Do Acquiring Firms Achieve Their Mergers and Acquisitions Objectives? —Evidence from Japan—

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• Introduction

• Literature review and hypotheses development

• Research design

• Results

• Conclusions
IASB (2020) “Business combinations—disclosures, goodwill and impairment”
IASB (2020) “Business combinations—disclosures, goodwill and impairment”

• IASB proposed that acquiring firms disclose:

  - the strategic rationale behind their acquisitions, as well as management’s objectives for acquisitions
  - the metrics to monitor their post-acquisition performance
  - whether their projections are fulfilled several years after acquisitions
Reactions to IASB (2020)’s proposal

- It generated mixed reactions from practitioners:
  - The new requirements could be beneficial for users of financial statements (JICPA, 2020; SAAJ, 2020)
  - The proposed disclosures are highly costly and contain a large amount of confidential information (Keidanren, 2020)
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Literature review
(1) M&A objectives

• A primary reason for M&A is to create synergies such as improvements in management efficiency.

• Financial factors such as stock overpricing can also drive M&A.

• Managers conduct M&A to achieve personal goals such as maximizing their compensation.
Literature review

(2) M&A performance

• Acquiring firms earn small or no announcement returns, while acquired firms earn significant positive returns.

• Mixed results have been reported regarding long-term stock/accounting performance after M&A.

• It is unclear whether the stock market is sufficiently efficient when a M&A is announced.
Literature review

(3) Effects of narrative disclosure

- Narrative disclosure conveys new information to investors

- Narrative disclosure in financial statements is sometimes criticized as being “boilerplate”

- JICPA (2020) expressed concern that the new requirements could simply lead firms to present superficial information
Hypothesis 1: Operating performance

- A primary reason for M&A is the creation of synergy
- Managers sometimes conduct M&A for self-gain
- Rational managers are likely to disclose concrete M&A objectives

*When acquiring firms mention profitability, efficiency, or growth as M&A objectives, their financial indicators show greater improvements, compared with firms that do not.*
Hypothesis 2: Stock returns

• M&A do not necessarily result in positive outcomes for acquiring firms

• If managers mention concrete M&A objectives, those can be interpreted as a good indicator that the deal is not conducted for managers’ self-gain

• Therefore, concrete narrative disclosure is likely to be evaluated more positively by investors

When acquiring firms mention profitability, efficiency, or growth as M&A objectives, they experience higher stock returns, compared with firms that do not.
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Sample

- 232 M&A transactions in Japan were extracted

- Japan can be considered a desirable research site for several reasons:
  - Japanese stakeholders’ preference for conservatism in goodwill amortization
  - M&A transaction volume has rapidly increased in Japan
  - Therefore, detailed disclosures about M&A objectives are likely of interest to many conservative Japanese stakeholders
Sample

- M&A objectives are disclosed twice
  - (1) Press releases
  - (2) Financial statements

- Keywords related to M&A objectives were extracted and classified into three categories:
  - Profitability
  - Efficiency
  - Growth
Concrete objectives are more frequently mentioned in press releases than in financial statements.
• Relatively large deals are more likely to include disclosure of concrete objectives.
Cross-industry deals are less likely when firms pursue profitability improvements.
Methodology
H1: Operating performance

- This study assessed whether acquiring firms’ financial indicators showed improvements

- **Profitability**
  - Operating profit on sales
  - Ordinary profit on sales

- **Efficiency**
  - Total assets turnover
  - Fixed assets turnover

- **Growth**
  - Sales growth
  - Total assets growth
Methodology
H2: Stock return

- This study assessed acquiring firms’ stock returns by comparing:
  - (1) M&A where the keywords profitability, efficiency, or growth were mentioned to
  - (2) M&A where none of these keywords were mentioned

\[
\text{CAR}_i = \sum_{t} A\text{R}_{i,t}
\]

\[
\text{BHAR}_i = \left( \prod_{t} (1 + R_{i,t}) \right) - \left( \prod_{t} (1 + R_{m,t}) \right)
\]
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H1: Operating performance (description in press releases)

M&A objectives presented in their press releases were not realized on average:

- Profitability (Operating profit on sales)
- Efficiency (Total assets turnover)
- Growth (Sales growth)

: Statistically significant difference
H1: Operating performance (description in financial statements)

M&A objectives presented in their financial statements were not realized on average.

- Profitability (Operating profit on sales)
- Efficiency (Total assets turnover)
- Growth (Sales growth)

: Statistically significant difference
H2: Stock return
(description in press releases)

- M&A objectives presented in their press releases were not valued by the stock market.
H2: Stock return (description in financial statements)

- M&A objectives presented in their financial statements were positively valued only in the short term.
## Discussion

- Short-term higher stock returns after submission of financial statements, but not after press releases

<table>
<thead>
<tr>
<th>Press releases</th>
<th>Financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concrete objectives are more frequently used</td>
<td>Succinct description better conveys the specific objectives?</td>
</tr>
<tr>
<td>Mentioning M&amp;A objectives that apply to most M&amp;A?</td>
<td>Related information (e.g. overall performance, future investment plan) helps investors?</td>
</tr>
<tr>
<td>Obscuring the objectives specific to each deal?</td>
<td></td>
</tr>
</tbody>
</table>
Additional analyses

• No significant difference in stock returns “1 year” after the M&A or later

• To examine this point further, the group of firms that included either of the keywords was divided into a subgroup of firms:
  - (1) those that saw improvements in their financial indicators
  - (2) those that did not
Stock returns by improvements in operating performance (description in press releases)

- Acquiring firms that saw improvement in their financial indicators earned higher long-term returns.

