Mergers and Acquisitions: Do They Create Or Destroy Value?

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745p  840p + 10p = £11.9b
50%  31% (up from 5%)
The Remedies

- 2011 changes to Takeover Code:
  - Bidder needs to state intentions after the takeover
  - Staff representatives can give views on takeover

- Other suggestions
  - Disenfranchise “short-term” shareholders
  - National interest test: “too easy for foreign firms to buy UK rivals”
Two Sides To (Almost) Every Story

- Cadbury had announced closure of Somerdale in 2007
- Bournville headcount had fallen from 2,000 in 2007 to 1,000 in 2009; operating costs 3x German comparables
  - 2017: Mondelez completed a £75m modernisation; £18m new global research operation
  - Pay rise praised by Unite: “set the benchmark within the food, drink, and agriculture industries for other employers to follow”
- Maternity pay increased from 4 to 9 months
The Evidence

- US targets, 1980-2005
  - Target: 7% runup, 15% announcement
  - Bidder: 0.5% runup, 0.7% announcement
  - Overall: 7% runup, 11% announcement

- So shareholders gain overall, *on average*
Pie-Growing Mergers
Pie-Splitting Mergers
Potential Losers From Pie-Splitting

- **Customers**
  - Zero or negative effects on rivals, suggesting no collusion; increased efficiency of merged firm
  - Positive effects on corporate customers
  - “Taken together, the customer and rival results are strongly inconsistent with the monopolistic collusion hypothesis”

- **Suppliers**
  - Only non-retained suppliers lose; retained suppliers increase market share
  - Efficiency gains from mergers passed onto suppliers (and customers)
Potential Losers From Pie-Splitting (cont’d)

- Employees
  - Wages and employment rise
- Taxpayers
  - Minor role
- Bondholders
  - Mixed effects on bidder bonds, positive effects on target bonds
- Target shareholders, if market myopic
  - Most mergers targeted at firms and industries with little R&D
  - After a failed merger, target returns to original price)
Effects of Takeover Probability

- Encourages R&D
  - To increase efficiency and ward off (hostile) takeovers
  - To become more attractive and encourage (friendly) takeovers

- Improves efficiency
  - Combats “quiet life”; spurs creation of new plants and destruction of old plants
Bidder Gains Revisited

- Average gains of 0.5% (runup), 0.7% (markup) mask huge variation
- 1998-2001: US acquirers lost $240bn through M&A
  - Small number of bad deals by very large acquirers. Without them, acquirers would have gained overall
Why Might Acquirers Undertake Bad Deals?

- **Deliberate**
  - Paid for deals (Chris Gent’s £10m, William Harrison’s $20m)
  - Paid for size
  - Prestige, empire-building (Daewoo)
  - Bidder returns related to CEO’s stake, corporate governance

- **Unintentional**
  - Bidder returns related to overconfidence
The Role of M&A Advisors

- Critical, since CEOs have limited expertise
- Paid only a success fee, but success ≠ announcement
  - Is reputation a mitigant?
- Investment banks matter (IQ range of 1.26% of $10bn)
  - Not just execution houses
- Past performance doesn’t affect market share
  - Even though it significantly predicts future performance
- But past market share affects future market share
  - Even though it \textit{negatively} predicts future performance
- Potential culprit: market share league tables. Replace with performance league tables
The Role of Short-Term Traders

- Recall from Lecture 4: holding period ≠ orientation
- “Short-term” investors will have acquired their shares from “long-term” investors
- Activist arbitrageurs
  - Target deals with low premiums and where CEOs receive outsized payments
  - Significantly reduce the probability of a takeover; increase premium if takeover still occurs
- But case for preventing voting with borrowed stock in an M&A deal
A National Interest Test?

- Foreign investors import
  - Superior governance
  - Superior social norms
- Potentially subject to substantial lobbying; driven by errors of commission not omission
- Takeovers can split or shrink the pie, but nothing specific to foreign takeovers
- National interest should be to promote great companies, which discipline helps
  - Tariffs (which reduce discipline) need not be in national interest
Going Forwards

- “Grow the Pie: Creating Profit for Investors and Value for Society” (Cambridge University Press, 2020)
- Twitter/LinkedIn: @aedmans
  - Time Management in the Digital Age
  - Finding Purpose in Your Career
  - Public Speaking Without Fear
  - Mental and Physical Wellness
  - Facts, Data, and Evidence: Knowing What To Trust
  - The Growth Mindset and the Abundance Mentality