MERGERS AND ACQUISITIONS AND CORPORATE GOVERNANCE

Anant K. Sundaram

Ever since Professor Henry Manne coined the phrase "the market for corporate control" in 1965, the phenomenon of mergers & acquisitions (M&A) has been closely associated with corporate governance.[1] In his article, Manne (1965, p. 113) developed a straightforward argument that, by hindsight, seems obvious: "The lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently. And the potential return from the successful takeover and revitalization of poorly run company can be enormous." Thus was the born that notion that in economies with active markets for corporate control, shareholders of poorly governed companies will sell, thereby lowering share prices in the financial marketplace, with the lower prices creating the incentive for outsiders to accumulate control rights, replace the incumbents, and restructure the firm to create value for themselves.

Thus was also born the study of the links among takeovers, corporate governance, and firm performance. In the process, these links have come to be among the most extensively researched topics in the fields of finance and strategic management. Masterful summaries of this research chronicle evidence from the 1970s (Jensen & Ruback, 1983), the 1980s (Jarrell, Brickley & Netter, 1988), and the 1990s (Andrade, Mitchell & Stafford, 2001), revealing a few recurrent and compelling themes that are now accepted as conventional wisdom:[2] On average, target shareholders gain, while acquirer shareholders break even (they may even lose slightly); the ability to capture takeover gains remain elusive, and

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value creation is difficult – acquirers should prepare to be disappointed; hubris, empire-building, and overconfidence are as common a set of takeover motivations as are synergy gains; combined acquirer and target shareholder wealth effects are positive; the medium of exchange matters: announcements of stock-based acquisitions send negative market signals, while that of cash-based acquisitions send small positive signals; poorly performing targets are more likely to be subject to takeover bids; bad bidders may subsequently become potential takeover targets themselves. Many of these issues have been addressed in great depth in the companion chapters in this Volume.

Buying and selling companies and divisions entail perhaps the most important set of decisions in the life of a firm, involving as it does a set of consequences that are interlinked with just about every aspect of a firm's strategy and operations, even its very existence. In the past two decades M&A has arguably become the most important means by which firms the world over are implementing strategies to grow their businesses. During the period January 1980 to January 2000, worldwide, there were nearly 70,000 completed M&A transactions for a total US$ value approaching $9 trillion (we will examine the data there in more detail later). During this period, transactions that involved just a U.S. firm as either an acquirer or a target accounted for well over half of the number and nearly 70% in value, suggesting that the U.S. market for corporate assets is by far the most mature.[3] To put these numbers in perspective, consider that the U.S. economy accounts for about a third of the world's GDP.

The purpose of this Chapter is to examine the market for corporate control from the standpoint of its links to corporate governance. Specifically, it seeks to examine the following questions: What role does M&A play in corporate governance? How does this role complement or conflict with the role that other governance mechanisms can play? What are the theoretically postulated governance roles for M&A, and how well have these postulates been borne out in practice? Is the conventional wisdom really correct – i.e. is it indeed true that markets perceive value-creation from M&A with skepticism? What do we know about the types of M&A that can *create* value for the acquirer? Conversely, are there situations in which M&A activity could mask or even encourage poor governance practices? How can we identify such types of M&A?

Admittedly, this is an ambitious menu. Hence, it would be somewhat foolish to presume that we can comprehensively address every single one. This Chapter has a more modest goal: That goal is to attempt to *adequately* address the answers to these questions. In the process of doing so, some selectivity is unavoidable. In particular, it is important to distinguish between governance issues that arise in the case of the acquirer (e.g. the type of asset bought, price paid, the role of CEO motivations, the medium of exchange, the role of the board) versus those that

arise in the case of the target (e.g. the use and abuse of takeover defenses, the role change-of-control compensation contracts, the role of various Delaware court rulings, the role of alternative constituency statutes). This Chapter will primarily focus on the former, i.e. governance issues that arise in the case of the acquiring firm. We will address target-related governance issues only in passing. Moreover, with some initial exceptions, most of the detailed evidence in this Chapter will focus on what we know from the U.S. context.

The Chapter is structured as follows. First, with a view to make it self-contained, it begins with a definition of "corporate governance," discusses the menu of mechanisms by which the corporation can be governed, and examines the role that M&A plays. It then marshals aggregate U.S. and non-U.S. evidence on the number, values, and types of completed M&A activity worldwide, starting with 1980 with a view to draw broad inferences for the links between M&A and corporate governance. Next, it examines the evidence on market reactions to specific types of M&A announcements to get a sense of how – and more importantly, why – particular types of M&A might be viewed by financial markets as reflecting value-creating governance practices while others reflect governance shortcomings. It summarizes the evidence, and examines the implications of the evidence – both the aggregate evidence and that based on market reactions – for boards and managements of both acquirers and targets (the latter only briefly). The Chapter concludes with a brief discussion of the challenges that lie ahead.

CORPORATE GOVERNANCE AND ROLE OF M&A

Corporate Governance: A Definition

"Corporate governance" refers to the top management process that manages and mediates value creation for, and value transference among, various corporate claimants (including the society-at-large), in a context that simultaneously ensures accountability toward these claimants (Sundaram, Bradley, Schipani & Walsh, 2000, p. 112).

Several key aspects of the definition are worth noting. Corporate governance is a process rather than an outcome. Governance is explicitly in the *top management* realm. Corporate governance practices define the role of the boards and officers of the corporation, and account for a considerable portion of the job description of a CEO. In the modern corporation, at least in principle, no major strategy can be formulated for implementation without it being vetted and approved by the board. The definition emphasizes both *value creation* and *value transference*.

Value creation is the basic purpose of all corporate activity. While the concept of "value" is left vague in the definition above, it captures the idea of economic value and hence, "profits," and, in turn, *efficiency*. Obviously, a necessary condition of "good" governance is a focus on profits and efficiency. However, the existence of value implies the existence of economic rents, and in the presence of multiple claimants, they raise distributional issues. Good governance therefore also implies, even require, some form of "fair" and "equitable" value distribution. Thus, as with all large socio-economic questions, the methods and avenues to deal with questions of both efficiency and equity are at the heart of governance.

The definition also emphasizes the role of both *claimants* and *accountability*. The claimants in the corporation are stakeholders who, through either their implicit or explicit economic relationships with the firm, stake a claim to corporate revenues and cash flows. Such claimants include shareholders, employees, customers, creditors, suppliers, competitors, and even the society-at-large. Governance is a two-way street. As the corporation is responsible for its stakeholders, governance practices also simultaneously determine the process by which the firm's stakeholders (including the society-at-large) monitor and control the firm.

In much of the finance and strategic management literature, the definition of corporate governance has been viewed through the lens of an "agency" problem resulting from the separation of ownership and control between the firm and its capital providers.[4] However, as we see from the definition above, corporate governance is much more than simply the relationship between the firm and its capital providers. CEOs and boards surely concern themselves with a much larger menu of issues. We can obtain a better understanding of why (and how) as we examine the main external and internal mechanisms of corporate governance.

