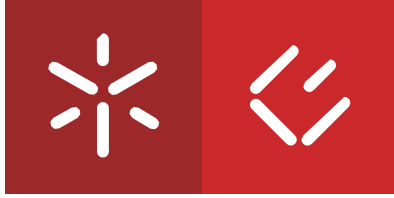


Universidade do Minho
Escola de Economia e Gestão

M&A announcement returns: the effects of the Industry's
market of corporate control competition.

Renato Ruas Fontainhas Lopes

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Tese de Mestrado em Finanças

Trabalho efetuado sob a orientação do
Professor Doutor Artur Rodrigues

dezembro de 2020

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Resume:

The main goal of this dissertation is to find out if the level of competition in the market for corporate control at the industry level has some influence on the returns that result from an acquisition for the acquirer and the target firms. Besides that, I also study the impact that the method of payment of the transaction can have in the returns for both acquirer and target firms.

The sample of this study is the acquisitions that took place in the United Kingdom between the years of 1999 and 2018 with public acquirers and targets.

It was not possible to establish a casual effect between the competition in the market for corporate control and the returns of both acquirer and the target firms.

As far as the acquirer firm's returns are concerned, I confirmed the hypothesis previously reported in the literature that payments done with cash have a positive effect and the ones done with equity influence negatively the returns. Regarding the target firms, it was not possible to establish a causal relation between the method of payment and the returns from the acquisitions.

Keywords: Acquisitions, Returns, Acquirer firm, Target firm, Competition in the market for corporate control, Method of payment

Resumo:

O principal objetivo desta dissertação é averiguar se a competição ao nível da indústria influencia os retornos tanto das empresas adquirentes como das empresas alvo. Além disso, também estudo o impacto que o método de pagamento usado nas aquisições pode ter nos retornos das empresas adquirentes e nas empresas alvo.

A amostra deste estudo abrange as aquisições que ocorreram no Reino Unido entre 1999 e 2018 e que apenas envolvem adquirentes e alvos públicos.

Não foi possível estabelecer uma relação causal entre a competição ao nível das indústrias no Reino Unido e os retornos das empresas adquirentes e das empresas alvo.

Foi confirmada a hipótese que é descrita na literatura já existente de que os pagamentos realizados através de dinheiro têm um efeito positivo nos retornos das empresas adquirentes, enquanto os pagamentos realizados através de ações influenciam negativamente os retornos das empresas adquirentes. Quanto às empresas alvo, não foi possível verificar uma relação causal entre o método de pagamento e os retornos derivados das aquisições.

Palavras chave: Aquisições, Retornos, Empresas adquirentes, Empresas alvos, Competição no mercado corporativo, Método de pagamento

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1. Introduction

The main purpose of my dissertation is to study the impact that mergers and acquisitions have on firms returns in industries with different levels of competition in the market of corporate control.

In the world of business, firms need to do a lot of efforts in order to reach excellence and efficiency in a very competitive market. Mergers and acquisitions are an example of fast and efficient measures that firms can apply. Mergers and acquisitions (M&As) define the consolidation of companies and assets over some different types of financial transactions, like mergers, acquisitions and many others. A merger occurs when the acquiring firm understands that the value of a firm together with other firm is bigger than the sum of the values of the firms separated, according to Erel (2012).

One of the reasons is that M&A's are a way of creating synergies: if the value of two firms together is bigger than the individual value of each firm separated, we can say that the merger creates synergies. Another reason can be the acquisition of a new technology or competence: having the most recent technology is crucial to be competitive in the market. So, instead of developing the technology, it might be easier for a firm to acquire another firm that already has a more developed technology. Another incentive to the M&A's can be an easier entry in a new market. The entrance can be difficult due to the prevailing competition, but a firm can merge with another one that is already in that market. An additional reason can be the increased access to funds: by joining the funds of the two firms, other possibilities of investment are created. In M&A's, there can also be tax benefits because if a firm has a higher tax liability, it has also higher profits too. By joining another firm, the high profits can be used to compensate the losses incurred by the other firm, and this way the profits are reduced and the amount of taxes paid is also reduced.

In this dissertation, I use recent M&A data of industries in the United Kingdom to capture the most recent M&A wave post financial crisis. I investigate whether gains to acquirers are related (positively or negatively) to the degree of competition for listed industries.

I try to answer the following questions: “Do bidders from less competitive industries make better deals for their shareholders?” and “How are the CARs of bidder and target firms affected by market competition?”.

2-Literature Review

The existent literature on M&A's is much vast. Several studies on the occurrence of M&A's have been conducted analysing different aspects, such as the profitability for both acquirer and target firms; the relation between the degree of competition in the market for corporate control, the premiums and the relation between the method of payment used and the premiums for both acquirer and target firms.

The main reasons leading to M&A's occurrence are the external shocks to industries, according to Gort (1969), Jensen (1986), Morck, Shleifer and Vishny (1988). Ling and Petrova (2011) found that beyond this factor, the improvement in the competitiveness and in the efficiency is another reason that helps to explain M&A's.

Regarding the premiums from M&A's, the literature presents two different views. Ravenscraft and Scherer (1989) studied M&A's from 1975 till 1977 and found that they had a negative impact on the premiums of the targeted firms. However, many other authors found positive premiums resultant from the M&A's. Healy, Palepu and Ruback (1992) concluded that M&A's have a positive impact in the value of the firms by improving the asset productivity, which leads to higher operating cash flows. Other authors, such as, Jensen and Ruback (1983), Jarrell, Brickley and Netter (1988) reached the conclusion that M&A's lead to positive premiums for both the acquirer and target firms.

