Do cross border and domestic acquisitions differ? Evidence from the acquisition of UK targets

Abstract

We investigate the determinants of short term wealth effects for both public acquiring and target shareholders following the announcement of UK acquisitions over the period 1990-2005. Regardless of their nationality, overall acquirers incur losses, with domestic acquirers under-performing cross-border acquirers in general. For the latter no differences in returns between regions are found once the differences in corporate governance regimes are controlled for. Instead it is firm characteristics and in particular firm leverage that largely explains acquirers returns. All targets gain significantly but the higher returns associated with international deals disappear once bid characteristics are controlled for.

Introduction

Cross border transactions are a key feature of the merger wave of the 1990s (Martynova & Renneboog, 2008) with a threefold increase in the volume of cross border deals compared to domestic transactions over the past twenty years (Mantecon 2009). More recently Erel, Liao and Weisbach (2012) establish that one third of global deals involve firms from different countries. Developed countries account for over two thirds of cross border acquisitions with the UK at the forefront accounting for the majority of European deals, (Faccio & Masulis, 2005). Yet compared to domestic merger and acquisitions (M&As) our understanding of cross border transactions is limited and mixed. This is especially true in the context of the UK.

This is surprising as the UK is the predominant market for corporate control in Europe (Martynova & Renneboog, 2011). This is partly due to the dispersed ownership structure of public firms, a well-developed and liquid stock market, a high free float of shares and high disclosure standards (McCahery & Reeneboog, 2002). Similar to the US, the UK has a market based governance regime with strong shareholder protection and extensive disclosure (La Porta et al,. 2000). Yet the UK has a more competitive takeover market than that of the US, (Moeller & Schlingemann, 2005). Firmly rooted in common law tradition, the strict takeover legislation reinforces the strength of investor protection in the UK which contributes to an active takeover market.

Despite this, much of the empirical work on the UK focuses on outward acquisitions (Aw & Chatterjee 2000: Gregory & McCorriston 2005: Conn et al,. 2005) with only Danbolt (1995), (2004) and Danbolt & Maciver (2012) focusing on inward acquisitions into the UK. More recently, Goergen & Renneboog, (2004), Moeller & Schlingemann (2005), Moschieri & Campa (2009) and Martynova & Renneboog (2011b) present evidence of the uniqueness of the UK market, which partly motivates for this study.

Given the limited research on inward acquisitions into the UK and the distinctiveness of this market the aim of this paper is to improve our knowledge of these phenomena by examining the short term announcement effects for shareholders in acquiring and target firms following the announcement of a UK bid during the 1990-2005 time frame. Within this environment we

compare returns to the different sets of domestic and international bidders and their targets. We focus on publicly listed companies. In addition we examine the determinants of shareholders' returns in bidders and targets using firm specific data as called for by Moeller & Schlingemann (2005).

Our study contributes to the M&A literature by providing new evidence on the determinants of wealth effects for domestic and international acquirers in the UK together with their targets. The nature of the market for corporate control in the target country can impact on acquirer's wealth (Fatemi & Furtado, 1988; Markides & Ittner, 1994; Corhay & Rad 2000). Bris & Cabolis (2008) call for further work into analysing domestic and cross border mergers, and so we add to the work of Danbolt (1995), (2004) and Danbolt & Maciver (2012), who examine returns to foreign acquirers into the UK, in several ways. First, we compare returns between domestic and international acquirers; second, we control for firm specific factors; third, we control for differences in the levels of shareholder protection and across time using the methodology of Martynova & Renneboog (2011b).

Whilst our results demonstrate that returns to all acquirers are, on average, significantly less than zero, the analysis suggests returns to foreign acquirers exceed those of domestic firms. Further analysis within the group of foreign acquirers reveals that the experience of overseas acquiring firms is far from uniform, with acquisitions by US firms destroying significantly more wealth than those of European acquirers although this effect disappears once the corporate governance regimes are controlled for. In sharp contrast to the acquiring firm experience, all target shareholders gain significantly but whilst returns from cross border acquisitions are marginally greater, the difference compared to domestic transactions is not significant.

Our paper shows some differences between the factors that drive returns to foreign acquirers and their targets compared to those that influence returns to domestic acquirers and their targets. In particular, the relationship between gearing and returns in acquiring firms differ markedly between domestic and cross-border deals. In domestic acquisitions, gearing exhibits a positive relationship with acquirers return, a result consistent with Jensen's (1986) Free Cash Flow hypothesis, but for foreign acquirers, and especially for European acquirers, the relationship is

negative. For targets of domestic bidders, the significant determinants of their returns are target profitability, which has a positive effect with relative size, and bidder toehold which has a negative impact, whilst for targets of foreign bidders the significant determinants are the exchange rate strength and form of payment offered with some variation between targets of US and European acquirers.

The paper proceeds as follows: in section 2 we present the research background with a brief review of the relevant literature and testable predictions. Section 3 is devoted to the data and methodology. The results are presented in Section 4 followed by the discussion and conclusion in Section 5.

2. Research background

2.1   Related literature

The motives for acquirers engaging in merger and acquisitions are well documented in the domestic literature (Berkovitch & Narayanan, 1993) in some contrast to cross border settings (Enel et al., 2012). International mergers and acquisitions can be value enhancing as they act as vehicles to bridge imperfections in factor, product and capital markets, (Doukas & Travlos 1988, Doukas 1995). Yet international deals result in more internal uncertainty for acquirers, (Gatignaan & Andeson, 1988), incomplete knowledge and hence a greater acquisition cost, (Markides & Ittner, 1994; Datta & Puia, 1995; Reuer et al., 2004).

Empirical evidence from Eckbo & Thorburn (2000), Aw & Chatterjee (2004), Conn et al (2005), Moeller & Schlingemann (2005) and Martynova & Renneboog (2008) suggest lower returns for acquirers from cross border deals in contrast to domestic deals. Yet more recent evidence finds acquirers fare better in cross border deals, Goergen & Renneboog (2004), Feito-Ruiz & Menendez-Requejo (2011), Danbolt & Maciver (2012) and Dutta, Saadi & Zhui (2013).