Mechanisms of Corporate Governance and the Role of M&A

Governance mechanisms can be broadly grouped into those that are *internal* to the firm, and those that are *external*. Although both sets of mechanisms are present in many instances, we can view them as being substitutes: If internal mechanisms ensure that the corporation is well-governed, external mechanisms presumably need to play a background role. The role of external mechanisms become more important when internal mechanisms fail or are deficient.

The most important *internal* mechanisms of corporate governance are: the structure and role of the boards, the role of the CEO vis-à-vis the board, the nature

of employment practices, and the nature of internal control systems and incentive systems in place to measure and reward the performance of employees of the firm.

The role of boards in the governance process is central. In most corporate economies, it is the board of directors that is charged with the task of mediating and managing the trade-offs among stakeholders, the task of approving strategy and budgets, and the task of setting compensation. The board is also responsible for ensuring that the firm acts in a legal and socially responsible manner. Key questions in understanding the role of boards include issues of board composition, board size, whether non-equity constituencies are represented, and whether the board is independent. CEOs, as the ultimate go-betweens for company management and boards, play a crucial role in governance. For example, are they just responsible for the executive functions in the firm or are they also in control of the board, its appointment, and its actions? Compensation and control systems are important in that they are responsible for aligning the reward (and punishments) systems to the goals of the firm. For instance, are managers paid with fixed salaries and bonuses, or are they also compensated with stocks and stock options? The latter type of compensation would presumably better align managers' and shareholders' interests, if the goal of the firm is to create shareholder value. Similarly, what is the role of performance-related versus performance-unrelated compensation (such as golden parachutes for top management in the event of a change of control)? The internal governance issue that is perhaps the most important from the standpoint of the day-to-day operations of the firm is the nature of employment practices. Typical questions here include: How are employees hired and promoted? How is their human capital built and retained? How long do they stay with the firm? Does the firm have a relationship-based contract with its employees, or does it hire and fire at will?

But all of these internal mechanisms operate in an external environment. There are at least four important *external* mechanisms of corporate governance: capital markets, product markets, managerial labor markets, and the market for corporate control.

External capital markets – both equity and debt markets – exercise discipline both because firms have to subject themselves to its scrutiny when they wish to raise external funds, and because financial markets help determine the structure of equity ownership. The source of product market discipline is obvious: In competitive economic systems, firms that cannot consistently produce (relative to their competition) cheaper, faster, better, and more innovative products that the consumer demands will not survive. Competition will ensure that only the "fit" survive. Similarly, managerial labor markets ensure that managers from better-performing firms will be rewarded and worse-performing firms penalized by their "price" in the marketplace.

Arguably, the most important and prevalent external mechanism of governance and the most widely discussed in both the finance and strategy literatures – at least in the Anglo-American system of corporate governance – is the role played by the market for corporate control. As we have already noted, with an active market for corporate control, shareholders of poorly governed companies can sell their shares, thereby lowering share prices in the financial marketplace, with the lower prices creating the incentive for outsiders to accumulate control rights, replace the incumbents, and restructure the firm. This market ensures that underperformers and their managers will get weeded out through acquisitions, and that acquiring firms will extract higher value and synergies from these firms by putting them to more efficient uses; i.e. by reducing costs and increasing revenues. An active market for corporate control ensures that such a threat will be present, and the threat is presumed to be sufficient to ensure governance discipline.

The arguments for an effective market for corporate control implicitly assume that: (1) There will always be the credible threat of a hostile takeover that will act as a substitute for failures in internal mechanisms of governance, and those that managerial labor markets, financial markets, and product markets do not or cannot correct; (2) The institutional environment that consists of regulations and laws, or takeover defenses that targets can mount, will not inhibit the existence of such a threat; and (3) Such takeovers will be done for the "right" reasons, i.e. for the reason that markets ensure that assets will be put to their most efficient uses.

We cannot take for granted that these assumptions always hold. The threat of hostility can disappear for numerous reasons. Potential acquirers may be unwilling or unable to use the method of hostile takeover if they are using stock rather than cash as the medium of exchange. If a private (as opposed to public) target acquisition is being considered, hostility may not be an option since such targets often have a majority (as in the case of an owner-managed private firm) or even 100% (as in the case of a division of a larger company) equity owner who can exercise the right not to sell. The target firm can respond with defenses such as poison pills (shareholder rights plans that issue new shares to non-threatening shareholders in the event of someone acquiring a "control" threshold), white knight strategies (preemptively seeking out a friendly buyer), poison outs (clauses in target's debt or other contracts that get triggered by a change of control), crown jewel strategies (selling off attractive divisions or assets to others), defensive recapitalizations (loading up with debt by repurchasing shares to make themselves unattractive), greenmail (targeted share repurchases), staggered boards (whereby only a certain proportion of the incumbent board can be removed at any time, thus rendering ineffective the threat of a proxy contest), and so forth. Laws and regulations can also deter the market for corporate control. For instance, nearly 30 U.S. states have

enacted "alternative constituency" statutes that can thwart an acquirer's moves by appealing to the impact of the takeover on non-shareowning constituencies; many Delaware court rulings (such as those resulting in the "just say no" defense) have given incumbent boards wide berth to reject bids by appealing to possible strategic demerits of the takeover (as they view it); many U.S. states require supermajorities (e.g. Delaware requires 85%) for tender offers to succeed in the event that the target board rejects the offer.

Takeover motivations can differ too. While we might like to believe that managers live in a Manne-sian, efficiency- and synergy-seeking world and would not consciously waste trillions of dollars of their owners' wealth, plenty of other motivations are possible. In a persuasive article, Roll (1986) examined the sum total of M&A evidence and concluded that perhaps the most compelling explanation for growth by acquisitions is CEO hubris.[5] Similarly, Shleifer and Vishny (2001) argue that many acquisitions are, in fact, "stock-market driven" – i.e. managers capitalize on their temporarily overvalued stock prices to pursue acquisitions only to "tangible-ize" such overvaluation (to coin a word), thus pre-empting the market's subsequent valuation reversal and correction back to fundamentals. Conversations with numerous CEOs and investment bankers over the years reveal yet another common (but rarely researched!) reason: Acquirers want a particular target because they do not want their competitors to have it. Sometimes, less savory reasons, such as being to able to exercise anticompetitive market power or increase top management compensation (since firm size is highly correlated with CEO compensation) leads to acquisitions.

Thus, as with any market-driven phenomenon, the market for corporate control is a double-edged sword. While it can, in principle, be a potent force for correcting managerial inefficiencies and poor governance practices, there are also situations in which it can abet or encourage such practices. We turn next to the aggregate evidence in this regard during the 1980s and the 1990s, with a view to examine which of these two roles it has, in fact, played.

STRUCTURE AND TYPES OF M&A ACTIVITY DURING THE 1980s AND THE 1990s

Although there were at least three other acquisition "waves" in the U.S. during the 20th century, the level, pace, and the worldwide scope of M&A activity that began gathering steam during the early 1980s and, after a brief lull, resumed during the second half of the 1990s was the most impressive. Based on an analysis of the M&A database from Securities Data Corporation, we see from Table 1 that there were 68,621 M&A transactions worldwide during these two decades, for a

Table 1. Total Number and Value of Acquisitions During the 1980s and 1990s by Acquirer/Target Location (Value in $ Billions; Percentages are Those of "All" for Each Decade).

