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A New Hypothesis on the Determinants of Acquisitions

Nigel Garrow

Introduction

Merger and acquisition (M&A) activity is a significant factor in business in most advanced economies. According to Thomson Reuters, the value of M&A deals completed globally during the 12 months to November 2009 was US$1.8 trillion. However, the acquirers’ shareholders often lose value. Much of the literature on M&A is centred on the UK and US markets, with only a modest level of research within Australia.

This paper suggests a new proposition to explain why M&A activity may be value destroying for the acquirers: Success or failure for the acquiring firm’s shareholders in M&A is a function of the combined tenure, personal motivation, and recent performance of the Chairman and Chief Executive Officer (CEO) of the acquiring firm. This examination of the combined effectiveness of the Chairman and CEO is not something that appears to have been undertaken before. The paper will present the constituent hypotheses of the main proposition, followed by a literature review, a presentation of findings from a pilot study, conclusions and next steps.

Four constituent hypotheses, each of which refers to the performance of the Chairman and CEO, arise out of the pilot study:

**Hypothesis 1.** The length of time that the Chairman and CEO of the acquiring firm have been together in their respective positions at the time of the acquisition will determine the success or otherwise of the outcome of the acquisition.
Hypothesis 2. The personal motivation of the CEO and Chairman will determine the M&A activity within the acquiring firm.

Hypothesis 3. The stability of the acquirer’s strategy during the three year period prior to the acquisition and the performance of the acquirer during that three year period will influence the prospect for success for the acquirers’ shareholders; the longer the joint tenure of the Chairman and CEO then the more stable will be the acquirer’s strategy and the firm’s performance will be better.

Hypothesis 4. The premium paid for a target firm will be greater the longer the period of joint tenure by the Chairman and CEO and when the largest shareholders of the acquiring firm also own a significant share of the target firm.

Literature Review

A number of long run M&A event studies (Firth, 1980, Tichy, 2001, Tuch and O'Sullivan, 2007) have found that acquirers' shareholders lose value whilst target firm shareholders gain value. In a study of 420 acquisitions in the UK across the period 1984-1992 Gregory (1997) concluded that ‘takeovers were, on average, wealth reducing events for acquiring companies’ (Gregory, p.972). Agrawal et al (1992) came to a similar conclusion in a large scale study in the US of mergers and acquisitions during the period 1955-1987, with stockholders of acquiring firms losing value during the five years following the merger.

Many factors shape a bid, and these can materially affect the outcome for the shareholders. Tuch and O'Sullivan (2007) reviewed a number of studies which examined these factors finding that the acquisition of hostile targets, transactions that are paid for with cash and
acquisitions of larger targets are associated with superior (or less negative) performance, while there is mixed evidence on the benefits of related acquisitions. Also of interest in their review was that firms with high P/E’s at the time of acquisition tend to perform worse than previously during the period after the acquisition completion than firms with low P/E’s; they suggest that hubris could be an explanatory factor.

Australia has limited M&A literature, ranging from topics which are quite specific to the Australian market such as independent expert reports (Eddey, 1993, Bugeja, 2005), to more general reviews on Australian takeovers (McDougall et al., 1986, Bishop et al., 1987) which between them cover the period 1970-1985. A number of papers have been written about M&A in the banking and financial services market, with considerable attention being given to the efficiency and competitive effects of such activity in Australia, particularly in the context of the ‘Four Pillars Policy’ (Harper, 2000, Valentine and Ford, 2001, Goddard and Walker, 2002, Neal, 2004, Wu, 2008). Contrary to some international studies, Bishop et al (1987) in their study of over 1400 takeovers in Australia concluded that ‘on average shareholders gain considerably when they own shares of companies involved in takeover transactions’ (a finding generally supported by Malone and Ou (2008)); ‘shareholders of target firms gain most, but shareholders of bidding firms also gain’ (Bishop et al, p.x).

Sharma and Ho (2002), who studied 36 Australian acquisitions between 1986 and 1991, had a number of observations, which challenged earlier findings on M&A, noting that management self-interests (agency hypothesis) are an important motivator in Australian acquisitions, whilst not disregarding the hubris hypothesis.
Pilot Study

The pilot study involved the examination of a small sample (five) of large acquisitions completed in Australia during the period August 2001 to May 2005. The acquisitions were identified from the ThomsonOne database and were selected on the basis that they involved ASX listed firms for which the annual reports of both the acquirer and target were available from the Aspect Huntley database. Each of the acquisitions was for a transaction value in excess of $200 million, and the date of completion meant that at least three annual report periods were available after the acquisition.