The empirical and theoretical literature on cross border studies is still its infancy (Bertrand & Zuniga, 2006). Of the limited empirical evidence on cross border mergers conducted much of the focus has been on US based firms (Erel et al, 2012). Some evidence suggests significant differences in target returns from domestic as oppose to international acquisitions. Evidence in

support of this effect is documented in the US by Harris & Ravenscraft (1991), Swenson (1993) and Eun et al, (1996), in the UK by Danbolt (2004), and across Europe by Campa & Hernando (2004). Yet Servaes & Zenner (1990), Dewenter (1995), Eckbo & Thornburn (2000) and Goergen & Renneboog (2004) find no support for the presence of a cross border effect for target shareholders.

In summary, the evidence on the wealth effects of international acquisitions for acquiring and target firm shareholders is inconclusive. Similar to Eckbo & Thorburn (2000) we undertake an experiment of two different sets of bidders participating in the same market for corporate control. We differ from them in that international acquirers in our sample are more geographically dispersed. Furthermore we test for the presence of a cross border effect for UK target shareholders and for the determinants of returns to both sets of acquirers and targets using firm specific data.

2.2   Testable predictions

Returns to acquirers in foreign markets may vary to those generated in domestic markets due to the benefits/costs of geographical diversification that arise from cross border deals. Cross border mergers enable firms to expand their boundaries (Conn et al., 2005).   If this form of diversification is of value to acquiring firms we would expect their announcement returns to exceed those of domestic acquirers, lending support for the multinational network theory. On the other hand gains to domestic buyers may exceed those of their foreign counterparts due to the cost of geographic diversification being outweighed by the benefits to the foreign buyer and/or due to information asymmetry problems experienced by the foreign acquirer. Our foreign sample is divided into two regions namely the US, and Europe[1].The justification for these groupings is that they account for ninety per cent of our sample but yet differ in terms of shareholder protection. Both the UK and the US can be classified as having very high standards of investor protection in contrast to most European countries (Hagendorff et al,. 2008).

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[1] We also include a third category, "Rest of the World", but the sub-samples for regions within this category are too small to allow any meaningful analysis to be carried out.

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The role of investor regime in target countries for international acquirers has been investigated more recently in cross border studies with conflicting evidence emerging. Moeller & Schlingemann (2005) find that acquisitions of UK targets generate lower returns for US acquirers than Canadian, French and German targets, who attribute this to the strength of the shareholder protection regime in the UK as acquirers have to pay a premium to targets to compensate them for adopting a weaker corporate governance system (Kuipers, Miller & Patel, 2009 and Starks & Wei, 2013). Similarly Martynova & Renneboog (2011a) establish that UK targets generate higher returns than their Continental peers in both domestic and cross border deals. This is consistent with Rossi & Volpin's (2004) evidence of superior gains to targets the greater the strength of their investor protection regime. In contrast, Dahlquist et al (2003) establish that acquirers gain from acquisitions of targets from well protected environments due to the higher disclosure and lower agency costs associated with these deals. Given the above, we test the role of the domicile of the acquirer on acquiring and target shareholder returns. We adopt the methodology devised by Martynova & Renneboog (2011a) who compile a very comprehensive set of corporate governance indices capturing all the major changes in corporate governance regulation from 1990 to 2005 (same time frame as our sample) across the US and European countries. Four measures are employed in this study, namely the anti-director index (as per La Porta et al, 1997,1998) which is extensively used, whilst the second one, shareholder rights protection index is the summation of shareholder rights to appoint directors, shareholder decision power, board structure and information availability to shareholders. The other two measures encapsulate indices capturing minority shareholder rights protection and creditor rights protection. Similar to Martynova & Renneboog (2011a), we capture the differences in each measure for acquiring and target companies for our foreign sub-sample before summing the differences across the four measures to give a total difference, (TOTDIFF). A positive difference suggests greater shareholder (or creditor) protection in the country of the acquirer than that of the target while a negative difference suggest greater shareholder (or creditor) protection in the country of the target to that of the acquirer. As the target country, the UK affords higher shareholder protection in all cases, whilst in terms of creditor protection the UK offers equal or greater protection, with the exception of some European countries namely Denmark, Sweden, the Netherlands and Germany, with differences in the latter ceasing from 2000 onwards.

The characteristics of acquiring firms may have an impact on their returns. If markets are efficient, valuation metrics such as market to book [MTBV]) should be reflective of the firm's investment opportunity set and managerial skill. Under Q-theory, Tobin's Q (typically proxied by MTBV) is simply a proxy for growth opportunities. Alternatively, behavioural finance theories (such as that of Shleifer & Vishny, 2003) might view such metrics as potential proxies for over or under valuation. Support for the mis-valuation hypothesis from overpayment by glamour acquirers has been well documented in domestic studies for the US by Dong et al,. (2006) and Ang & Chen (2005), and in the UK by Bi & Gregory (2011), although Dong et al (2006) also find support for the Q-hypothesis. By contrast, Bi & Gregory (2011) find more support for the over-valuation hypothesis than the Q-theory of mergers, although these results are only found in the long run returns, not the announcement period returns. Returns to acquiring firms have been found to depend on specific resources of their targets. Hence we use the relative Q ratio to proxy for the growth potential of the merged entity.

Several studies test the free cash flow (FCF) hypothesis of Jensen (1986) which finds that firms with unused borrowing capacity and/or large free cash flow are more likely to engage in value destroying acquisitions (Harford 1999, Lang, Stulz and Walking 1991). We test for the importance of FCF by controlling for cash resources in both acquiring and target firms, and by measuring their pre-bid gearing ratios. We also capture the past performance of target firms through the use of the return on equity variable. Goergen & Renneboog (2004) find that targets gain more the higher their return on equity.