	Decade	U.S. Target		Non-U.S. Target		All Targets	
		1980s	1990s	1980s	1990s	1980s	1990s
Number							
U.S. acquirer	1980s	8569 (66.3%)		208 (1.6%)			
	1990s		22921 (41.2%)		2892 (5.2%)		
Non-U.S. acquirer	1980s	1403 (10.9%)		2746 (21.2%)			
	1990s		2745 (4.9%)		27137 (48.7%)		
All acquires	1980s					12926 (100.0%)	
	1990s						55695 (100.0%)
Total for 1980s and 1990s						68621	
Value							
U.S. acquirer	1980s	$1,248.1 (70.3%)		$21.2 (1.2%)			
	1990s		$3,684.8 (52.1%)		$330.6 (4.7%)		
Non-U.S. acquirer	1980s	$229.6 (12.9%)		$276.6 (15.6%)			
	1990s		$534.0 (7.6%)		$2,520.6 (35.7%)		
All acquires	1980s					$1,775.5 (100.0%)	
	1990s						$7,070.0 (100.0%)
Total for 1980s and 1990s						$8,845.5	

Note: Acquisitions' refers to completed deals in SDC "deal type" categories 1, 3, 4, and 11. "1980s" refers to the period January 1980 to January 1, 1990 (and similarly for "1990s").

Source: Securities Data Corporation, Thompson Financial Research; author's analysis.

total value US$8,845 billion.[6] Of this, the 1980s accounted for about one-fifth of the total number and value, while the 1990s accounted for four-fifths. During the 1980s, M&A transactions that involved a U.S. firm as either an acquirer or target accounted for almost 80% of all transactions (and 85% of the value) – in other words, M&A activity that took place outside the U.S. (i.e. non-U.S. targets being acquired by non-U.S. acquirers) accounted for less than one-fifth. Thus, the 1980s was the "U.S." decade of the growth and maturation of M&A as a major tool for strategy implementation.

However, the rest of the world saw a dramatic rise in M&A activity during the 1990s: The number of non-U.S. acquisitions of non-U.S. targets grew nearly *ten-fold* from about 2,700 in the 1980s to over 27,000 in the 1990s, while it grew slightly less than three-fold in the U.S. during the same periods. During the 1990s, the non-U.S. market for M&A accounted for almost half the total number and almost 36% of the value of all M&A transactions worldwide. Thus, within a decade of the phenomenon maturing in the U.S., it appears to have caught on in the rest of the world too, as a major tool for strategy implementation.[7]

As we will see in more detail in the next section, there is a great bias in a substantial amount of M&A research, in that it has almost exclusively focused on public target acquisitions (i.e. targets whose stocks trade on a public stock exchange).[8] The reason is that it is easier for researchers to obtain (and therefore analyze) target company data when it is publicly traded, and the implicit presumption is that the insights from such analysis is also applicable to the non-public realm.[9] But there are some important differences for the acquirer in public-target versus non-public target acquisitions, rendering such an assumption questionable (more on this later).

In order to examine this further, Table 2 breaks down the data in Table 1 by public versus non-public target acquisitions. The results are striking: During the two-decade period only 16% of the acquisitions done worldwide were those of public targets; this proportion was 22% in the 1980s, and the relative importance of public target acquisitions declines to 14% during the 1990s. The proportions by value tell a different story. Although public target acquisitions are less than a fifth of the number, reflecting the fact that public companies tend to be much larger than non-public companies and divisions, they account for approximately half of the total value of acquisitions. The data are quite similar for both U.S. and non-U.S. M&A activity.

Thus, in attempting to understand M&A and its implications for governance from the standpoint of the acquirer, to consciously or otherwise focus just on public targets – as much of the past research has done – is to throw away nearly 58,000 of the approximately 70,000 relevant data points during this period![10] Doing so jettisons a large slice of the acquisition experience, and

Table 2. Number and Value of Acquisitions During the 1980s and 1990s by Target Public Status and Acquirer/Target Location (Value in $ Billions).

	Decade	Public Targets		Non-public Targets		All Targets	
		Number	Percent	Number	Percent	Number	Percent
Number							
U.S. firms acquiring U.S. targets	1980s	2076	24.2	6493	75.8	8569	100.0
	1990s	3435	15.0	19486	85.0	22921	100.0
	Both	5511	17.5	25979	82.5	31490	100.0
U.S. firms acquiring non-U.S. targets	1980s	25	12.0	183	88.0	208	100.0
	1990s	399	13.8	2493	86.2	2892	100.0
	Both	424	13.7	2676	86.3	3100	100.0
Non-U.S. firms acquiring U.S. targets	1980s	298	21.2	1105	78.8	1403	100.0
	1990s	329	12.0	2416	88.0	2745	100.0
	Both	627	15.1	3521	84.9	4148	100.0
Non-U.S. firms acquiring non-U.S. targets	1980s	448	16.3	2298	83.7	2746	100.0
	1990s	3976	14.7	23161	85.3	27137	100.0
	Both	4424	14.8	25459	85.2	29883	100.0
All acquisitions	1980s	2847	22.0	10079	78.0	12926	100.0
	1990s	8139	14.6	47556	85.4	55695	100.0
	Both	10986	16.0	57635	84.0	68621	100.0
Value							
U.S. firms acquiring U.S. targets	1980s	$649.4	52.0	$598.7	48.0	$1,248.1	100.0
	1990s	$2,152.2	58.4	$1,532.6	41.6	$3,684.8	100.0
	Both	$2,801.6	56.8	$2,131.3	43.2	$4,932.9	100.0
U.S. firms acquiring non-U.S. targets	1980s	$4.9	23.1	$16.3	76.9	$21.2	100.0
	1990s	$121.4	36.7	$209.1	63.3	$330.5	100.0
	Both	$126.3	35.9	$225.4	64.1	$351.7	100.0
Non-U.S. firms acquiring U.S. targets	1980s	$108.9	47.4	$120.7	52.6	$229.6	100.0
	1990s	$302.0	56.6	$232.0	43.4	$534.0	100.0
	Both	$410.9	53.8	$352.7	46.2	$763.6	100.0
Non-U.S. firms acquiring non-U.S. targets	1980s	$127.6	46.1	$149.0	53.9	$276.6	100.0
	1990s	$1,117.4	44.3	$1,403.2	55.7	$2,520.6	100.0
	Both	$1,245.0	44.5	$1,552.2	55.5	$2,797.2	100.0
All acquisitions	1980s	$890.8	50.2	$884.7	49.8	$1,775.5	100.0
	1990s	$3,693.0	52.2	$3,376.9	47.8	$7,069.9	100.0
	Both	$4,583.8	51.8	$4,261.6	48.2	$8,845.4	100.0

Note: Acquisitions' refers to completed deals in SDC "deal type" categories 1, 3, 4, and 11. "1980s" refers to the period January 1980 to January 1, 1990 (and similarly for "1990s"). Public' target implies that the target firm is listed on a stock exchange.