The summary details of the acquisitions in the pilot study are as follows:

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Target</th>
<th>Completion Date</th>
<th>Acquirer Net Assets at or near Completion</th>
<th>Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wesfarmers</td>
<td>Howard</td>
<td>August 2001</td>
<td>$1,617m</td>
<td>$2,023m</td>
</tr>
<tr>
<td></td>
<td>Smith</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Burns Philp</td>
<td>Goodman</td>
<td>June 2003</td>
<td>$758m</td>
<td>$2,000m</td>
</tr>
<tr>
<td></td>
<td>Fielder</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Symbion/Mayne</td>
<td>Faulding</td>
<td>October 2001</td>
<td>$1,410m</td>
<td>$2,355m</td>
</tr>
<tr>
<td>Fosters</td>
<td>Southcorp</td>
<td>June 2005</td>
<td>$4,600m</td>
<td>$3,200m</td>
</tr>
<tr>
<td>Healthscope</td>
<td>Gribbles</td>
<td>December 2004</td>
<td>$137m</td>
<td>$288m</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Each of the acquisitions was significant in size for the acquirer, reflected in the relationship between the consideration and the acquirers' net assets prior to the acquisition.
For each firm involved in these acquisitions their annual reports were examined for the three year period prior to the acquisition and for the acquirers the three year period after the acquisition. The main financial performance measures adopted in this analysis were net profit after tax (NPAT), net debt, NPAT/Net Assets, and share price.

**Hypotheses**

The Pilot Study has suggested a new proposition, related to the period of joint tenure of the Chairman and CEO of the acquiring firm, and a series of supporting hypotheses as follows:

Hypothesis 1. The length of time that the Chairman and CEO of the acquiring firm, have been in their respective positions at the time of the acquisition will determine the success or otherwise of the outcome of the acquisition.

The first hypothesis suggests that joint tenure will influence the outcome of an M&A transaction, and that this could be positive for acquirer shareholders. In today’s Australian board rooms there is often just one executive member of the board, the CEO, with the remainder being non-executive directors led by the Chairman.

No research has been identified which specifically examines the importance or otherwise of joint Chairman and CEO tenure in normal business situations, let alone as it may apply in an M&A context. The literature that does exist regarding tenure tends to focus on individual roles. In a US study Henderson et al. (2006) found that firm-level performance improved steadily with tenure in the ‘stable’ food industry. Executive turnover in acquired firms tends to be high (Walsh, 1988, Bergh, 2001, Krug and Shill, 2008) and has an adverse effect on M&A outcomes. Poor performance is likely to trigger CEO change, and that in turn will
instigate other changes (Henderson et al., 2006); conversely, successful organizations with long tenured CEO's are less likely to undertake strategic change (Boeker, 1997).

In the pilot study the tenure of both the Chairman and CEO from the acquiring firm, prior to the acquisition, was examined and compared with the NPAT and NPAT/Net Assets of the acquirer for the three year period after the acquisition, as follows:

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>NPAT growth 3 years post completion vs. completion year</th>
<th>Joint Chairman and CEO Tenure at Completion (years)</th>
<th>NPAT/Net Assets in each of 3 years post acquisition (%)</th>
<th>Equity vs. Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wesfarmers</td>
<td>+50%</td>
<td>9</td>
<td>12/14/26</td>
<td>Mainly equity</td>
</tr>
<tr>
<td>Mayne/Symbion</td>
<td>-42%</td>
<td>1</td>
<td>5/-15/4</td>
<td>All equity</td>
</tr>
<tr>
<td>Burns Philp</td>
<td>+386%</td>
<td>6</td>
<td>13/51/32</td>
<td>Mainly debt</td>
</tr>
<tr>
<td>Fosters</td>
<td>-88%</td>
<td>1</td>
<td>26/21/3</td>
<td>All debt</td>
</tr>
<tr>
<td>Healthscope</td>
<td>+178%</td>
<td>7</td>
<td>7/10/8</td>
<td>More equity</td>
</tr>
</tbody>
</table>

The greatest improvement in NPAT during the three years following the acquisition arose from those acquisitions (Wesfarmers, Burns Philp, and Healthscope) where the joint tenure of the acquirers' CEO and Chairman were longest, namely 9 years, 6 years, and 7 years respectively. Conversely, the two acquirers who performed poorly as measured by NPAT change during the three years after the acquisition were those where the joint tenure was
just one year at Mayne Symbion and Fosters. In this very small sample, the debt/equity
structure of the transaction appears to have had no marked effect on the outcomes.