The role of the exchange rates has been well documented in the international literature with acquirers hypothesised to gain the stronger their currency vis a vis their target resulting in lower financing costs for them (Froot & Stein, 1991; Kang, 1993; Markides & Ittner, 1994; Conn et al., 2005). Alternatively acquirers may lose the stronger their currency is, as the value of future repatriated profits will be lower (Cakici, 1991). We test for the significance of the exchange rate on the wealth of foreign acquirers using a similar procedure to Harris & Ravenscraft (1991),

Kiymaz & Mukherjee (2000) and Gregory & McCorriston (2005) to calculate exchange rate strength[2].

Considerable debate exists about the sources of value (synergy) for acquiring firms. The most commonly tested source is operating synergy whereby related acquisitions are thought to be more synergistic due to greater potential for economies of scale/scope and lower integration costs compared to unrelated deals. Evidence in support of relatedness in both domestic literature include Morck et al (1988), Slusky & Caves (1991), and in the international literature by Fatemi & Furtado (1988), Markides & Ittner (1994), Goergen & Renneboog (2004), Moeller & Schlingemann (2005) and Dos Santos et al,. (2008). In contrast, Doukas & Travlos (1988) and Conrad & Rad (2000) find superior gains from product diversification by international acquirers. We test for the significance of acquiring and target firms being in the same industry sector using the 2 digit SIC codes to proxy for relatedness. Finally we test for the impact of a bidding firm toehold in the target firm in a similar form to Sundarsanam et al (1996). Such an investment reduces free rider problems and deters competing bids resulting in larger gain to acquirers (Stulz et al,. 1990, Betton & Eckbo, 2000 and Mantecon, 2009), whilst lowering returns for targets.

We control for a number of variables including relative firm size, bid reaction and form of payment. Greater gains have been found to accrue to acquirers the larger their target (Asquith et al, 1983; Jarrell & Poulsen, 1989; Markides & Ittner, 1994; Danbolt, 1995; Fuller, Netter & Stegemoller, 2002; Moeller & Schlingemann, 2005). The assertion is that large combinations result in revenue enhancement and cost savings via greater economies of scale. Alternatively, large acquirers may overpay for smaller targets due to insignificant wealth effects for them (Loderner & Martin, 1990) or larger combinations will cost more to integrate (Agrawal, Jaffe & Mandelker, 1992; Beitel & Schiereck & Wahrenburg, 2004) Hostile deals are more common in the UK than in any other country (Moschieri & Campa 2009), and hence we control for bid reaction.

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[2] The exchange rate of the foreign currency (in terms of £) on the announcement day is first de-meaned and then scaled by its mean.

Finally, we control for payment form as acquirers may use a variety of forms including cash, shares or a mixed consideration. Empirical evidence suggests acquirers lose from share exchanges because it signals over valuation of acquirers stock or uncertainty over the true value of the target, (Conn & Nielsen, 1977; Bradley, 1980; Dodd, 1980; Myers & Majluf, 1984; Travlos, 1987; Franks & Harris, 1989; Loughran & Vinjh, 1997; Walker 2000). However foreign bids primarily (although not exclusively) are all cash, partly due to target shareholders' reluctance to accept foreign equity (Gaughan, 2002). The form of payment is often cited for the presence of a positive cross border effect for target shareholders, so we are careful to control for this effect. The full detail of these variables is given in Table 1.

3   Data and Methodology

3.1   Data

The sample consists of completed acquisitions of UK public companies for the period 1990 to 2005. The acquiring firms are listed domestic (UK) or international (US, European, Rest of the World) with deal values greater than £1 million and involve the acquisition of more than 50% of shares acquired. The data on the acquisitions is obtained from *Thomson Financial Securities Data Corporation* (SDC) and *Thomson Financial Datastream* is our source for all returns and financial data. We require data to be available on market capitalisation and returns, together with the full information needed to calculate all the firm specific variables for both acquirer and target companies.

The final sample consists of 288 completed acquisitions, of which 169 are purely domestic and 119 are foreign. Of these foreign acquirers, 56 are from the US, 51 are from the EU, and 12 are from other countries. The nationality of the acquirers is shown in Table 2 where we see that domestic takeovers comprise 59% of the sample. By far the largest overseas acquirer nation is the US, with 56 deals, followed by France and Germany with 14 each. Table 3 shows the acquisition activity each year. The number of foreign acquisitions increases over time with just over under two thirds of these takeovers occurring in the latter half of the sample time period.

3.2 Method

Following Alexandridis (2008), Draper & Paudyal (2008), Hagendorff et al,. (2008), and Petmezas (2009) we calculate cumulative abnormal returns for the 5-day period (-2,2) days

around the announcement date. In the absence of any wholly convincing evidence on the most appropriate model for estimating abnormal returns, particularly in the UK (Michou, Mouselli & Stark (2007); Gregory & Michou, 2009), we choose to use simple market-adjusted returns (MARs) in this investigation. Draper and Paudyal (2008) also favour a market adjusted returns model. Although our mean abnormal returns are similar using the market model, we prefer MARs as close inspection of the market-model parameters shows some implausible beta values in some cases, almost certainly as a result of thin trading problems. Despite the obvious advantage of avoiding such thin trading problems, the use of market-adjusted returns has the disadvantage of not providing regression estimates and so not allowing the use of Patell t-tests. We could, of course, simply rely upon a cross-sectional t-test (which we report) to form inferences, but instead choose to allow for the possibility of non-normality in the 5-day return window abnormal returns by using the bootstrapped skewness-adjusted t-statistic described in Lyon et al (1999), more normally associated with long-term return studies. We further test for non-normality by running a Wilcoxon signed-rank test for differences of the MAR medians from zero.