Source: Securities Data Corporation, Thompson Financial Research; author's analysis.

hence governance implications associated with that experience, in the life of a typical acquirer. (We examine differences in market reactions to the two types of acquisitions and their implications for corporate governance in more detail in the next section.)

Table 3 examines the data broken down by deal attitude: i.e. whether the acquisition was "hostile" or non-hostile.[11] Using the SDC definition of hostility, we see that approximately 5% of the public target acquisitions completed by U.S. acquirers (of U.S. targets) was hostile during the 1980s; this proportion falls to less than 1.5% during the 1990s.[12] However, what is quite interesting (and perhaps surprising, since it is often assumed that the institution of the "hostile takeover" is a largely U.S. invention) is that non-U.S. firms undertook relatively more hostile acquisitions (as percentage of total) than U.S. firms did during this period: over 8% of U.S. targets and nearly 11% of non-U.S. targets were acquired in a hostile fashion by non-U.S. acquirers. And unlike the case of U.S. acquirers of U.S. targets, there was no fall-off in the proportion of hostile acquisitions of non-U.S. acquirers of non-U.S. targets. And perhaps unsurprisingly, non-public targets are rarely the object of a hostile takeover; during these two decades, only one-tenth of 1% of all acquisitions worldwide of non-public targets was hostile.

Andrade et al. (2001) and Holmstrom and Kaplan (2001) compare the medium of exchange, types of bids, and whether bids are contested for U.S. public targets during the 1980s versus the 1990s. In the 1980s, approximately 33% of all public target acquisitions were done with all stock, and about 46% used at least some stock; these percentages went up to 58 and 71%, respectively, during the 1990s. In the 1980s, there were 1.6 bids made of each deal, while this number fell during the 1990s to 1.2 (and the number of bidders per deal fell from 1.2 to 1.0). They also report that related acquisitions went up from 40% of all deals to 48% between the two periods. Holmstrom and Kaplan (2001) note that acquisitions during the 1980s used much more leverage compared to the 1990s, and the 1980s saw high levels of leveraged buyouts (which virtually disappeared in the 1990s).

Thus, summing up the aggregate evidence from the 1980s in relation to the 1990s, we observe that:

> M&A activity grew by a factor of four (as measured by the number of deals) during the 1990s compared to the 1980s; M&A activity became a global phenomenon during the 1990s, while it was largely a U.S. phenomenon during the 1980s.
>
> Acquisitions of non-public targets substantially outnumbered those of public targets during both eras, both in the U.S. and abroad; non-public target acquisitions are rarely hostile.
>
> Hostility declined dramatically in the U.S. during the 1990s relative to the 1980s; contrary to popular belief, non-U.S. firms were not only as (if not more) likely to engage in hostile

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Table 3. Hostile Acquisitions During the 1980s and 1990s by Target Public Status and Acquirer/Target Location (Value in $ Billions).

	Decade	Public Targets		Non-public Targets		All Targets	
		Number Hostile	Hostile as % Public	Number Hostile	Hostile as % Non-public	Number Hostile	Hostile as % Public + Non-public
Number							
U.S. firms acquiring U.S. targets	1980s	105	5.1	6	0.1	111	1.3
	1990s	46	1.3	3	0.0	49	0.2
	Both	151	2.7	9	0.0	160	0.5
U.S. firms acquiring non-U.S. targets	1980s	1	4.0	1	0.5	2	1.0
	1990s	16	4.0	1	0.0	17	0.6
	Both	17	4.0	2	0.1	19	0.6
Non-U.S. firms acquiring U.S. targets	1980s	25	8.4	2	0.2	27	1.9
	1990s	7	2.1	0	0.0	7	0.3
	Both	32	5.1	2	0.1	34	0.8
Non-U.S. firms acquiring non-U.S. targets	1980s	48	10.7	13	0.6	61	2.2
	1990s	177	4.5	14	0.1	191	0.7
	Both	225	5.1	27	0.1	252	0.8
All acquisitions	1980s	179	6.3	22	0.2	201	1.6
	1990s	246	3.0	18	0.0	264	0.5
	Both	425	3.9	40	0.1	465	0.7
Value							
U.S. firms acquiring U.S. targets	1980s	$111.0	17.1	$1.6	0.3	$112.6	9.0
	1990s	$54.2	2.5	$2.5	0.2	$56.7	1.5
	Both	$165.2	5.9	$4.1	0.2	$169.3	3.4
U.S. firms acquiring non-U.S. targets	1980s	$0.2	4.1	$0.1	0.6	$0.3	1.4
	1990s	$8.3	6.8	$0.1	0.0	$8.4	2.5
	Both	$8.5	6.7	$0.2	0.1	$8.7	2.5
Non-U.S. firms acquiring U.S. targets	1980s	$44.2	40.6	$0.1	0.1	$44.3	19.3
	1990s	$5.5	1.8	–	0.0	$5.5	1.0
	Both	$49.7	12.1	$0.1	0.0	$49.8	6.5
Non-U.S. firms acquiring non-U.S. targets	1980s	$37.3	29.2	$4.7	3.2	$42.0	15.2
	1990s	$80.7	7.2	$1.0	0.1	$81.7	3.2
	Both	$118.0	9.5	$5.7	0.4	$123.7	4.4
All acquisitions	1980s	$192.7	21.6	$6.5	0.7	$199.2	11.2
	1990s	$148.7	4.0	$3.6	0.1	$152.3	2.2
	Both	$341.4	7.4	$10.1	0.2	$351.5	4.0

Note: "Acquisitions" refers to completed deals in SDC "deal type" categories 1, 3, 4, and 11. "1980s" refers to the period January 1980 to January 1, 1990 (and similarly for "1990s"). "Public" target implies that the target firm is listed on a stock exchange. "Hostile" is as defined by the SDC database.

Source: Securities Data Corporation, Thompson Financial Research; author's analysis.

transactions, but their levels of hostile takeover activity did not decline during the 1990s as it did in the case of U.S. firms.

The use of stock rather than cash rose during the 1990s, as did the number of related acquisitions; the use of leverage (and LBOs) declined.

Bids were more likely to be contested during the 1990s compared to the 1980s.

We will explore the corporate governance implications of this evidence in a later section, after first examining how the stock market reacted to M&A announcements during the 1980s and the 1990s, broken down by deal structure, medium of exchange used, target size relative to acquirer size, target public status, and relatedness.

MARKET REACTIONS TO M&A ANNOUNCEMENTS

The announcement effects of M&A events have been widely studied. A vast majority of the studies have, however, focused on public target acquisitions. As previously noted, part of the reason for this is that the data are easier to obtain in the case of public targets, and the implicit assumption is that the insights from public target acquisitions will readily carry over to the non-public setting as well. We will see in this section that the evidence relating to these two types of acquisitions is in fact quite different, with fairly significant implications for corporate governance. Also, as we argued in the previous section, to ignore the non-public acquisitions in a firm's life is two throw away over four-fifths of the acquisitions done by a typical firm (and over half the value). In this section, we first present the evidence on public target announcements, and then examine those of non-public targets.