Another measure of performance is share price. The movement in share prices across the
period from 12 months prior to completion to three years after completion shows a similar
relationship to joint tenure that the NPAT analysis shows: the longer the joint tenure period
for the Chairman and CEO at the time of the acquisition the more favourable the share price
movement across the four year period. The following chart compares share price
movements at different points in time versus the share price for the acquirer at completion
(C). During the four year period the share price of the three firms with longest joint tenure
increased by the greatest percentage and compared favourably with the ASX change across
the same time period (Wesfarmers +112% versus +8% for the ASX, Burns Philp +61% versus
+58%, Healthscope +95% versus +92%), whereas the share price of Fosters went up just 19%
versus +48%, and the share price of Mayne Symbion fell by 14% versus +16%.

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Share price at (C) vs. 12 months prior</th>
<th>Share price at (C) vs. 4 months prior</th>
<th>Share price 3 months post completion</th>
<th>Share price 3 years post completion</th>
<th>Joint Tenure, years, at Completion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wesfarmers</td>
<td>+104%</td>
<td>+26%</td>
<td>+10%</td>
<td>+4%</td>
<td>9</td>
</tr>
<tr>
<td>Mayne/Symbion</td>
<td>+46%</td>
<td>+16%</td>
<td>-9%</td>
<td>-41%</td>
<td>1</td>
</tr>
<tr>
<td>Burns Philp</td>
<td>-15%</td>
<td>-4%</td>
<td>+36%</td>
<td>+89%</td>
<td>6</td>
</tr>
<tr>
<td>Fosters</td>
<td>+17%</td>
<td>+4%</td>
<td>+7%</td>
<td>+2%</td>
<td>1</td>
</tr>
<tr>
<td>Healthscope</td>
<td>+28%</td>
<td>+9%</td>
<td>+25%</td>
<td>+52%</td>
<td>7</td>
</tr>
</tbody>
</table>
Once the acquisition had been completed three of the CEO’s remained for at least a further 3 years, whereas the CEO of Mayne Symbion left about one year after acquiring Faulding and the CEO of Fosters left about 2 years after the Southcorp acquisition; both of these latter CEO’s were of the shortest tenure of all the CEO’s at the time of completion. Of the chairmen, all except one left their positions within about 2 years of completion.

From the pilot study there seems to be support for Hypothesis 1.

Hypothesis 2. The personal motivation of the CEO and Chairman will determine the M&A activity within the acquiring firm.

Gregory (1997) observed that his findings were more compatible with Roll’s (1986) hubris hypothesis or other ‘managerialist theories of behaviour’ than with shareholder value maximisation (Gregory, p.998). Hypothesis 2 considers the role that the personal motivations of the CEO and Chairman may play in influencing M&A activity and whether these influences are mitigated as a result of longer joint (Chairman and CEO) tenure. Two variables are examined; compensation for the CEO, and hubris.

Hubris is defined in Collins Dictionary (2001) as ‘pride or arrogance, ambition ultimately causing the transgressor’s ruin’. The hubris hypothesis is that decision makers in acquiring firms pay too much for their targets on average; if there are no gains in takeovers, hubris is necessary to explain why managers do not abandon these bids since reflection would suggest that such bids are likely to represent positive errors in valuation (Roll, 1986). Roll’s (1986) fundamental assumption is that markets (financial, product, and labour) are efficient, and that if a rational bidder offers target shareholders more than the market price of their stock then the market has incomplete information regarding the cash flow outlook of the
bidding and the target, and that the bidder has this information. By offering target shareholders more than the market price of their stock then the bidders’ shareholders will lose value in the market equivalent to the premium that is being offered to the target shareholders (excluding any costs which may be incurred in completing the transaction).