We then run regression tests using these Bidder and Target CARs as dependent variables, with a range of variables selected to test the hypotheses described above. All regressions we report use White (1980) corrections for heteroscedasticity. Specifically, we regress the 5-day event window CARs on:

$$CAR = \alpha + \beta_1 \text{ LOGRELQ} + \beta_2 \text{ CASHRESBID} + \beta_3 \text{ CASHRESTGT} + \beta_4 \text{ BIDGEAR} + \beta_5 \text{TGTGEAR} + \beta_6 \text{ ROETGT} + \beta_7 \text{ RELATEDDUM} + \beta_8 \text{ LOGRELSIZE} + \beta_9 \text{ SHARES} + \beta_{10} \text{ BIDTOE} + \beta_{11} \text{ HOSTILE} + \varepsilon$$

For the sub-samples of foreign bids, we include *FOREX,* and *TOTDIFF*. Table 4 shows the correlation matrix of the variables used. The results for the Bidder and Targets and their subsamples are reported in separate regression models in Tables 7 and 8.[3]

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[3] In general, we do not control for tax effects as conducted by Manzon, Sharp & Travlos (1994) as unlike their sample period there are no clear examples of tax regimes changing in the period we investigate. However, Huizinga & Voget (2009) show that when the American Jobs Creation Act of 2004 enabled (albeit temporarily) US multinationals to repatriate profits at a flat rate of 5.25% from October 2004 to the end of 2005 this resulted in a six fold increase in repatriated profits. We tested for this by including a dummy variable for US acquisitions completed from October 2004 onwards. As this variable was insignificant for both bidders and targets, and none of our other inferences change, we have not reported these results in the paper.

4. Results

4.1 Announcement returns of acquirers and targets

Table 5 reports the announcement returns for the 5-day window for the full sample and sub-samples based on domicile of acquirer. Results for acquirers are reported in Panel A while those for targets are contained in Panel B. The clear message that emerges from the CARs is that the acquisition of UK listed targets is a significantly wealth-reducing event for bidders as a whole. This is consistent with the evidence of Alexandridis, Petmezas & Travlos (2010) that the greater the competition for public targets as in the case of the UK, US and Canada the lower acquirers returns. Mean announcement period abnormal returns are -1.07%, with a median of -0.62%, a result that is statistically significant both in terms of the bootstrapped skewness-adjusted t-test, a simple cross-sectional t-test or a test for the median being significantly different from zero. Domestic acquirers experience significant negative abnormal returns of -1.30% compared to an insignificant -0.75% for foreign bidders, a result robust using medians rather than means. This supports our first hypothesis of differences in returns across domicile of acquirer and concurs with the evidence of Kang (1993), Goergen & Renneboog (2004), Martynova & Renneboog (2011) and Danbolt and Maciver (2012).

Amongst the foreign bidders, US acquirers do relatively badly whilst EU acquirers do relatively well. US acquirers earn a significant announcement period return of -1.39%, a result that is significant (p= 0.04 using our preferred bootstrapped skewness-adjusted t-statistic), whereas EU acquirers earn an insignificant -0.23% on announcement. This differs from Danbolt (1995) who finds US acquirers performed better than European acquirers in the UK. These overall negative announcement period returns for acquirers, together with the fact that there are clear inter-country differences, may suggest the importance of both the strength of the investor protection in the target country and to a more limited extent in the country of the acquirer. Datta & Puia (1995) and Doukas & Kan (2006) establish that global diversification is loss making for US acquirers. Moeller & Schlingemann (2005) also establish lower announcement returns for US acquirers from the acquisition of UK targets which they attribute to the sophistication of shareholder protection regime in the UK. More recently Francis et al (2008) demonstrate positive wealth effects for US acquirers but only for those into countries with a weak legal and institutional environment. However, Hagendorff et al (2008) establish that US acquirers

experience lower announcement returns than their European counterparts but their sample is restricted to bank mergers. We see here that the effect carries through to a broader sample, and it is of interest that the significant negative returns are associated with bidders from the UK and US only. Hence we will control for differences in the strength of investor protection in the multivariate analysis.

In contrast, target returns are significantly positive across all markets. The average 5-day CAR is 20.96% for all targets, and although cross-border targets have slightly higher returns than domestic targets (22.84% compared to 19.50%), the difference is not significant using a conventional t-test for differences which differs to Danbolt (2004) and Danbolt and Maciver (2012). US acquired targets earn the highest returns (25.30%) compared to European acquired targets (20.07%) although the difference is only marginally significant consistent with Danbolt (2004) and Danbolt and Maciver (2012).

4.2 Multivariate analysis:

The results reported so far signify variation in returns to acquirers across their domicile in contrast to the more homogenous nature of target returns. A multivariate regression framework is used to identify the role of deal and firm specific variables in explaining these abnormal returns. We also test for the significance of US and European acquirers in the foreign sub-sample given the results established earlier. Summary statistics for these variables are presented for the full sample, the domestic sub-sample, and the foreign sub-sample in Table 6.

Significant differences between domestic and foreign sub-samples are as follows. First, foreign bidders have a smaller relative size of target, and a smaller bidder toehold. Not surprisingly, the proportion of bidders offering equity is significantly higher for domestic bidders. At the 10% level, the cash resources of domestic bidders are smaller than those of the foreign bidders. Last, given the results that follow, we emphasise that bidder or target gearing does not differ significantly between UK and foreign acquirers.

Table 7 presents the regression estimates where the dependent variable is the 5 day CAR to all acquiring firms and the domestic, foreign, US and EU subsamples also. A combination of firm and transaction characteristics are shown to determine acquirers returns. Greater explanatory power emerges for domestic acquiring firm returns in contrast to foreign acquirers.

Relative market valuations are important for overall returns and the result is consistent with the Schleifer & Vishny (2003) hypothesis, which is concerned with *relative* over valuation rather than any absolute valuation metric. The market is wary of overvaluation but only in the domestic sub-sample.