Market Reactions to Public Target Acquisitions

Table 4 summarizes the evidence on acquirer and target announcement effects from public target acquisitions, and in some cases, compares the evidence for the 1980s versus the 1990s. The data here are summarized from Tables 1 and 3 of Andrade, Mitchell and Stafford (2001), as well as the author's own analysis.[13] Acquirer and target announcement effects are similar for during the 1980s and the 1990s. During the 1980s, the acquirer market reaction to a public target announcement (measured by the Day [−1,+1] excess return) is −0.4%, while it is −0.32% during the 1990s (although the latter is statistically significant, it is not

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40

Table 4. Characteristics of Public Target Acquisitions: A Comparison of the 1980s and the 1990s.

Characteristic	1980s	1990s
Percent acquisitions done with all stock[a]	32.9%	57.8%
Percent acquisitions done with all cash[a]	45.3%	27.4%
Percent done with any stock[a]	45.6%	70.9%
Percent related acquisitions[a]	40.1%	47.8%
Bidders/Deal[a]	1.2	1.0
Bids/Deal[a]	1.6	1.2
Average premium[a]	37.7%	34.5%
Announcement effects: (Day [−1, +1])		
Acquirer	−0.40%[a]	−0.32%[b,*]
Target	16.00%[a,*]	15.90[b,*]
Combined (Acquirer + Target)	2.60%[a,*]	1.40%[b,*]
Acquirer: all stock	−1.50%[a,*]	−1.05%[b,*]
Acquirer: all cash	0.40%[a]	1.44%[b,*]
Related	NA	−0.56%[*]
Unrelated	NA	0.22%[b]
Acquirer NYSE listed	NA	−0.46%[b,*]
Acquirer NASDAQ listed	NA	−0.21%[b]
Smallest quintile relative size	NA	1.49%[b,*]
Next-to-smallest quintile relative size	NA	0.13%[b]
Middle quintile relative size	NA	−0.25%[b]
Next-to-largest quintile relative size	NA	−1.25%[b,*]
Largest quintile relative size	NA	−1.73%[b,*]

[a] From Tables 1, 3, and 4 of Andrade, Mitchell and Stafford (2001).
[b] Based on author's analysis of 2305 public target acquisitions made by publicly listed U.S. acquirers from January 1990 to March 2000.
[*] Statistically significant.

economically significant).[14] For the target firm, it is 16.0 and 15.0% respectively, both statistically and economically significant. Combined returns are positive and significant, although it fell from 2.6% during the 1980s to 1.4% during the 1990s. The average premiums paid are similar: 37.7% during the 1980s, compared to 34.5% during the 1980s.

Turning to the impact of medium of exchange (data only for the 1990s), we see that the acquirer announcement effects are negative and significant for all-stock transactions (−1.05%), while they are positive and significant for all-cash transactions (+1.44%). Announcement effects for related target acquisitions of public targets are not higher than those for unrelated acquisitions.

And, acquisitions made by the larger, older-economy NYSE firms have a worse announcement effect than those made by higher-technology firms of NASDAQ. When we break down the announcement effects by the relative sizes of the target value to acquirer value (again data only for the 1990s), we observe a near-monotonic decrease in the announcement effect – the larger the relative size of the public target, the worse the market reaction on the acquirer's stock price. For instance, the announcement effect for the smallest quintile of relative size is +1.49%, while it is −1.73% for the largest quintile.

Market Reactions to Non-Public Target Acquisitions

In the recent past, researchers have turned their attention to market value effects of acquisitions of non-public firms.[15] Of course, with non-public targets, it is only possible to examine the market value effects for the acquiring firm. Table 5 summarizes the evidence on acquirer and target announcement effects for non-public target acquisitions. Given the relatively recent vintage of the research in this area, much of the data are for the 1990s.

The results are dramatically different from those that the conventional wisdom based on public target acquisitions would suggest. First, acquirer announcement effects are large and positive for non-public target acquisitions, with the three-day excess return of +2.05% (it is also massively significant, with a *t*-statistic of over 24, which we do not report in the table). Second, the announcement effects for both stock- and cash-based acquisition announcements are positive and significant (+2.19 and +1.48%, respectively), with the returns to stock being higher. Third, both related (+2.11%) and unrelated (+1.98%) acquisition excess returns are positive and significant, as are the excess returns for NYSE acquirers (+1.13%) and NASDAQ acquirers (+2.67%; the NASDAQ returns are again significantly higher than those for NYSE acquirers).

When we break down the announcement effects by the relative sizes of the target value to acquirer value, we observe a near-monotonic increase in the announcement effect – the larger the size of the non-public target, the better the market reaction on the acquirer's stock price. For instance, the announcement effect for the smallest quintile of relative size is +1.81%, while it is +2.73% for the largest quintile. This is opposite to what we observe in for public target acquisitions.

Summarizing the evidence on announcement effects:

> Where data are available to compare, acquisition announcement effects as measured by stock price changes during the 1980s and the 1990s appear to be largely similar.

Table 5. Characteristics of Non-Public Target Acquisitions: A Comparison of the 1980s and the 1990s.[a]

Characteristic	1980s (%)	1990s (%)
Percent acquisitions done with all stock	NA	18.3
Percent acquisitions done with all cash	75.2[b]	45.2
Percent related acquisitions	NA	53.3
Announcement effects: (Days [−1,+1])		
Acquirer	1.15[b,*]	2.05*
Acquirer: all stock	2.64[c,*]	2.19*
Acquirer: all cash	0.09[c]	1.48*
Related	NA	2.11*
Unrelated	NA	1.98*
Acquirer NYSE listed	NA	1.13*
Acquirer NASDAQ listed	NA	2.67*
Smallest quintile relative size	NA	1.81*
Next-to-smallest quintile relative size	NA	1.68*
Middle quintile relative size	NA	1.99*
Next-to-largest quintile relative size	NA	2.05*
Largest quintile relative size	NA	2.73*

[a] 1990s data are based on author's analysis of 10,139 non-public target acquisitions made by publicly listed U.S. acquirers from January 1990 to March 2000.
[b] From Table 3 in Hansen and Lott (1996), whose data cover the period 1985–1990. The definitions of "all cash" are not strictly comparable.
[c] From Table 2 in Chang (1998), whose data cover the period 1981–1992. The definitions of "all stock" and "all cash" are not strictly comparable.
* Statistically significant.

> With *public* target acquisitions, target firm shareholders gain, while acquirers break even; the typical premium paid is a little over one-third of the target's pre-bid price; stock-based acquisitions send negative signals while cash-based acquisitions send positive signals; related acquisitions do not elicit better announcement effects; older-economy acquirers seem to have worse announcement effects; market reactions are worse the larger is the size of the target relative to the size of the acquirer.
>
> With non-public target acquisitions, acquiring firms' shareholders gain (although we cannot assess the premium paid in this case); both stock- and cash-based acquisitions elicit positive announcement effects, with stock doing better; both related and unrelated acquisitions elicit positive announcement effects, with related doing better; both high-technology and older-economy firms do well, although high-technology acquirers do better; market reactions are better the larger is the size of the target relative to the size of the acquirer.

