M&A activity and the survival of European IPO candidates

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Abstract

This thesis uses 3,134 European IPO firms since 1991 to 2015 to determine the impact of post-IPO acquisition behavior on long-term performance, likelihood of delisting and survival profile. The findings show that serial acquirers exhibit long-run underperformance as measured by value- and equally-weighted daily abnormal portfolio returns. Becoming an acquirer in one year post-IPO, increases the likelihood of delisting, acquiring in later periods does not. Cox PH model results show the hazard of delisting is lower for frequent acquirers, with acquisition deals three and five years post-IPO. No evidence suggests high delisting rates of IPOs are a result of acquisitions.

Project definition

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Executive summary

The main motives of going public, among others, are to pursue external growth, finance expansion and enjoy better access to capital. The repercussions of the decisions made during the post-IPO phase, as Jain and Kini (1999) phrase it, make the firm to evolve and, in course of time, to become an acquisition target, surviving self-sufficient or even failed entity. The main aim, at least to owners and managers of the firm, is to maintain good performance and maximize profits, which implicitly means that firms are able to maintain their reputation, corporate identity and capital stability. By that, the measure of ultimate superior performance can be the survival of the firm.

Despite the fact that IPOs are often seen as confident issues with promising future prospects (Stoughton et al., 2001), five years after going public, the percentage of delisted IPOs ranges from 9.2% to 47.2% across countries and time spans (Bennouna, 2015). Literature has alredy pinned down various IPO (deal and firm) characteristics to have an impact to the survival of the IPO. However, these inferences, to the best of author's knowledge, are limited to the markets outside Europe. Revisiting the impact of IPO characteristics on survival, this paper aims to provide evidence from the European IPO market as a whole. When comparing Europe to the US market, where most of the research on this topic rests, authors point out to the clear distinction between the general performance of these two arenas in terms of size and differences in set of regulations. This makes Europe as a whole, an interesting area to investigate further. Complementary to the logit analysis, as commonly used in the stream of literature for IPO survival, I also use survival analysis (Cox proportional hazard model), which facilities consideration of the duration of how long the IPO has survived.

In the light of taking corporate decisions as an important determinant to the long-term performance and ultimate survival of the firm, I also investigate in detail IPOs with acquisition activities and if corporate takeovers have an impact to long-term performance and survival. IPOs seek growth and expansion to new markets and often use the raised capital from the public issue to finance their objectives and to facilitate later acquisitions. In addition to this, the existing long-term performance puzzle as documented initially by Ritter (1991) and Loughran and Ritter (1995) is partly explained through the acquisition factor of IPOs (Brau et al., 2012). As IPOs have high level of capital infusion from the proceeds, the managers are prone to heavy investing (Brau et al., 2012, Titman et al., 2004), even at the risk of building empires of lower value. This would lead to long-term underperformance as soon as the market corrects for the irrationality. Besides this, the lack of experience in the public markets make IPOs dawning players to integrate consequent acquired targets, which in turn results in long-term underperformance.

I revisit long-term IPO performance, taking into account the acquisition activities in the first few years after going public. I use calendar-time daily portfolios to measure performance based on the Fama-French three factor model, together with the momentum factor (Carhart, 1997). The results show that serial acquirers exhibit significant long-term negative daily abnormal returns of around 1.00%. The underperformance slightly varies as per the usage of value- and equally-weighted portfolios, and the inclusion of momentum factor. The sign is however persistent when accounting to acquisition behavior in the one or three years post-IPO.

In addition, as IPOs are more likely to have accelerated growth after the public issue, and are more prone to do acquisitions, I argue that they lack capabilities to incorporate the fast external growth to their shortly (in terms of presence in the public market) established premises. By that, IPOs that do frequent acquisitions soon after going public reach limits to growth, which complemented with inability to integrate fastly acquired targets, are more likely to fail over time. The results however show the opposite. Becoming an acquirer in one year post-IPO, increases the risk of delisting, whereas acquiring in later periods does not, when accounting to control IPO deal charactersitics. The Cox PH model results show the hazard of delisting is lower for frequent acquirers, with acquisition deals three and five years post-IPO. No evidence is found to support the idea that IPOs are unable to incorporate the targets they pursue for external growth. Instead, the high monitoring they receive from investors and the public eye may put more pressure to seek valuable projects. Afterall, the general conclusion provided in the study by Bessler and Zimmermann (2011) that European IPOs are able to capitalize on economies of scale seems also as a reasonable implication of the results.

Even though this study closely follows the existing literature for IPOs with respect to acquisitions, much of the already established M&A wisdom has not been incorporated. By that, next issue to consider is the characteristics of the M&A deals IPOs engage in. Furthermore, the difference between these conclusions, as opposed to the traditional wisdom from M&A literature that acquisitions bring low value to shareholders, may be partly attributed to the performance measure. Announcement acquisition returns, as a main measure for shareholder wealth, compared to ultimate survival of acquiring firms, do not bring aligning results. For future research, it should be also evaluated if acquisition deals with lower benefits to shareholders turn out to be benefitial afterall when considering the hazard of delisting.