Noticeably acquirer gearing has a positive impact on bidder returns overall, and this clearly shows through in the domestic sub-sample. Maloney et al,. (1993) find a positive relationship between returns to US acquiring firms around announcement and their own leverage prior to the merger. However, acquirer gearing has a significant *negative* association with cross-border acquirer returns and this is significant also for the European acquirers. Gregory & Wang (forthcoming) establish that bidders' gearing has a negative association with their announcement period returns in the case of pure cash acquirers. Since our foreign sample acquire mainly for cash, whilst the domestic sample acquire mainly for equity, this effect could be present here. Cross border deals are paid for with cash sourced from internal funds and/or borrowings. Bidders acquiring overseas may experience difficulty in borrowing to finance such deals (Martynova & Renneboog 2009) and this is likely to more problematic in Europe where creditor protection has weakened (Martynova and Renneboog, 2011).

Similarly Doukas & Kan (2006) report losses to US acquirers in overseas markets is closely related to their own leverage. Gregory & Wang (forthcoming) conjecture that the negative relationship in cash only bids may be reflective of market concerns over the likelihood of financial distress, following cash acquisitions by leveraged firms. Leverage of the combined entity is likely to increase post the merger which the market appears wary about (Ghosh & Jain 2006; Morellec & Zhaanov 2008). Kling et al (2011) also demonstrate that returns to Chinese acquirers in cross border deals is negatively related to their own leverage, which suggests

regardless of the source of debt overseas acquisitions are a source of financial risk for acquiring firms.

Target firm characteristics are also important, as acquiring cash rich targets has a significant negative impact on acquirers' returns overall, a result that also holds in the domestic sub-sample. Target profitability has a positive impact on acquirers returns overall but only in the foreign sub-sample.

Overall, acquirers lose from larger transactions, consistent with Agrawal, Jaffe & Mandelker (1992) and Beitel, Schiereck & Wahrenburg (2004) but this only holds for the domestic sub-sample. Surprisingly, acquirers overall gain from industry diversification, although this is significant only in the domestic context.

In common with findings elsewhere in the literature, equity financed acquisitions are significantly negatively associated with acquirers returns overall, although this fails to be significant in either the domestic or foreign sub-sample.. Foreign exchange effects are significant, but only for the European sub-sample. Whilst controlling for the difference in corporate governance regimes of the acquirer and targets in the foreign subsamples offers no explanatory power, in unreported tests we note that it is important in explaining the under-performance of US acquirers, in so far as with no controls for governance, US acquirers would appear to under-perform other foreign acquirers. Once governance is controlled for, this is no longer the case. Similarly controlling for differences in international taxation (not reported) provides no explanatory power.

In summary, it is interesting that fears of overvaluation and support for the FCF hypothesis apply to domestic acquirers only, in contrast to foreign buyers where the main concern is their own gearing level. Target resources appear to matter especially target liquidity for domestic acquirers while target profitability matters more for foreign acquirers.

Turning to Table 8, where the results for target firms are presented, it appears that deal characteristics are the most important determinants of target returns. Few of the firm specific

variables are significant except for target profitability and, to a more limited extent, bidder liquidity, with evidence that more profitable domestic targets earn higher premia, affirming the Goergen & Renneboog (2004) result. Target profitability is inversely related to returns for targets of European acquirers, whilst bidder liquidity is positively related to returns for targets of US acquirers, suggesting rather different factors motivate US acquirers compared to EU acquirers, with target premia adjusted accordingly. Relatively large combinations are associated with lower returns for targets overall, a result consistent with Campa & Hernando (2004), but this is only found in the domestic market. As predicted, the presence of a toe-hold by bidders has a negative and significant impact on target returns overall, a result consistent with Betton, Eckbo & Thorburn (2009), in that toeholds reduce offer prices for targets and deters rival bids. This negative and significant association applies to both the domestic and European sub samples, despite toeholds being less prevalent in foreign acquired firms (as shown in Table 5). Similarly, and as expected, overall hostile bidders pay more for targets, consistent with Goergen & Renneboog (2004) and Martynova & Renneboog (2006) although this result holds only for the European sub-sample. Foreign acquired targets, and European ones in particular, gain significantly the weaker their exchange rate relative to their acquirers. Furthermore returns for these cross border targets, and targets of US buyers in particular, are higher when shares are not part of the payment. Finally, in the European sub-sample some support is shown for the significance of the differences in corporate governance regime, as UK targets lose from acquisitions into different (and weaker) regimes as mechanisms in place in the country of their acquirer differs to that of the UK.

5. Conclusion

In this paper we examine the short term wealth effects of UK acquisitions for both acquiring and target firm shareholders using a sample of 290 acquisitions from 1990-2005. We include international acquirers in the analysis and deploy a comprehensive set of firm specific data in order to assess the determinants of shareholder returns. We hypothesise that returns to acquirers differ across their domicile due not only to geographical diversification but also to differences in shareholder protection regimes.

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Furthermore we test for the impact of mis-valuation, free cash flow, target profitability, exchange rate strength and relatedness (operational synergy proxy) in explaining acquirer and target shareholder returns.

We find, consistent with the literature, that overall acquirers experience negative announcement period returns. Taken as a whole, domestic firms fare worse than their foreign counterparts, but within the foreign sub-set, US acquirers under-perform relative to their European counterparts but this disappears once we control for differences in the corporate governance regimes. Target shareholders gain significant positive announcement returns but there are no significant differences between domestic and international deals.

Our cross-sectional analysis reveals differences in the determinants of acquirers' and target wealth with some support presented for the role of free cash flow in explaining returns. For domestic acquirers' relative size, related deals, relative Q ratio and target cash resources have a negative influence, while their own gearing level has a positive influence. Importantly, though, the results for gearing are completely different between domestic and foreign sub-samples. Bidder gearing has a positive relationship with domestic acquirer returns, a result that is consistent with the free cash flow hypothesis. However, for foreign bidders, acquirer gearing has a negative relationship with acquirer returns and holds particularly for European acquirers. Highly geared acquirers purchasing overseas targets would be undertaking a considerable riskier investment strategy than would the same highly geared acquirer purchasing a domestic target. Finally, we note that the foreign acquirers gain more the greater the profitability of their targets and in the case of the European sub-sample the stronger their own currency relative to sterling.