We turn next to an examination of the corporate governance implications of the evidence that we have marshaled in this section and the previous one.

CORPORATE GOVERNANCE IMPLICATIONS OF THE EMPIRICAL EVIDENCE

Governance Implications of the Evidence on Announcement Effects

The evidence examined thus far points to some straightforward guidelines for boards and top managements. Conventional wisdom has it that it is difficult to create value with M&A, and that acquirers should prepare to be disappointed.[16] This conclusion is not surprising, given the fact that the typically quoted market reaction points to M&A being viewed by markets as a zero excess return, "you-get-what-you-pay-for" type of event, if we use the short-term impact on the acquirer stock price upon announcement as the guide. It is a fair guide to the extent that financial markets are reasonably efficient most of the time – the announcement effect is simply an unbiased forecast of what is subsequently expected to happen.

We need to keep in mind that value-creation from M&A occurs only if the acquirer performs *better than expected relative to the price paid*: i.e. if the price (including the premium) initially paid is lower than the PV of the base-case value of the target plus the PV of the subsequently realized synergies. But this is not easy to make happen. If we assume a competitive market for corporate control (or that the target firm's shareholders are effective at bargaining away the PV of the forecasted synergy gains up-front, e.g. through use of anti-takeover strategies), then the acquirer pays up-front for value that (s)he hopes to ultimately realize over the long run. Even if the acquirer performs as well as initially expected – in the sense of improving efficiencies to realize all the initially forecasted synergies – that only gets it to the break-even point! Value is created only if the acquirer performs better than expected, or is able to exploit major information asymmetries to acquire the target at a price below its fair value even when the market for corporate control is competitive. Both of those are difficult to do. Thus, it should perhaps come as no surprise that the typical acquirer fails to create value as measured by this standard.[17]

So why would a board that subscribes to the principle of shareholder value maximization accede to such a high likelihood of apparent value-destruction? Put differently, why do boards and top managements willingly spend trillions of dollars to implement strategies via M&A whereby, if they are lucky, they break even, and seemingly in a majority of the cases, they reduce their shareholders' wealth? As Andrade, Mitchell and Stafford (2001, p. 118) point out, "... in an efficient economy, there would be a direct link between causes and effects, mergers would happen for the right reasons, and their effects would be, on average, as expected by the parties during negotiations." The challenge, then,

for boards, is to understand some of the "right" reasons and motivations for acquisitions.

First, the conventional wisdom may somewhat overstate the case, since much of it is implicitly based on empirical evidence in relation to public target acquisitions, and even there, often those of the larger and higher-profile public targets. Second, the market does view the average non-public target acquisition as a positive-NPV event for the acquirer, regardless of size, relatedness, medium of exchange, and industry. Even in the case of public target acquisitions, those that are done with cash and are of relatively smaller targets elicit positive market reactions. In other words, there are categories of acquisition where the market gives the acquirer the benefit of doubt. Where the evidence on value-destruction is fairly unambiguous is when the public target is large, and stock is used as the medium of exchange.

We can readily explain why smaller targets are more likely to create value (or at least, destroy less value) for the acquirer. It is easier to undertake due diligence, acquisitions are quicker to carry out, and post-acquisition integration is likely to be smoother and faster, with smaller targets. There are smaller managerial egos and power to battle, fewer entrenched managerial positions to displace (or duplicate), and smaller acquisitions are less likely to be driven by considerations such as hubris and empire-building motives on the part of the acquiring CEO. A large acquirer also brings to the table better bargaining and negotiating strengths, as well as more experienced lawyers and investment bankers. Moreover, it is less likely that information intermediaries such as analysts, media, and risk-arbitragers will become involved in the acquisition process of a small firm, and thus more likely that the acquirer can exploit mis-valuations arising from the information asymmetries vis-à-vis the market.

Why should non-public target acquisitions, especially the larger and stock-based ones, create value for the acquirer? With non-public targets, there are a number of reasons why an acquirer can potentially come out ahead. One, private owners might be willing to cash out for a liquidity discount (Fuller, Netter & Stegemoller, 2002), and that accrues as a premium to the buyer. Two, even in a situation in which non-public targets are auctioned off, the seller may not recoup all the gains. Hansen (2001) points that in the auction market for companies, sellers seek to limit both the number of bidders and the amount of information that they reveal to buyers – despite the fact that a considerable auctions literature suggests that the reverse should be true for a seller that wants to extract the highest price – because of the potential costs of information revelation. Three, there may be a discount associated with information asymmetries between the buyer and the seller, in the spirit of the classic "lemons problem." Four, with stock-based acquisitions of a large non-public target, the seller becomes a blockholder

in the combined firm, and is perhaps able to more effectively monitor the buyer's post-acquisition behavior (and the buyer's incentive to gamble with their shareholders' money).

As to the opposite market value reaction to cash- versus stock-based acquisitions with public target acquisitions, the well-known argument for why stock as a medium of exchange creates a negative market reaction has to with signaling – The use of stock signals overvaluation of the acquirer's stock, and the market corrects appropriately for such overvaluation. But if that is true, why does the market not read a similar signal when non-public target acquisitions, especially larger ones, are announced? As Chang (1998) argues, acquiring firms are more likely to reveal private information to a potential blockholder of the combined firm than they are to a group of dispersed shareholders. Thus, the willingness of private owners to hold a large block of shares conveys favorable information and hence a positive stock market reaction.

All that said, is the implication that boards of acquirers should recommend against large, stock-based acquisitions of public targets? The recommendation here gets a bit murky. Shleifer and Vishny (2001) argued that acquirers can use their temporarily overvalued stock as a cheaper cost of capital source to buy a real asset when the going is good; they point out that, despite the (expected) initial negative reaction by the market, this may be quite a sensible strategy if the firm's value will revert to its intrinsic value in the long run, i.e. if the acquirer's stock price would have declined in the long run in any event as the market corrects its mistake. Thus, even in the case of large, stock-based public target acquisitions, "good" or "bad" depends on what we use as the benchmark. If we live in a world in which the benchmark available is not the best but the second-best, then the Shleifer-Vishny baseline of "what the acquirer's stock price would have been in the long-run if they did nothing" is indeed a relevant one to validate the usefulness of an acquisition strategy.[18]

Corporate Governance Implications of the Aggregate Data

In relation to macro-trends, we observed a four-fold rise in the role of M&A during the 1990s compared to the 1980s, both in the U.S. and abroad (and in relative terms, even more so abroad). This might seem to imply that the market for corporate control, its role as a source of governance discipline, and its role as an effective complement to the discipline from both internal and other external sources was alive and well. This, despite the fact that both leverage and hostility all but disappeared during the 1990s, to be replaced by stock and amicability. Holmstrom and Kaplan (2001, p. 124) argue as much, when they conclude:

> Managers initially fought takeovers with legal maneuvers and by enlisting political and popular support. They were successful in that hostile takeovers became more costly in the 1990s. But by that time, managers, boards, and institutional shareholders had seen what LBOs and other market driven restructurings could do. Thanks to lucrative stock option plans, managers could share in the market returns from restructured companies. Shareholder value became an ally rather than an enemy. This explains why restructurings continued at a high rate in the 1990s, but for the most part on amicable terms. There was less of a need for high leverage as deals could be paid for with stock with less worry that managers would abuse this privilege.