To test for hubris in the pilot study the Factiva database was used to identify the number of mentions that each of the Chairman and CEO received in ‘Major News and Business Publications: Australia and New Zealand’ during the 12 month period prior to completion and during the month of completion. The number of combined mentions (Chairman and CEO) was 189 for Fosters, 97 for Mayne Symbion, 67 for Burns Philp, 57 for Wesfarmers, and 24 for Healthscope; there is an inverse relationship between media mentions (measure for hubris) and Joint Tenure, suggesting that hubris may be mitigated by length of joint tenure.

Any discussion regarding remuneration will almost certainly involve consideration of Agency Theory and the relationship between agent and principal. Eisenhardt (1989) questions whether a behaviour-oriented contract (e.g. salaries) is more efficient than an outcome-oriented contract (e.g. stock options)? A motivational factor for a CEO that may result in a drive toward M&A activity is remuneration. Khorana and Zenner (1998) observed that the compensation of acquirers’ executives related positively to changes in firm size prior to an acquisition, whereas the compensation of executives in non-acquiring firms was not related to changes in firm size. The positive effect of mergers on CEO compensation, notably as a result of increases in firm size, was also observed by Bliss and Rosen (2001).
Guest (2009) found that CEO’s are rewarded equally for bad and good acquisitions, that those well rewarded are more likely to re-acquire, and that acquirers’ compensation increases significantly the year following the acquisition but changes moderate thereafter.

In the pilot study, with one notable exception (Burns Philp), the change in the remuneration of the CEO in the year of the acquisition was quite significant and this is consistent with the findings of Guest (2009), as was the finding that in three of these cases remuneration changes moderated after completion. At Healthscope the CEO’s remuneration continued to grow rapidly, potentially a reflection of their continuous programme of M&A activity. In the case of Burns Philp’s CEO remuneration increased significantly two years later, corresponding with a marked increase in the firm’s NPAT.

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Remuneration change at acquisition</th>
<th>Remuneration change 3 years after acquisition vs. yr prior to acquisition</th>
<th>NPAT 3 years after acquisition vs. year prior to acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wesfarmers</td>
<td>+163%</td>
<td>+101%</td>
<td>+146%</td>
</tr>
<tr>
<td>Mayne Symbion</td>
<td>+90%</td>
<td>+115%</td>
<td>-50%</td>
</tr>
<tr>
<td>Burns Philp</td>
<td>-28%</td>
<td>+41%</td>
<td>+466%</td>
</tr>
<tr>
<td>Fosters</td>
<td>+32%</td>
<td>+2%</td>
<td>-86%</td>
</tr>
<tr>
<td>Healthscope</td>
<td>+56%</td>
<td>+99%</td>
<td>+256%</td>
</tr>
</tbody>
</table>
There is neither a discernible relationship between joint tenure and remuneration, nor between NPAT change from the year prior to the acquisition and three years after the acquisition; however, in the case of the two poorest performers in terms of NPAT growth, the CEO of both companies changed. The next stage of this research will explore the relationship between the structure of the CEO compensation and performance. Dey (2008) found that the structure of the compensation is associated with firm performance and that ‘firms with greater agency conflicts have better governance mechanisms’ (Dey, p.1143).

In summary, there is some evidence of an inverse relationship between hubris and joint tenure, and remuneration generally increases quite significantly as a result of a major acquisition, potentially providing support for Hypothesis 2.

Hypothesis 3. The stability of the acquirer’s strategy during the three year period prior to the acquisition and the performance of the acquirer during that three year period will influence the prospect for success for the acquirers’ shareholders; the longer the joint tenure of the Chairman and CEO the more stable the acquirer’s strategy and the better the firm’s performance.

According to Henderson et al. (2006) general managers typically instigate major changes in their first 6-18 months in office, and it takes 2-4 years for a firm to align itself with a new CEO’s paradigm. The inference from Henderson et al. (2006) research is that longer tenure is likely to be associated with a more stable business strategy, whilst changes in CEO are likely to be associated with changes in strategic direction. The five acquisitions examined in this pilot study indicate the benefit to acquiring firm shareholders of continuity of strategy, and
consistency of performance prior to a major acquisition. The following section is a brief review of strategy, performance and joint tenure for the firms involved in the pilot study.

