

**Maria L. Goranova**  
Ph.D. Candidate/ABD  
Syracuse University

## **SUMMARY OF DISSERTATION PROPOSAL**

### **On Both Sides of the Deal: How Overlapping Institutional Owners affect Mergers and Acquisitions?**

Mergers and acquisitions (M&A), as representing corporate decisions that can fundamentally change the value of the firm (Sirower, 1997) have been an integral part of the management research. The extant literature had cast considerable doubts on the ability of mergers and acquisitions to create value above and beyond the respective values of the merging companies, or the target and the bidder, and in contrast, has warned about the value destruction potential of such deals. In practice, however, M&A are more widespread than ever and are often accompanied by significant losses for shareholders, thus raising questions about the ability and motivation of corporate managers. The investigation of the antecedents of the wealth destruction in the context of mergers and acquisitions is even more pertinent in the light of massive losses reported by Moeller et al. (2005) (i.e. acquiring firms shareholders lost \$240 billion from 1998 through 2001), as well as the historical persistence of M&A waves.

Prior literature has recognized the potential for agency problems behind M&A, in particular that managers may pursue acquisitions in order to increase their compensation, enhance their reputation and visibility or to reduce their employment risk (Amihud & Lev, 1981; Denis et al, 1997). Such pursuit of self-interest on the part of managers should be constrained by corporate governance mechanisms. Recently, institutional investors as

sophisticated owners that can analyze, evaluate, and compare companies more efficiently, embodied the promise of better and more effective monitoring. Yet this promise has remained largely unfulfilled (Edwards & Hubbard, 2005). Thus the question arises, why more shareholders' wealth is destroyed in a time when influential owners such as institutional investors have more ownership, power and are more vocal than ever.

The present paper draws on recent management research suggesting that different owners have heterogeneous and at times conflicting interests, as well as differential impact on organizational outcomes (eg. Hoskisson et al, 2002; Tihanyi et al 2003; Brickley et al. 1988; Kochhar & David, 1996; David et al. 1998; Johnson & Greening, 1999; Thompson & Pedersen 2000; Ryan & Schneider, 2002). Such heterogeneity among owners' interests could limit their aggregate monitoring ability and thus facilitate managerial pursuit of self-serving goals. For example, institutional owners as fiduciaries are obliged to make prudent investments under the trust law, and thus tend to hold diversified portfolios (Brancato, 1997). In practice, some institutional owners hold stock not only of the acquiring firm, but also of the target firm, making it unlikely that they will have the same interests or face similar wealth effects as the non-overlapping owners. Such heterogeneous interests among owners, however, may dilute the accountability of agents, which in turn could be conducive to managerial hubris and lead to value-destroying deals. By investigating the ownership profile of both acquirers and targets, I propose that owners' conflicting interests facilitate agency problems and thus exacerbate agency costs, as managers can pursue their own interests at the expense of the firm while managing appearances of acting in the interest of (some) shareholders.

**Hypothesis 1:** *Overlapping institutional ownership in the acquirer and the target firms will be positively related to the shareholder losses for the acquiring firm.*

**Hypothesis 2:** *Overlapping institutional ownership in the acquirer and the target firms will be positively related to the transaction value of the deal.*

**Hypothesis 3:** *Overlapping institutional ownership in the acquirer and the target firms will be negatively related to the total shareholder gains for the both firms.*

**Hypothesis 4:** *Overlapping institutional ownership in the acquirer and the target firms will be positively related to the shareholder gains for the target firm.*

## **Method**

**Study Sample.** A sample of mergers and acquisitions that were announced in the period 1998-2004 was obtained from Bloomberg database. Financial and ownership data is obtained from CRSP, Compustat and CDA/Spectrum Thomson Financial's 13F database.

**Dependent variable.** Three measures of shareholders gains/losses were calculated, the first two are based on the Market adjusted returns (MAR) and Cumulative abnormal returns (CAR), and multiply the calculated aggregate abnormal returns by the market value of the firm 2 days prior to the announcement of the deal. A third measure directly follows Moeller et al. (2005) approach by subtracting the market value on the day following the announcement from the market value 2 days prior to the announcement of the deal. Cumulative abnormal returns (CAR) and market adjusted returns (MAR) for the three days (-1,+1) surrounding the announcement of the merger or acquisition were calculated following the method outlined in Brown & Warner (1985).

**Independent variables.** Overlapping ownership is measured with the number of institutional investors that own stock in both the acquiring and the target firm. Furthermore the percentage owned by overlapping owners in the acquiring firm, as well as in the target, was calculated. All ownership data was extracted from CDA/Spectrum Thomson Financial's 13F database for the quarter preceding the M&A announcement.

**Controls.** Following prior research (e.g. Moeller et al., 2004; Sanders, 2001; Amihud & Lev, 1981; Morck, Shleifer and Vishny, 1990; Lang, Stulz, Walkling, 1989; Wright et al., 1996; Carrow, Heron and Saxton, 2004; Haunschild, 1993), I control for firm size, performance, growth opportunities and cash flows. Data for financial control variables was extracted from Compustat annual tapes; all financial controls used in the analyses are measured at the end of the year before the date of the M&A event. Furthermore, data on the deal characteristics used by prior research was extracted from Bloomberg mergers and acquisitions database. These include whether the deal is diversifying or not, method of payment, whether the deal is hostile, final ownership stake, and whether the deal is completed. Finally in order to account for the cyclical nature of the M&A activity I use dummy codes to control for year effects.

## **Results**

Across all three measures of gains overlapping ownership is negatively related to acquiring firm's shareholder returns. Consistent with the hypothesis 2, overlapping ownership is positively related to the transaction value of the deal. The results of this analysis are consistent with the shareholder returns for the acquiring and the target firm, since managers that overpay for the acquisition may expect to detract from their firm

value, while the shareholders of the overpaid for entity would benefit. Similarly Palepu, Healy and Bernard (2000) suggest that if an acquirer offers a relatively high premium, financial analysts typically believe that the transaction is less likely to create value for the acquiring firm shareholders.

Although a value transfer hypothesis would suggest no effect of the overlapping ownership on the aggregate value created for the shareholders of both entities, I find that overlapping ownership is negatively related to the total (combined) shareholder value. Thus in the presence of heterogeneous effects managers face less restraint in conducting inefficient and value-destroying deals, therefore providing support for hypothesis 3. Furthermore, consistent with the overpaying hypothesis, overlapping ownership is significantly positively related to target gains across all three measures of gains investigated.