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盈餘操控對購併公司股價長期表現之影響

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Earnings Management and the Post-Acquisition Performance of Acquiring Firms

Abstract

Previous studies have documented that the acquiring firms in mergers significantly underperform those in tender offers after acquisitions. Two hypotheses have been proposed to explain the poor post-acquisition stock performance of mergers: the method of payment (cash vs. stock) and book-to-market effect (value vs. growth firms). This paper attempts to explore an alternative hypothesis, earnings management, to account for the long-run performance after the acquisition. We argue that bidders in stock-financed mergers have incentives to boost up pre-merger earnings and this manipulation behavior causes the subsequent poor performance. We find that stock mergers do have aggressive levels of earnings management than cash mergers, and these high manipulated earnings are significantly and negatively related to the abnormal returns of stock mergers. However, there is no relationship between the degree of earnings management and long-run performance of cash mergers. Moreover, book-to-market ratios cannot explain the long-run abnormal returns of acquisitions when manipulated earnings are controlled. All these results suggest that the poor performance of stock mergers is mainly due to earnings manipulations, rather than the book-to-market effect or payment method.

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中文摘要

過去的文獻發現購併公司若選擇以合併方式進行，其購併後之股價長期表現不佳。後續的研究提供了兩個可能的解釋原因：付款方式的差異(以股票融資或現金交換)和偏低的淨值市價比。本文則提出一個新的假說 – 盈餘操控行為 – 來解釋這樣的現象。本文的論點在於以股票融資的購併公司可能虛報盈餘以降低購併成本, 而導致日後偏低的股票報酬。我們發現以股票融資的購併公司確實存在有盈餘操控的現象，而且這些虛報的盈餘與長期股票報酬呈顯著的反向關係；以現金交換的購併公司則沒有發現這些現象。同時我們也發現，當盈餘操控行為被控制後，淨值市價比並沒有辦法解釋股票的長期報酬。所以，真正影響購併後股價長期表現的原因，不是購併公司所選擇的付款方式，也不是淨值市價比，而是其購併時的盈餘操控行為。

An growing body of literature document that the post-acquisition stock returns of acquiring firms in mergers is significantly lower than those in tender offers. For example, Langetieg (1978) and Asquith (1983) show that acquiring firms have negative abnormal returns over one to three years after the merger. Agrawal, Jaffe and Mandelker (1992) demonstrate that acquiring firms experience a significant loss of about 10% during the five post-acquisition years, while acquirers do not suffer any negative performance for tender offers. Loughran and Vijh (1997) further show an abnormal return of –16% for bidders in mergers during a five-year period following the acquisition. This significant negative post-acquisition return of mergers is puzzling since past studies (e.g., Healey, Palepu, and Ruback (1992)) have shown no evidence that merged firms cut back on positive NPV projects. This also casts a doubt on the traditional wisdom which suggests that firms merge together to explore the synergies of the combined firm.

There are two explanations proposed in the literature to account for the different performance between mergers and tender offers. The first one is the means of payment hypothesis. Under the asymmetric information, Myers and Majluf (1984) show that firms will issue equity only when it is overvalued. This suggests that acquiring firms will use stock to finance an acquisition when their managers perceive the overvaluation of their equity. Otherwise, cash-financed acquisitions would be chosen. As a result, if the market will correct the mis-valuation over time, it is expected to see the underperformance for acquiring firms in stock-financed acquisitions, and outperformance in cash-financed acquisitions during the post-acquisition period. Since mergers tend to be stock-financed and tender-offers tend to be cash-financed (see Martin (1996) and Rau and Vermaelen (1998)), on average, mergers will underperform and tender offers will not. Loughran and Vijh (1997) support this hypothesis and find that acquiring firms in stock mergers perform very poorly in the post-acquisition period, while acquiring firms in cash tender offers earn significant positive abnormal returns. Mitchell and Stafford (2000) also document the underperformance of acquirers in stock mergers.

Another reason to explain the severe underperformance of mergers is the performance extrapolation hypothesis. Lakonishok, Shleifer and Vishny (1994) find that low book-to-market firms (growth firms) significantly underperform the high book-to-market firms (value firms) over the five post-formation years. They attribute the under- (out-) performance of growth (value) firms to the investors' extrapolation of past extreme stock returns and sales growth associated with growth (value) firms. Since acquiring firms in the mergers tend to be low book-to-market firms (Martin (1996) and Rau and Vermaelen (1998)), it is very likely that both managers and investors are overoptimistic in the mergers, making the bidding prices too high and thus suffering severe subsequent return reversals. Rau and Vermaelen (1998) support this conjecture. They report three-year cumulative abnormal returns of -17.3% for growth bidding firms and 7.6% for value bidding firms. They argue that the underperformance of bidding firms in mergers and the outperformance in tender offers are due to the book-to-market effect, regardless of the method of payment.