The obvious interpretation is that, compared to the previous decade, internal governance mechanisms had become so prevalent and substantive during the 1990s that the threat of a hostile takeover or of being purchased with cash (backed by debt) rather than stock was less necessary to make incumbent managements behave.

But the corporate governance crisis and the market collapse of the early 2000s would suggest that it was perhaps too sanguine a conclusion to draw. The other external mechanisms had also failed to some extent, and it is not at all clear that internal governance mechanisms stepped in to fill the void. The financial markets of the 1990s did not turn out to be the source of discipline that was hoped for. Investor decisions were based (as it turned out) on poor or corrupted information fed by conflict-laden analysts, questionable accounting practices, poorly-informed media, and the myth of a recession- and inflation-free, technology-driven "new-economy." By hindsight, it would seem that in the 1990s (especially the second half), markets ended up providing capital at lower than required, in relation to true cash flow prospects.

There is, as yet, no clear evidence on the disciplining role of managerial labor markets or internal governance mechanisms, but anecdotally, it seems that those too may have failed to play an adequate role. It would appear that the myth got created during the 1990s that top management talent had become rare. Boards were willing to provide extremely largely sums to attract and retain senior managers.[19] Compensation contracts seemed to precede performance, rather than the reverse. Boards of many leading companies (and even governance standards-setting institutions such as the New York Stock Exchange) were ineffective, seemingly lacking the ability, interest, or competence to challenge CEOs. The hoped for pay-for-performance effects of stock options turned out to be small or even non-existent. Option contracts seemed to become a one-way bet at the shareholders' expense, or essentially a form of rent-extraction from the shareholders (see, e.g. Bebchuk, Fried & Walker, 2002).

Preceding this mix was the introduction of many so-called "alternative constituency" statutes by state legislatures during the late 1980s and the early 1990s and the articulation of the "just-say-no" defense by the Delaware courts,[20]

which, some argued, made shareholder value-enhancing tender offers difficult and time-consuming to carry out. Although it is clear that neither set of regulatory developments had a significant impact on the overall pace of acquisition activity, this confluence of events is certainly consistent with the disappearance of the hostile takeover in the U.S. during the 1990s. At the extreme, it seems *plausible* that, when all the data are fully in and the events analyzed through the lens of some history, we may just as well conclude that the stock and the amicability of the 1990s takeover markets simply reflected the fact that the market for corporate control had lost its teeth, and, in an unintended way, helped hasten the governance crisis.

Indeed, the plea reflected in the title of a 2002 Op-Ed article by Henry Manne in the *Wall Street Journal* – the same Manne who, nearly forty years prior, coined the phrase "market for corporate control" – says it well: "Bring Back the Hostile Takeover."[21]

Corporate Governance and Target Company Boards

The preponderance of market-related evidence in the case of public targets is that their shareholders walk away with most, if not all of the takeover gains. Thus, it would seem that the average public target board is effective in extracting up-front much of the PV of expected future synergies from the acquirer via the premium that (s)he is made to pay. Indeed, the evidence from announcement effects would suggest that large public targets, and those that are the object of stock-based takeovers may be extracting up-front even more than the full value of the PV of acquirer's expected future synergies; i.e. they seem to be making the acquirer overpay.

Yet, considerable controversies surround the use takeover defenses by targets, the role change-of-control compensation contracts such as golden parachute awards, and the role of state-level alternative constituency statutes that seek to protect various classes of non-shareowning stakeholders in the event of a hostile takeover. While a detailed examination of these issues is beyond the scope of this Chapter, we briefly address them by summarizing the broad evidence.

Comment and Schwert (1995) provide convincing evidence that poison pill rights issues, control share laws, and business combination laws have not systematically deterred takeovers and are unlikely to have caused the demise of the 1980s market for corporate control. They show that poison pills and control share laws are associated with higher takeover premiums for selling shareholders, both unconditionally and conditional on a successful takeover, and argue that, if anything, antitakeover measures increase the bargaining position of target

firms, but they do not prevent many transactions. In a detailed and carefully done empirical analysis that attempts to correct for many possible econometric biases in previous research on takeover defenses, Bhagat and Jeffreis (2002) conclude antitakeover measures are not effective in preventing takeovers or in enhancing management's job tenure – in other words, they do not do a good job of insulating managers from the consequences of poor performance or ineffective governance.

With regard to change-of-control severance packages, Narayanan and Sundaram (1998) show that golden parachute awards have no impact on firm performance, nor on the likelihood of a firm being taken over.[22] Similarly, despite Manne's conjecture (see Note 21) that target managers' stock-based compensation contracts may have led them to expropriate value from their shareholders, there is, as yet, no empirical evidence to back up that assertion – it is a wide open issue for further research. Some have suggested that the stakeholder statutes enacted by states have been used by directors as takeover shields. By the early 1990s, thirty states in the U.S. had enacted such statutes (also called "constituency statutes"; McDaniel, 1991) that allowed directors to consider the interests of non-shareholder constituencies in corporate decisions. But the net effect of these statutes were marginal. Studies concluded that they did little to alter the centrality of shareholder primacy in U.S. corporate law (Singer, 1993; Springer, 1999).

On the surface, therefore, the sum total of the empirical evidence on the effectiveness of antitakeover defenses and stakeholder statutes would suggest that boards of public targets are perhaps doing a reasonable job of value-capture, in the sense of attempting to maximize their shareholders' value in takeover situations.[23] There is certainly no empirical evidence that can point to target boards systematically doing the reverse.

CONCLUDING REMARKS

The phenomenon of M&A is here to stay. Despite the lull in activity in the early 2000s – which probably just reflects the general slowdown in investment spending accompanying a worldwide recession – there is little doubt that it will continue to be a major vehicle for strategy implementation for global corporations.

The most widely accepted item of conventional wisdom with regard to M&A has it that acquirers' boards should prepare to be disappointed, and that value creation is extremely difficult. However, as we saw above, that wisdom pertains only to a relatively small slice (albeit, larger as a proportion of the total value) of the overall M&A activity, those that involve large, stock-based acquisitions of public targets. A strategy of growth through *non*-public targets or of public

target acquisitions using cash is not viewed as acquirer value-neutral (let alone value-reducing) by the financial markets. Quite the opposite. Even in the case of large, stock-based public target acquisitions, the "disappointment" that the acquirer should prepare for is relative: If it turns out that such acquisitions are likely to be less disappointing than the alternative, that may not be such a bad thing. As to value creation being a difficult thing to achieve, one might argue that is true for *any* source of value, not just acquisitions. As to the effectiveness of target boards, the evidence would seem to suggest that they are, at least on the surface, doing an adequate job of taking care of their shareholders' interests.