Similarly returns to targets differ somewhat between the domestic and cross-border sub-samples. For targets of domestic acquirers, their relative size and bidder's toehold are all associated with lower target returns while target profitability is associated with higher target returns. For the targets of foreign bidders' acquisition by equity and the stronger the relative exchange rate the lower target returns. For US acquired targets acquisition by equity lowers their returns while they gain the greater the cash resources of their acquirer. Targets of European acquirers gain more from hostile deals and lose the greater their own profitability, the stronger the relative exchange

rate, when acquirers have a toehold and are from a different corporate governance regime to that of the UK.

Overall the results in this study provide evidence that UK acquisitions have an adverse impact on acquirers' wealth, especially for domestic and, to a lesser extent for US acquirers, which do not spill into higher returns for each of their respective targets. Future research could focus on providing a more thorough rational for the poorer performance of UK acquirers in their home market which is likely to have policy implications given the better performance depicted for European acquirers into the UK. The 'positive' cross border effect seems to have disappeared for target shareholders, which may be partly reflective of changing international conditions in the global marketplace. Finally, the difference depicted for the significance of acquirers' gearing across the domestic and foreign subsamples is worthy of further exploration.

Table 1: Variable definitions

Variable	Definition
LOGRELSIZE	The log of the relative size of the market value of the target to that of the acquirer as at 3 months pre-bid
RELATEDDUM	Dummy equal to one if the acquirer and target share the same 2-digit SIC code
BIDTOE	The percentage of any toehold shareholding that the acquirer has in the target
LOGRELQ	The log of market-to-book of the acquirer less that of the target
HOSTILE	Dummy equal to one if the acquisition is defined as hostile by SDC Platinum
SHARES	Dummy equal to one if the acquirer finances the bid using equity or part equity
BIDGEAR	Debt to market value ratio of the acquirer as at year end prior to deal announcement
TGTGEAR	Debt to market value ratio of the target as at year end prior to deal announcement
CASHRESBID	Cash and marketable assets of the acquirer divided by acquirer net assets at year end prior to deal announcement
CASHRESTGT	Cash and marketable assets of the target divided by target net assets as at year end prior to deal announcement
ROETGT	The return on equity of the target as at year end prior to bid announcement
FOREX	A de-meaned exchange rate of the foreign currency (in terms of £) at the time of the bid normalised by the average (in the case of the Eurozone countries using a shadow rate before the inception of the Euro)
TOTDIFF	Sum of the difference in the corporate governance regime in acquiring and target for countries, i.e difference in the anti-director index, shareholder rights protection, minority shareholder rights protection and creditor rights protection indices as defined by Martynova & Renneboog (2011b)

Table 2: Distribution of acquisitions by Country of Acquirer

Frequency by Country of Acquirer	Number	Percentage
Australia	2	0.69
Belgium	2	0.69
Canada	2	0.69
Denmark	5	1.73
Finland	1	0.34
France	14	4.86
Germany	14	4.86
Ireland	3	1.04
Italy	2	0.69
Japan	4	1.38
Netherlands	6	2.08
Spain	2	0.69
Sweden	2	0.69
Switzerland	4	1.38
United Kingdom	169	58.6897
United States	56	19.44
Total	288	100

Note: the table presents the number of acquisitions and percentage of the total number of acquisitions across country of acquirer. The summary statistics are provided on the basis of a sample of 288 acquisitions from 1990-2005. Acquirers are publicly listed in their domestic stock market.

Table 3: Distribution of acquisitions by year

Year of Acquisition	Number	Percentage	Domestic number and percentage	Foreign number and percentage	US number and percentage	European number and percentage
1990	12	4.2	5 (2.9)	7 (5.9)	1 (1.8)	5 (9.8)
1991	16	5.6	11 (6.5)	5 (4.2)	1 (1.8)	3 (5.9)
1992	3	1.0	1 (0.6)	2 (1.7)	1 (1.8)	0 (0)
1993	4	1.3	3 (1.8)	1 (0.8)	1 (1.8)	0 (0)
1994	7	2.5	5 (2.9)	2 (1.7)	2 (3.6)	0(0)
1995	15	5.2	7(4.2)	8 (6.7)	4 (7.1)	3 (5.9)
1996	3	1.0	1 (0.6)	2 (1.7)	0 (0)	1 (2.0)
1997	31	10.7	16 (9.5)	15 (12.6)	10 (17.9)	5 (9.8)
1998	36	12.5	16 (9.4)	20 (16.8)	12 (21.4)	7 (13.7)
1999	34	11.8	30 (17.8)	4 (3.4)	2 (3.6)	2 (3.9)
2000	38	13.2	19 (11.2)	19 (16.0)	6 (10.7)	9 (17.6)
2001	14	4.9	11 (6.5)	3 (2.5)	0 (0)	3 (5.9)
2002	12	4.2	7 (4.2)	5 (4.2)	4 (7.1)	1 (2.0)
2003	10	3.5	5 (2.9)	5 (4.2)	5 (8.9)	0 (0)
2004	24	8.4	14 (8.3)	10 (8.4)	4 (7.1)	6 (11.8)
2005	29	10	18 (10.6)	11 (9.2)	3 (5.4)	6 (11.8)
Total	288	100	169 (100)	119 (100)	56 (100)	51 (100)

Note: the table presents the number of acquisitions by year and percentage of total number of acquisitions across domicile of acquirer (domestic and foreign, US and European). The summary statistics are provided on the basis of a sample of 288 acquisitions from 1990-2005.