This paper explores an alternative hypothesis, earnings management, to justify the poor post-acquisition performance of mergers. We argue that bidding firms of stock mergers have incentives to inflate their pre-merger earnings to an unusual high level to save acquisition costs. This income or cash flows adjustment is allowed by generally accepted accounting principles (GAAP) in an accrual-based accounting system, which is designed to have a better reflection on firms' underlying business conditions than a cash-based accounting system. However, this also provides an opportunity for managers to manipulate earnings by adjusting both the timing and amount of revenues and expenses. If investors use the reported earnings to estimate the expected stock price but are not aware that managers of acquiring firms may inflate their earnings, investors are thus overoptimistic. As the private information of acquirers is revealed over time, investors may recognize that they were paying too high prices initially. As a result, the larger the degree of earnings manipulation, the larger the subsequent price correction. We argue, in this paper, that the price correction due to acquirers' manipulating earnings leads to the underperformance in stock mergers.

We also conjecture that the earnings management hypothesis can account for both the means of payment and performance extrapolation hypotheses. In other words, the driving force behind both hypotheses is the managerial behavior of manipulating earnings, which causes over-optimism (pessimism) of investors. Previous studies find that the equity offerings and the firms' book-to-market ratios are correlated with the level of earnings management. For example, Teoh, Welch, and Wong (1998a and 1998b) and Chan, Cooney, Kim and Singh (2003) show that equity-issuing firms tend to use discretionary accounting accruals, which proxy for the managerial cash flows adjustments, to boost up reported earnings. Erickson and Wang (1999) find a similar earnings-increasing behavior for acquirers in stock-for-stock mergers. Moreover, Chan, Chan, Jegadeesh and Lakonishok (2003) find that firms with large degrees of earnings management tend to be growth firms with outstanding past stock and sales performance. Therefore, stock-financed acquirers with low book-to-market ratios are expected to be more aggressive in manipulating earnings, thus leading to their underperformance during the post-acquisition period. Put differently, the main reason why the post-acquisition performance for mergers is poor is not because of the payment method or book-to-market value, but because of the bidding firms' earnings management behavior.

We collect our sample from SDC Mergers and Acquisition database. We select acquisitions which were announced and completed between January 1980 and December 1999 and classified as mergers. Similar to Loughran and Vijh (1997), we find that stock mergers significantly underperform in the long-run while cash mergers outperform, albeit marginally significant. The results generally hold when we apply different methodologies (such as buy-and-hold abnormal return, cumulative abnormal return and calendar-time portfolio regression approach) and benchmarks (e.g., control firms matched with size/boo-to-market, size/ boo-to-market/industry, size/boo-to-market/pre-event performance). This suggests that the poor post-acquisition performance of mergers is primarily due to the negative abnormal returns of stock mergers.

When comparing the stock- and cash-financed mergers, we find strong evidence suggesting that acquiring firms were managing earnings upwards prior to stock mergers. On the contrary, cash mergers do not show any pattern of abnormal levels of earnings management. The abnormal discretionary current accruals (which proxy for the degree of earnings management) are significantly and negatively related to long-run abnormal returns for stock mergers, but no strong relationship for cash mergers. Moreover, stock bidders tend to be growth firms with significantly lower book-to-market ratios than cash acquiring firms. However, after we control for the discretionary accruals, there is no remarkable difference in book-to-market ratios between stock and cash mergers. This pattern also persist when we examine the long-run returns. Specifically, book-to-market ratios cannot explain the long-run abnormal returns of mergers when discretionary accruals are controlled. All these results suggest that the poor performance of stock mergers documented in the literature is mainly due to earnings manipulations, rather than the book-to-market effect or payment method. As a result, our findings dispute the previous research and provide a new avenue to examine the mergers and acquisitions.

This paper also contributes to the long-run performance literature. We re-visit the performance of acquisitions by incorporating data in 90s, which are not examined in the extant literature. We find that the poor performance of stock mergers is robust. Therefore, we support the idea that the long-run abnormal returns are real, and add new evidence to a recent debate of whether the long-run abnormal stock returns are nothing but statistical artifacts (Fama (1998)).

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