1. Wesfarmers and Howard Smith. Wesfarmers, for whom hardware retailing was an important strategic business unit (SBU), acquired Howard Smith which was also predominately a hardware retailer, and then integrated it into their own hardware SBU. The Hardware division within Wesfarmers achieved consistent growth during the three year period (1999-2001) prior to the Howard Smith acquisition, and this SBU accounted for 33% of Wesfarmers total revenue in 2001. From 1999 to 2001 Wesfarmers Hardware division increased EBITA from $87m to $137m, and increased ROCE from 17.9% to 25.1%. In Howard Smith, their Hardware division accounted for 59% of total revenue in 2000; divisional revenue and EBIT had increased by 39% and 100% respectively during the five years from 1996.

   Broadly speaking, these were two good businesses within the same market, integrated into an established SBU. The Chairman and CEO of Wesfarmers had been together for 9 years prior to acquiring Howard Smith.

2. Mayne Symbion and Faulding. Mayne Symbion operated in two industry segments (health care and logistics) with health care accounting for 37% of sales in 1999; Faulding operated predominantly within the health care segment, accounting for 78% of their sales revenue. From 1996 to 2000 Faulding had consistent year on year growth in its NPAT and NPAT/Net Assets from $28m and 7.0% to $78.3m and 11.6% respectively. Faulding’s strategy increasingly focussed
on healthcare products fuelled by a steady stream of acquisitions, including the acquisition of Bullivant for $139.3m in 1999; their share price increased from $6.85 (April 2000) to $17.0 (October 2001). For an eight year period (1993-2000) Faulding had had the same Chairman (Alan McGregor) and CEO (Ed Tweddell).

Mayne restructured and repositioned itself, culminating in November 1998 in a reclassification on the ASX from a transport to a healthcare business. They sold their shares in Optus in 1998 and steadily disposed of their various transport businesses. However, in 2000 their NPAT fell to -$174m from $483m in the previous year (which included the exceptional gain on the sale of their Optus shares) with abnormal expenses impacting the business. The chairman of OneSteel was brought into the business for two years as CEO. During his tenure Faulding was acquired in October 2001, and further restructuring occurred with a virtually new management team appointed. In 2003, significant costs of $513m adversely impacted the business mainly through write downs. During the period 1997 to 2005 Mayne Symbion had two Chairmen, three CEO’s, a significant change in strategy, and inconsistent business performance.

3. Burns Philp and Goodman Fielder. Burns Philp, a consumer products and business to business products food manufacturer with interests in Europe, the Americas and Australia, acquired Goodman Fielder which had a similar manufacturing profile to Burns Philp but with a stronger bias to consumer products especially in Australia. Goodman Fielder experienced a fairly volatile trading performance with NPAT ranging from -$77m to $163m during the period
1998-2002, coinciding with 4 different Chairman and a programme of acquisitions, disposals, and restructurings. Burns Philp enjoyed stability in its Board and a recovery from the turmoil created by their global herb and spice strategy during the 1990’s; their NPAT steadily increased from $65.9m in 1999 to $146.2m in 2002. Burns Philp’s Chairman and CEO had been together for 6 years prior to acquiring Goodman Fielder.

4. Fosters and Southcorp. Fosters with two main SBU’s, beer and wine, acquired Southcorp which had become a focussed wine producer. Southcorp had undergone a significant change in strategy from a profitable, diverse group in 2000 with a NPAT of $205m (only 29% of sales were in wine) to a wine dominated business in 2004. This was accomplished through a series of business disposals and, most notably, the acquisition of Rosemount in February 2001 for $1.5bn. Southcorp then had four CEO’s from 2000 to 2003 and a NPAT loss of $923m in 2003. Fosters, a business historically dominated by beer increased their global position in the wine market through the acquisition of US based Beringer in 2001 for $2.9bn. From the year prior to the Beringer acquisition, when NPAT was $428m on net assets of $2.3bn, Fosters moved to a NPAT of $463m on net assets of $4.5bn in 2003. Arguably there was a strategic, or related, fit from Southcorp into Fosters; unfortunately in the case of Southcorp’s acquisition of Rosemount and Fosters acquisition of Beringer shareholder value had been reduced and there was therefore no track record of performance improvement during the three years prior to this acquisition. At the time of the Southcorp acquisition the joint tenure of the Fosters Chairman and CEO was just one year.
5. Healthscope and Gribbles. Healthscope acquired Gribbles to develop a ‘second, but related, leg’ to their strategy, namely pathology. Healthscope was a focussed business during the period leading up to the purchase of Gribbles, having made a series of other hospital acquisitions and integrations. During the period 2000 to 2004 Healthscope’s NPAT and Net Assets increased from $5.9m and $60.5m to $18.1m and $137m respectively. By contrast, Gribbles NPAT had ranged from $10.2m to -$51.3m on net assets in the range $247m to $293m during the period 2001 to 2004. The Chairman and CEO of Healthscope had joint tenure of 7 years prior to the Gribbles acquisition.