CAR by:
- Growth improvements
- Efficiency improvements
- Profitability improvements

Exhibited improvements (n=38)
No improvements (n=78)

: Statistically significant difference
Stock returns by improvements in operating performance (description in financial statements)

Acquiring firms that saw improvement in their financial indicators earned higher long-term returns

- CAR by profitability improvements
- CAR by efficiency improvements
- CAR by growth improvements

: Statistically significant difference
Robustness tests
(1) Heckman’s two-stage treatment effect approach

- Factors that can affect the firms’ decision to mention concrete objectives are controlled

\[ MENTION = \text{Probit} (\beta_0 + \beta_1 CROSS + \beta_2 SIZE + \beta_3 RELSIZE + \beta_4 OP SALES + \beta_5 TATRUNK + \beta_6 GROWTH + Industry\ dummy + Year\ dummy) \]
Robustness tests
(1) Heckman’s two-stage treatment effect approach

- Results in the main analysis hold when controlling self-selection bias

Panel B: Second stage

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>CAR (2 months)</th>
<th>CAR (1 year)</th>
<th>CAR (2 years)</th>
<th>CAR (3 years)</th>
<th>BHAR (2 months)</th>
<th>BHAR (1 year)</th>
<th>BHAR (2 years)</th>
<th>BHAR (3 years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>\textit{MENTION}</td>
<td>0.042**</td>
<td>0.010</td>
<td>0.000</td>
<td>-0.007</td>
<td>0.042**</td>
<td>0.024</td>
<td>0.040</td>
<td>0.071</td>
</tr>
<tr>
<td></td>
<td>(0.016)</td>
<td>(0.042)</td>
<td>(0.048)</td>
<td>(0.033)</td>
<td>(0.017)</td>
<td>(0.049)</td>
<td>(0.069)</td>
<td>(0.078)</td>
</tr>
<tr>
<td>\textit{LAMBDA}</td>
<td>-0.028</td>
<td>0.041</td>
<td>0.081</td>
<td>0.029</td>
<td>-0.034</td>
<td>0.081*</td>
<td>0.086</td>
<td>0.129</td>
</tr>
<tr>
<td></td>
<td>(0.034)</td>
<td>(0.040)</td>
<td>(0.052)</td>
<td>(0.080)</td>
<td>(0.038)</td>
<td>(0.044)</td>
<td>(0.070)</td>
<td>(0.089)</td>
</tr>
<tr>
<td>Intercept</td>
<td>0.009</td>
<td>0.060</td>
<td>0.124**</td>
<td>0.239***</td>
<td>0.014</td>
<td>0.020</td>
<td>0.100</td>
<td>0.146*</td>
</tr>
<tr>
<td></td>
<td>(0.026)</td>
<td>(0.036)</td>
<td>(0.041)</td>
<td>(0.042)</td>
<td>(0.029)</td>
<td>(0.039)</td>
<td>(0.061)</td>
<td>(0.069)</td>
</tr>
<tr>
<td>Adjusted R-square</td>
<td>0.010</td>
<td>-0.007</td>
<td>-0.004</td>
<td>-0.008</td>
<td>0.008</td>
<td>-0.003</td>
<td>-0.008</td>
<td>-0.006</td>
</tr>
</tbody>
</table>
Robustness tests
(2) Propensity score matching

- Treatment group is matched with control group based on propensity score

Control (not mention)  

Treatment (mention)  

Low  

High  

Propensity score  
(Probability to mention concrete objectives)

Matched for testing H2

Excluded

Excluded
Robustness tests

(2) Propensity score matching

Results in the main analysis hold when controlling self-selection bias

<table>
<thead>
<tr>
<th>Difference (p-value)</th>
<th>2 months</th>
<th>1 year</th>
<th>2 years</th>
<th>3 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Difference (p-value)</td>
<td>4.0% (0.048)</td>
<td>-5.0% (0.404)</td>
<td>-10.6% (0.166)</td>
<td>-15.0% (0.100)</td>
</tr>
</tbody>
</table>

Panel A: CAR
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Conclusions

• Disclosed M&A objectives were not realized on average in terms of financial indicators related to profitability, efficiency, and growth

• In the short period, acquiring firms earned higher stock returns when concrete M&A objectives were mentioned in the financial statements

• In the long run, the stock market adjusted firms’ valuation based on their actual performance
Implications

• Results partially support the IASB’s proposal
  - The M&A objectives presented in narrative disclosure statements are rarely realized
  - Narrative disclosure might mislead investors in the short term, resulting in the overpricing of acquiring firms

• Concern that the IASB’s proposal could lead to more “boilerplate” disclosures remains valid
  - More discussion is needed regarding how to develop effective requirements for narrative disclosure to reflect firms’ actual performance
Thank you!