However, the disappearance of hostility, leverage, and cash during the 1990s do create cause for concern. If corporate combinations are the outcome of no more than friendly deals with emphasis on risk-sharing between the acquirer and the target through the use of stock swaps, the market for corporate control could cease to be the disciplining mechanism that it once was. In a situation in which the other mechanisms of governance are either ineffective or have become co-opted, the weakening of this important external force for improved governance would be an extremely unwelcome development for the economy.

NOTES

1. Marris (1964) is also sometimes credited with independently having coined this phrase.

2. For an excellent summary of the U.S. evidence from a managerial perspective, see Bruner (2001); for a summary of the strategic management literature see Datta, Pinches and Narayanan (1992); for the non-U.S. and cross-border evidence, see Denis and McConnell (2003).

3. However, as we will see, the market share of U.S. firms in M&A transactions dropped sharply during the 1990s relative to the 1980s despite the fact their volume increased three-fold, suggesting that it became a phenomenon of worldwide scope. In other words, while the market for corporate control became a fairly mature phenomenon in the U.S. during the decade of the 1980s, it took another decade for it to catch on in the rest of the world.

4. The best example of this perspective is Jensen and Meckling (1976), which, building on the earlier works of Coase (1937), and Alchian and Demsetz (1972), argues that incentives of corporate managers to maximize shareholder value is proportional to the fraction of the firm's shares they hold in their personal portfolios. This view of the governance problem, one that focuses on just the relation between the firm and its capital providers has become so dominant in the literature that it is almost automatically accepted. For example, in a comprehensive summary of the corporate governance literature in finance, Shleifer and Vishny (1997, p. 738) define corporate governance as the process "that deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment," and readily admit that their ". . . perspective on corporate governance is a straightforward agency perspective, sometimes referred to as the separation of ownership

and control." See Bradley, Schipani, Sundaram and Walsh (1999) for a more detailed discussion of these issues.

5. Subsequent empirical work (e.g. Berkovitch & Narayanan, 1993; Hayward & Hambrick, 1997) found support for Roll's hubris hypothesis.

6. Thus, the average target was purchased for $132 million.

7. This conclusion is strengthened by the fact that acquisitions of foreign companies by U.S. acquirers rose from 1.6 to 5.2% of all transactions from the 1980s to the 1990s, while acquisitions of U.S. companies by foreign acquirers fell from 10.9% of all transactions to 4.9%. This also suggests that M&A activity had begun to move substantially outside the geographic boundaries of the U.S.

8. This has changed in the recent past, as some researchers have begun to focus more attention on non-public targets: see, for example, Hansen and Lott (1996), Chang (1998), and Fuller, Netter and Stegemoller (2002). We will address them in greater detail in the next session.

9. A vast majority (nearly 95% as recorded by the SDC database) of non-public target acquisitions involve just two categories, those that are privately held (i.e. typically owner-managed or controlled) and those that involve sales of subsidiaries or divisions of larger firms.

10. Even if we were to focus on the total value rather than number, non-public targets represent about half, a sizeable proportion.

11. The definition of what constitutes "hostile" is prone to considerable subjectivity, and measurements vary depending on the definition and the data source used. Some scholars believe that this is not a particularly meaningful distinction, since it is in the "eyes of the beholder" and many so-called hostile deals share the characteristics of friendly deals (see Schwert, 2000, who also examines the measurement differences that arise when different data sources are used). Interestingly, many M&A practitioners often say the opposite: That there is no such thing as a "friendly" acquisition and that all acquisitions are characterized by varying degrees of unfriendliness! In any event, data on hostility are not as useful for precise measurements as they are for examining trends over time – i.e. for any given definition, we can compare two different eras to make sensible judgments about the relative importance of that particular definition of the phenomenon.

12. Using a different definition of hostility (and different data source), Andrade, Mitchell and Stafford (2001) report 14% of public target acquisitions were hostile during the 1980s and 4% during the 1990s, showing a trend (and relative proportions) similar to that from the SDC data we report here.

13. The author's results are based on an analysis of approximately 2,300 public target and 10,200 non-public target acquisitions undertaken by publicly listed U.S. firms during the 1990s, and is ongoing research at the time of writing.

14. This is consistent with the −0.37% acquirer excess return documented by Mulherin and Boone (2000) for the period 1990–1999.

15. Hansen and Lott (1996) were the first to examine non-public target acquisitions, followed by Chang (1998) – both studies, however, suffer from small sample sizes. Fuller, Netter and Stegemoller (2002) examined non-public target acquisitions in detail, however, their acquirer sample was restricted to acquiring firms undertaking four or more acquisitions.

16. See, e.g. Sirower (1997) and Bruner (2001).

17. All of this evidence would also seem to be bolstered by studies on the long-run stock market performance of acquiring firms, many of which suggest that acquiring firms,

especially those that use stock or acquire "glamour" (as opposed to "value") targets underperform their benchmarks (see, e.g. Loughran & Vijh, 1997; Rau & Vermaelen, 1998). However, the evidence from these studies may be of somewhat limited practical value as they have been critiqued as being fraught with statistical problems that raise questions regarding their power to sort the "good" from the "bad" (see, e.g. the critiques in Barber & Lyon, 1997; Welch & Ritter, 2002).

18. Recalling the well-known example (and one that is now commonly commented upon as being a failure), that of AOL's acquisition of Time Warner, the Shleifer-Vishny argument would suggest that AOL's board probably did the right thing by their shareholders. Consider that, although the acquisition, in all likelihood, destroyed AOL shareholder value in the longer run, that value destruction may have been smaller than what might have resulted if AOL had done nothing, but instead, allowed its stock price to be treated as just another dotcom play when the bubble burst!

19. Krugman (2002) reports that in 1999, the average annual real compensation of the Fortune 100 CEOs ($37.5 million) was over 1,000 times the pay of ordinary workers.

20. Prior to the 1980s, boards relied on the business judgment rule. The business judgment rule gave wide leeway to directors to respond to a tender offer without fear of personal liability. Delaware courts found this to be an inherent conflict between the directors and shareholders, and applied a higher standard of scrutiny to the actions of directors, resulting in the ruling that, when boards determine that a change of control is inevitable, their duty is to agree to the highest price possible for shareholders (the "Revlon" standard). The law in Delaware then further developed to allow the board the discretion to "just say no" to a cash tender offer. Many other states have since adopted a similar rule.

21. Manne (2002, p. A18) also implies that the extensive use of stock and friendliness in takeovers had essentially become a form of side-payment to incumbents at the expense of shareholders: "The compensation paid to managers for such a change [of control] may take the form of a lucrative consulting arrangement, stock or stock options in the acquiring company, a generous severance package, or some other bonus. But the salient fact in each of these situations is that the managers and not the shareholders receive the premium being paid for control."

22. Bebchuk, Coates and Subramanian (2002) argue that staggered boards do act as an effective takeover deterrent. But weighed against the rest of the empirical evidence on the ineffectiveness of antitakeover defenses (and given the relatively small sample size in their analysis), it appears hard to escape the conclusion that takeover defenses are placebo rather than poison.

23. This raises a larger puzzle. Many of the targets were once acquirers themselves. The question that arises is, why are firms effective capturing returns to their shareholders as targets, but not so effective in their role as acquirers?

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