Table 4 Correlation matrix

This table presents the Pearson correlation coefficients between the variables. B2to2 and t2to2 are the five-day cumulative abnormal returns (-2,2) for acquirers and targets respectively. Logrelsize is the log of the relative size of the market value of the target to that of the acquirer as at 3 months pre-bid. Related is a dummy equal to one if the acquirer and target share the same 2-digit SIC code. Bidtoe is the percentage of any toehold shareholding that the acquirer has in the target. Logrelq is the log of market-to-book of the acquirer less that of the target. Bidgear is the debt to market value ratio of the acquirer as at year end prior to deal announcement. Tgt gear is the debt to market value ratio of the target as at year end prior to deal announcement. Cashresbid is cash and marketable assets of the acquirer divided by acquirer's net assets at year end prior to deal announcement. Cashrestgt is cash and marketable assets of the target divided by target's net assets at year end prior to deal announcement. Roetgt is the return on equity of the target as at year end prior to bid announcement. Hostile is a dummy equal to one if the acquisition is defined as hostile by SDC Platinum. Shares is a dummy equal to one if the acquirer finances the bid using equity or part equity. Forex is a de-meaned exchange rate of the foreign currency (in terms of £) at the time of the bid normalised by the average (in the case of the Eurozone countries using a shadow rate before the inception of the Euro). Totdiff is the sum of the difference in the corporate governance regime in acquiring and target for countries, i.e difference in the anti-director index, shareholder rights protection, minority shareholder rights protection and creditor rights protection indices as defined by Martynova & Renneboog (2011b)

Correlation	b2to2	t2to2	logrelsize	relateddum	bidtoe	logrelq	bidgear	tgtgear	cashresbid	cashrestgt	roetgt	hostile	shares	forex	totdiff
B2to2	1														
T2to2	-0.0192	1													
Logrelsize	-0.1526	-0.1855	1												
Relateddum	-0.1193	0.0328	0.072	1											
Bidtoe	0.0534	-0.1174	0.0649	-0.0923	1										
Logrelq	-0.0712	0.0551	-0.1524	0.0333	-0.0392	1									
Bidgear	0.1599	0.0141	0.0093	-0.0753	-0.0475	0.0744	1								
Tgtgear	-0.033	-0.0524	-0.0717	0.0222	-0.0321	-0.0188	0.0395	1							
Cashresbid	-0.127	-0.0401	0.0327	-0.0071	0.0677	-0.0073	0.0027	-0.1041	1						
Cashrestgt	-0.0965	0.0175	-0.0109	0.0297	-0.0049	-0.1563	-0.0489	-0.2322	0.3173	1					
Roetgt	0.1197	0.084	0.1292	-0.0382	-0.077	-0.1652	0.018	-0.1176	-0.0007	0.0944	1				
Hostile	0.0300	0.1331	0.0725	-0.0014	0.0868	-0.0169	-0.0095	0.0254	-0.0421	-0.0735	0.0184	1			
Shares	-0.1976	-0.1163	0.3281	0.0534	0.072	0.0905	-0.0456	0.0142	0.0927	-0.0136	-0.0201	0.0671	1		
Forex	0.0266	-0.0563	0.0893	-0.0298	0.0166	0.0258	0.0449	-0.0197	-0.0137	0.0400	-0.1352	0.0675	0.0542	1	
Totdiff	-0.1053	-0.1157	0.3684	0.0327	0.1076	0.0241	0.0421	0.0351	-0.0663	-0.1302	0.0462	-0.0408	0.4901	0.1428	1

Table 5: Mean and Median 5-day event window CARs

Panel A: acquiring firms

	Mean (%)	Median (%)	Conventional t-test prob	Bootstrapped skewness adjusted t-test	Wilcoxon signed rank test prob
CARs (-2,+2)					
Full sample) (n = 288)	-1.07	-0.62	0.005	0.015	0.002
Domestic (n = 169)	- 1.30	-1.26	0.019	0.021	0.005
Foreign (n = 119)	-0.75	-0.19	0.117	0.148	0.228
US (n= 56)	-1.39	-0.46	0.073	0.040	0.119
EU (n = 51)	-0.23	-0.08	0.742	0.775	0.866

Panel B: target firms

	Mean (%)	Median (%)	Conventional t-test prob	Bootstrapped skewness adjusted t-test	Wilcoxon signed rank test prob
CARs (-2,+2)					
Full sample (n = 288)	20.96	16.93	0.000	0.000	0.000
Domestic (n = 169)	19.50	16.34	0.000	0.000	0.000
Foreign (n = 119)	22.84	18.85	0.000	0.000	0.000
US (n = 56)	25.30	20.15	0.000	0.000	0.000
EU (n = 51)	20.07	17.31	0.000	0.167	0.000

Note: this table presents the Cumulative Abnormal Returns (CARs) during 5 days (-2,+2) surrounding the announcement for the full sample, domestic, foreign, US and EU subsamples. Abnormal returns are calculated using simple market-adjusted returns. Panel A reports the CARs for acquiring firms while Panel B presents the CARs for target firms. N denotes the number of observations.

Table 6: Summary statistics, partitioned by sub-sample

	Mean (%)	Std Err	Median	Mean (%)	Std Err	Median	Mean (%)	Std Err	Median	
	(all)			(domestic)			(foreign)			Diff
Logrelsize	-2.185	0.120	-1.916	-1.556	0.136	-1.456	-3.083	0.191	-3.009	---
Relateddum	0.536	0.029	1.000	0.547	0.038	1.000	0.521	0.046	1.000	
Bidtoe	2.013	0.533	0.000	2.847	0.865	0.000	0.822	0.370	0.000	++
LogrelQ	0.410	0.063	0.395	0.469	0.086	0.467	0.327	0.092	0.286	
Hostile	0.059	0.013	0.000	0.053	0.017	0.000	0.067	0.023	0.000	
Shares	0.356	0.028	0.000	0.541	0.038	1.000	0.092	0.026	0.000	+++
Bidgear	0.276	0.036	0.223	0.294	0.061	0.212	0.251	0.013	0.236	
Tgtgear	0.209	0.009	0.182	0.208	0.012	0.180	0.211	0.015	0.185	
Cashrestgt	0.106	0.006	0.069	0.100	0.008	0.065	0.113	0.011	0.070	
Cashresbid	0.117	0.009	0.069	0.103	0.010	0.057	0.138	0.017	0.073	_
Roetgt	0.119	0.027	0.169	0.115	0.026	0.144	0.125	0.054	0.198	
Forex	n/a	n/a	n/a	n/a	n/a	n/a	-0.024	0.007	-0.026	
Totdiff	n/a	n/a	n/a	n/a	n/a	n/a	-14.714	0.379	-17.000	
N	288	288	288	169	169	169	119	119	119	