There appears to be support for Hypothesis 3, namely stability in terms of both joint tenure and business strategy and performance as a basis for creating acquirer shareholder value.

Hypothesis 4. The premium paid for a target firm will be greater the longer the period of joint tenure by the Chairman and CEO and when the largest shareholders of the acquiring firm also own a significant share of the target firm.

Research generally indicates (Agrawal et al., 1992, Gregory, 1997) that target company shareholders gain in a sale but that acquiring shareholders lose value as a result of the acquisition, a position which is slightly different from Bishop et al. (1987) in relation to Australia. However, the same group of shareholders may have a significant stake in both the acquirer and the target firms. This certainly appears to be the situation in the firms examined in this pilot study, as the table below illustrates. In this situation these same shareholders may exert some influence on the acquirer’s Chairman and CEO to enable them
(the shareholders) to either exit an underperforming business, such as Southcorp, or crystallise a significant gain, for example at Faulding.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Shareholder stake in Acquirer and Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chase/National/Westpac/AMP/QIC</td>
<td>20% in Wesfarmers, 21% in Howard Smith</td>
</tr>
<tr>
<td>JPM/Westpac/National/Citicorp/RBC. (19% Reline in Southcorp)</td>
<td>54% in Fosters and 36% in Southcorp</td>
</tr>
<tr>
<td>JPM/ANZ/Westpac/National/RBC (48% Kintron for Burns Philp)</td>
<td>12% Burns Philp, 52% Goodman Fielder</td>
</tr>
<tr>
<td>Chase/National/Westpac</td>
<td>38% Mayne Symbion, 23% Faulding</td>
</tr>
<tr>
<td>National/JPM/ANZ/Cogent/Westpac</td>
<td>38% Healthscope, 63% Gribbles</td>
</tr>
</tbody>
</table>

The premium paid by the acquirer, comparing the target’s share price at completion with its share price four months prior to completion, is presented in the following chart:

<table>
<thead>
<tr>
<th>Acquirer/Target</th>
<th>Share price premium vs. 4 months prior to completion</th>
<th>Chairman/CEO joint tenure at Completion (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wesfarmers/Howard Smith</td>
<td>+67%</td>
<td>9</td>
</tr>
<tr>
<td>Mayne Symbion/Faulding</td>
<td>+32%</td>
<td>1</td>
</tr>
<tr>
<td>Burns Philp/G.man Fielder</td>
<td>+9%</td>
<td>6</td>
</tr>
</tbody>
</table>
There appears to be no particular pattern or relationship with these variables, except to observe that in the case of the two highest price premium the joint tenure was also highest (Wesfarmers and Healthscope). There is no prima facie evidence of hubris, as described by Roll (1986) since the firms paying the highest premium (Wesfarmers and Healthscope) were not the same as those exhibiting hubris (Fosters and Mayne Symbion).

This hypothesis requires further examination, in particular the possibility of a relationship between joint shareholding (acquirer and target) and bid premium.

