pointed out that investing in M&A and portfolio activity can help drive firm's competitive advanges. He showed there have been three M&A peaks since 1990: 1998-2000; 2005-2007 and 2014-2019. There are three main reasons to explain these peaks. These include 1) weak organic growth on global economy; 2) capital to fund M&A is cheap and accessible; 3) favorable hunting ground.

After that, he introduced that M&A represents only one of many capital allocation options. Other options include investing in organic growth and returning cash to capital providers by share repurchase, dividend payment or deleverage. He showed that most firms invest most of their money in firm's organic growth. Furthermore, in addition to materials and energy industries, M&A investment has been the second priority as firm investment in terms of money being spent over the past 20 years.

Finally, he found that acquirers continue to outperform their peers after M&A. On average, acquirers post-acquisition performance measured by TSR (total shareholder return) has improved over time. He proposed that long-term M&A success will ultimately be driven by not only an acquirer's ability to manage the price paid relative to the value of a target firm, but also its ability to execute on the long-term integration after the deal.

Session 3:
Fangyuan Ma: *"EPS-Sensitivity and Mergers"* (with **Sudipto Dasgupta** and **Jarrad Harford**)



Announcements of mergers in which the acquirer offers stock as payment to the target often discuss the impact of the deal on the acquirer's earnings per share (EPS), especially when the deal is EPS-accretive for the acquirer. **Fangyuan Ma** presented a paper which documents that the acquirer's EPS-sensitivity affects the payment structure of the deals, the premium that is paid, and the type of deals. She stated that cash is more likely to be used as the method of payment when a deal would incur mechanical EPS dilution in the case of stock payment. The paper provides evidence that acquirers prefer doing EPS accretive deals when (a) shareholder approval is required for deals (b) institutional investor horizon is shorter, and (c) managers' compensation is tied to EPS. Results suggest that the relative popularity of deals financed in cash since early 2000 could be a consequence of acquirers' EPS-sensitivity and low value-multiple acquirers pursuing high value-multiple targets.

Oliver Dessaint discussed the paper and provided comments.

Session 4

Anjana Rajamani: “Real effects of stock market valuations: Local valuation spillovers in M&A activity” **(with Frederik Schlingemann)**

Firm-level and aggregate valuations, such as market-to-book ratios or Tobin’s Q, feature prominently in the vast literature exploring patterns in M&A activity. **Anjana Rajamani** presented a paper documents large and persistent differences in the acquisitiveness of firms in the U.S. based on the location of their headquarters. The work hypothesizes and finds evidence that local peer effects in M&A activity contribute to such persistence. Specifically, valuation of local dominant industry positively impacts acquisitiveness of co-located and non-dominant industry firms. The paper shows that firms respond to idiosyncratic (noise) as well as non-idiosyncratic (signal) components of local dominant industry valuation, suggesting that firms try to learn from peer valuation. The paper also addresses the important role of firm location on acquisition decisions. Finally, she pointed out that the inability to separate signal from noise in local peer valuation results in less efficient acquisition decisions.

In his discussion, **Laurent Fresard**, stated that managers may use both private information and external signals to value the firm, however, private information can be correlated with external signal. He suggested to provide clearer explanation on (1) why the valuation of local firms in the dominant industry should be part of in the information set for managers use to make valuation decision; (2) why such valuation information is important for acquisition decisions; and (3) whether the value of these firms is correlated with any private information. He further addressed his concern on reversal causality. Moreover, he advised to pay more attention to the structure of industries. Finally, proxies for private information of managers, for example experience, past acquisitions’ performance, local network should be considered and included in the paper as well.

Micah Officer: "How do Equity Analysts Impact Takeovers?" (with **Eliezer Fich** and **Tingting Liu**)

While existing research consistently agrees with the tenet that analyst coverage affects firm value, there is widespread disagreement about how analysts (and their forecasts) are value relevant. Much of the existing literature centers on three plausible theories of the value added by analysts: 1) improved monitoring; 2) reduced information asymmetry; and 3) improved investor recognition. **Micah Officer** presented a paper that contributes to this literature by empirically examining the role of equity analysts in the M&A process. The paper found that firms covered by more analysts are more likely to become takeover targets and more likely to enter deals in which their acquirers initiate private merger negotiations. Moreover, when equity analysts' pre-acquisition price forecasts imply greater target undervaluation, 1) target firms are more likely to initiate their own sale; 2) takeover premiums are higher; 3) those premiums tend to be revised upwards during private merger negotiations; and 4) acquirer firms use less cash to structure the transaction. These results imply a material role for equity analysts during the M&A process: their coverage affects takeover probabilities while their price forecasts influence merger premiums and the merger consideration. Their findings support both investor recognition and information generation theories about the role of equity analysts in financial markets.

In his discussion, **Maxim Mironov** stated his concern on the endogeneity issue and the construction of the sample. He further explained that there may be an omitted variable (i.e. attractiveness for potential takeover) which strongly affects both analyst coverage and takeover probability. The author used lagged analyst coverage as the instrument variable to predict future analyst coverage to solve this issue. However, he suggested that the number of analysts who cover a given firm is highly auto- correlated and stable, thus inclusion of predicted coverage in the regression is almost the same as to include actual coverage. He also stated that the analysis of undervaluation premium has a similar endogeneity problem. He suggested to use radical change in coverage, i.e. due to bankruptcies of investment banks as the exogenous shock, as there is a drop in the coverage from N to 0 for all firms covered by these banks. He also advised to use 2008-2009 financial crisis as a source of this exogenous variation. In the paper, for each of the 1,324 target firms, authors identify similarly sized non-target firms from the same two-digit SIC industry as the control firm. He recommended the authors should use more firm characteristics as control variables, instead of only size to match the control firms.