Note: +,++,+++ (-,--,---) denotes that the domestic variable is significantly larger (smaller) than the cross border variable at the 10%, 5% and 1% levels respectively in a two-tailed test assuming unequal variances

Table 7: OLS Regressions of Announcement Period for Bidders' CAR Day -2 to Day +2

	(1) All	(2) Domestic	(3) Foreign	(4) US	(5) EU
Intercept	0.001	0.018	0.015	0.074	0.016
	(0.10)	(1.31)	(0.80)	(0.72)	(0.48)
Logrelq	-0.006*	-0.010**	0.000	0.005	0.003
	(-1.90)	(-2.41)	(0.12)	(0.71)	(0.42)
Cashresbid	-0.038	-0.067	-0.019	-0.041	-0.055
	(-1.33)	(-1.61)	(-.55)	(-0.82)	(-0.87)
Cashrestgt	-0.056**	-0.101**	0.005	0.033	0.004
	(-2.35)	(-2.95)	(0.21)	(0.65)	(0.15)
Bidgear	0.014***	0.015***	-0.075**	-0.081	-0.132*
	(5.45)	(9.58)	(-2.53)	(-1.53)	(-1.80)
Tgtgear	-0.002	-0.009	0.039	0.059	0.089
	(-0.07)	(-0.27)	(1.35)	(1.06)	(1.29)
Roetgt	0.015**	0.022	0.012*	0.005	0.025
	(2.31)	(1.30)	(1.85)	(0.46)	(0.71)
Relateddum	-0.016**	-0.025**	-0.005	-0.017	0.000
	(-2.22)	(-2.53)	(-0.58)	(-0.93)	(0.00)
Logrelsize	-0.004**	-0.005*	-0.002	0.001	-0.001
	(-2.21)	(-1.94)	(-1.13)	(0.24)	(-0.23)
Shares	-0.013*	-0.017	0.012	-0.007	0.017
	(-1.64)	(-1.56)	(0.86)	(-0.29)	(0.75)
Bidtoe	0.001	0.000	0.001	0.000	0.004
	(1.60)	(1.16)	(1.19)	(-0.21)	(1.39)
Hostile	0.001	-0.011	0.014	-0.012	0.002
	(0.04)	(-0.46)	(0.65)	(-0.29)	(0.04)
Forex	0.043		0.077	-0.028	0.172*
	(0.87)		(1.48)	(-0.19)	(1.77)
Totdiff			0.001	0.004	0.001
			(1.14)	(0.73)	(0.30)
N	288	169	119	56	51
Adj Rsq	12.55%	21.83%	11.60%	11.28%	28.36%

Note: the table shows the regression estimates of the acquirer's five-day cumulative abnormal return (-2,2) surrounding the announcement controlling for acquirer and target firm and other deal characteristics. Significance levels at 1%, 5% and 10% are represented by '***', '**' and '*', respectively. N denotes the number of observations.

Table 8: OLS Regressions of Announcement Period for Targets CAR Day -2 to Day +2

	(1) All	(2) Domestic	(3) Foreign	(4) US	(5) EU
Intercept	0.168***	0.151***	0.034	0.076	0.070
	(5.05)	(3.77)	(0.37)	(0.13)	(0.71)
Logrelq	0.010	0.002	0.020	-0.025	-0.010
	(0.70)	(0.14)	(0.70)	(-0.60)	(-0.30)
Cashresbid	-0.052	-0.124	0.167	0.585*	0.069
	(-0.46)	(-0.88)	(0.81)	(1.96)	(0.26)
Cashrestgt	0.028	-0.117	0.115	0.153	0.199
	(0.29)	(-1.05)	(0.75)	(0.63)	(0.89)
Bidgear	0.004	0.002	0.197	0.063	-0.091
	(0.67)	(0.21)	(1.05)	(0.28)	(-0.25)
Tgtgear	-0.082	-0.060	-0.149	-0.287	0.003
	(0.99)	(-0.46)	(-0.97)	(-1.12)	(0.01)
Roetgt	0.044	0.121*	0.016	0.062	-0.590**
	(1.52)	(1.67)	(0.39)	(1.39)	(-2.24)
Relateddum	0.019	0.007	0.031	-0.037	-0.024
	(0.67)	(0.21)	(0.66)	(-0.42)	(-0.25)
Logrelsize	-0.019**	-0.035**	-0.005	-0.017	-0.020
	(-2.89)	(-3.30)	(-0.53)	(-0.82)	(-1.44)
Shares	-0.028	-0.000	-0.146**	-0.168*	-0.072
	(-0.91)	(-0.01)	(-2.63)	(-1.95)	(-0.99)
Bidtoe	-0.003**	-0.002**	-0.003	-0.003	-0.030**
	(-3.01)	(-2.02)	(-1.13)	(-0.41)	(-2.75)
Hostile	0.144**	0.102	0.162	0.315	0.291*
	(2.27)	(1.39)	(1.35)	(1.09)	(1.98)
Forex	-0.144		-0.402**	0.765	-0.637**
	(-0.67)		(-1.90)	(1.31)	(-2.46)
Totdiff			-0.006	-0.006	-0.014**
			(-1.19)	(-0.18)	(-2.57)
N	250	140	110	53	45
Adj Rsq	9.21%	17.21%	11.70%	26.59%	33.09%

Note: the table shows the regression estimates of the target's five-day cumulative abnormal return (-2,2) surrounding the announcement controlling for acquirer and target firm and other deal characteristics. Significance levels at 1%, 5% and 10% are represented by '***', '**' and '*', respectively. N denotes the number of observations.

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