**Acquisition Outcomes**

The cumulative abnormal returns (CAR) for each of the acquirers were examined using a methodology similar to Capron and Pistre (2002) with two base points, 12 months prior to completion (column A) and the year of completion (column B), as follows:

**Cumulative Abnormal Returns**

<table>
<thead>
<tr>
<th>Time Period (mths.) (Ref. Completion)</th>
<th>Wesfarmers</th>
<th>Wesfarmers</th>
<th>Burns Philp</th>
<th>Burns Philp</th>
<th>Healthscope</th>
<th>Healthscope</th>
<th>Fosters</th>
<th>Fosters</th>
<th>Symbion</th>
<th>Symbion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>A</td>
<td>B</td>
<td>A</td>
<td>B</td>
<td>A</td>
<td>B</td>
<td>A</td>
<td>B</td>
</tr>
<tr>
<td>From -12 mths. To 0</td>
<td>78.13</td>
<td>20.99</td>
<td>14.96</td>
<td>-6.50</td>
<td>38.27</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Up to 12</td>
<td>86.11</td>
<td>7.98</td>
<td>-6.01</td>
<td>-27.00</td>
<td>48.19</td>
<td>33.23</td>
<td>-20.73</td>
<td>-14.23</td>
<td>-19.90</td>
<td>-58.17</td>
</tr>
<tr>
<td>Up to 24</td>
<td>80.03</td>
<td>2.80</td>
<td>2.41</td>
<td>-18.58</td>
<td>34.42</td>
<td>19.46</td>
<td>-25.75</td>
<td>-19.25</td>
<td>-25.93</td>
<td>-64.20</td>
</tr>
</tbody>
</table>

Four acquirers had CARs three years after completion which were consistent with
Hypothesis 1, whichever base point is selected; both Wesfarmers and Healthscope had a positive outcome, whereas the returns to shareholders for Fosters and Mayne Symbion were negative. In the case of the exception, Burns Philp, they converted their preference shares to ordinary shares 38 months after completion; taking this into account the CAR from the year prior to completion (column A) would become +7.1% and the CAR post completion (column B) would improve to -13.89%.

Conclusions and Next Steps

Prima facie, albeit from a small sample base, there appears to be support for the central idea of this paper namely that, with primary responsibility and accountability for merger and acquisition (M&A) outcomes residing jointly with the Chairman and Chief Executive Officer of the acquiring firm, the length of the joint tenure of these two officers of the acquiring firm at the time of the acquisition has a direct influence on acquirer shareholder returns, and potentially the four hypotheses underpinning the central idea have validity.

Specifically, length of joint tenure appears to be associated with superior acquirer share price performance across a four year period, continuity and success of historic strategy for the acquirer during the three year period prior to an acquisition, and strong NPAT growth during the three years following the acquisition. In this pilot study the ratio of debt to equity in the transaction doesn't appear to be a factor; an inverse relationship between hubris and offer price premium has emerged. In all but one of the acquisitions, the CEO received a significant increase in remuneration, potentially adding weight to arguments supporting agency theory in M&A; in the case of Burns Philp the increased remuneration for the CEO occurred at a later date, more aligned with the outcome of the acquisition in terms of
business performance. Business relatedness appears to benefit the acquirer (such as Wesfarmers) when the acquirer already has a successful track record in the business sector where the acquisition is occurring; where the acquirer already exists in a sector (Fosters and wine) but has a poor record of sector performance preceding the acquisition, then relatedness does not seem to assist the post acquisition outcome.

The pilot study is from the initial phase of an examination of Chairmen and CEOs in Australian M&A activity. A number of important questions emerge from this pilot study, not just the small sample size. For example, the acquisitions which were examined in the pilot study were large in relation to the acquirer’s net assets; this may in itself be an important factor in examining outcomes. The time period across which the pilot study examined acquirer performance may also be critical, as the findings for Burns Philp demonstrated; in this study the post acquisition period was three years, whereas in the Bishop et al. (1987) study the post acquisition time period was two years. The relatedness of target and acquirer shareholders also warrants further investigation. The share prices used in the pilot study are the quoted prices at the time as recorded by Aspect Huntley; the basis of comparison for the changes in firm share prices across time used in this study was the movement in the overall ASX index and the S&P/ASX 200 Accumulation index for the same time period. Dividend policies varied in the pilot study from Burns Philp which consistently paid no dividend to ordinary shareholders to Wesfarmers which enhanced the dividend payout in 2005 with a capital return to ordinary shareholders, whilst Fosters continued to increase annual dividend payments regardless of after tax profit changes; these factors warrant further analysis.
The next stage of this research program is to expand the sample base from the pilot study to 100 acquisitions in Australia, with the purchase consideration above $50m, and acquisitions occurring during the period 1995 to 2006, again involving ASX listed firms. A predictive model for M&A activity based on the hypotheses in this paper will then be developed.

References