Regarding the effect of the degree of competition in the market for corporate control in the premiums, the literature also presents some views. As far as the premiums of the acquirer firms are concerned, some authors as Mandelker (1974) and Asquith (1983) considered that if there is excessive competition in the market for corporate control considering public companies, the target firms have the majority of the benefits. Billet and Qian (2008) reached the same conclusion. Alexandridis, Petmezas and Travlos (2010) investigated the relation between the gains to acquirers and the degree of the competition for listed targets after controlling for firm and deal characteristics, variables that reflect

differences in the legal and institutional environment across countries, and other country fixed effects. They found that the level of competition across time and markets is generally negatively associated with acquirer returns and have a positive relation with takeover premiums and target returns.

On the other hand, other authors have found that the degree of competition is positively correlated with the premiums. Rossi and Volpin (2004) verified this pattern in the United States and also in the United Kingdom, where the competition is high. Alexandridis (2010), in his work, also concluded the same, by showing that the most competitive markets don't destroy value.

There's also some research about the impact of the method of payment in the returns of the acquirer and the target firms. Andrade et al. (2001), Bruner (2002), Fuller et al. (2002) and, Alexandridis et al. (2010) concluded that the payment method influences the creation of value for the firms derived from an acquisition.

Travlos (1987), Fuller et al. (2002), Moeller et al. (2004) and, Alexandridis et al. (2010) found that the returns of the acquisition of public firms in the moment of the announcement are lower for the acquirer firms if the acquisition is done in equity. When the acquisition is done in cash, the same authors noticed that the acquirer firms have higher returns when compared to acquisitions performed in equity.

3- Methodology

In this work the event study methodology (MacKinlay, 1997) is used to compute the M&A announcement returns. An event study measures the effect of a specific event on the value of a firm using financial market data.

The event study can be applied to mergers and acquisitions, and also in many other fields. The five-day cumulative abnormal return (CAR) is calculated in the same way as in Faccio, McConnell, and Stolin (2006), by adding the market-adjusted return of each acquirer for days $t-2$ to $t+2$, where t is the acquisition announcement day. The daily market return is calculated using the United Kingdom's Datastream value-weighted market index.

3.1-Data

The sample of acquisition announcements is extracted from the Thomson Financial SDC global M&As database. The period of time analysed is from 1998 to 2018. The total return indices were obtained directly from Thomson Reuters Datastream platform in Datastream codes. In this study, it was only considered the transactions in which the acquirer and the target companies are both public. In all the acquisitions, the acquiring firm had to end with at least 50% of the shares of the target company. Spin-offs, recapitalizations, self-tenders, exchange offers and repurchases were not considered either. The initial sample was constituted by 507 deals. After removing some observations due to the lack of relevant information, such as Datastream codes and other important financial information, the sample to run the regressions had 269 observations.

The main explanatory variable is market competitiveness, measured for each year of the sample (1998-2018). I also employ various other controls as independent variables in this regression: equity value, target-book-value of the acquirer and finally market competitiveness. I have also created a dummy variable called stock. I have attributed the value of 1 if the target is totally acquired in stock, and 0 if it's not.

3.2- Hypotheses

In this section, I present the different hypotheses to be tested, based on the literature review.

Hypothesis 1:

The higher the degree of competition in the market for corporate control, the higher the M&A's announcement returns for the target firms, but not for the acquirers.

Hypothesis 2:

The acquisitions done in equity provide lower announcement returns for the acquirer public firms than acquisitions done in cash.

4-Results and analysis

Table1.

This table presents the main explanatory variable, percentage of the industry's competitiveness in the market of corporate control for each industry of the sample according the SIC Industry Classification. The competitiveness index is obtained by calculating the medium value of the industry competitiveness for each industry type, taking into account the 20 years of the sample. The competitiveness index for each industry and for each year of the sample is calculated by dividing the number of acquisitions relative to each industry and to each year of the sample per the number of listed firms of the same industry and of the same year.

The number of acquisitions per year according to each industry and the number of listed firms for each industry in each year was obtained directly from SDC Platinum.

Industry	n Targets	Competition (%)
50 Energy	13	8%
51 Basic Material	14	7%
52 Industrials	57	18%
53 Cyclical Consumer Goods and Services	40	17%
54 Non-Cyclical Consumer Goods & Services	13	10%
55 Financials	88	12%
56 Healthcare	13	11%
57 Technology	31	19%
58 Telecommunications Services	2	8%
59 Utilities	4	14%

The total number of observations in this sample is 269. In order to obtain the competition index for each industry I calculated the competition value for each year from 1999 to 2018 and then calculated the mean of these values. For each year the competition value was determined by dividing the number of targets of my sample corresponding to each industry by the total number of public listed firms in the UK in that year.

The industries that present the higher level of competition are the industries of Technology (19%) and Industrials (18%) and the ones with lower level of competition are the industries Telecommunication Services (8%) and Basic Material (7%).

I divided these industries in 2 groups: "The most competitive industries" and "The least competitive industries". The most competitive ones are *Industrials, Cyclical Consumer Goods and Services, Financials* and also *Technology*. The least competitive industries are *Energy, Basic Material, Non-Cyclical Consumer Goods and Services, Healthcare, Telecommunications Services* and also *Utilities*.

Table 2:

In the following table I present some general descriptive statistics about the transactions according the competitiveness level of the acquirer industry. The first column of the table presents the mean and median values for all the transactions, the second one for the most competitive acquirer industries and the third one for the less competitive ones.

In the lines are presented the mean and median values of the transaction values, the acquirer size, the target size, the relative size, the premium of each transaction, and finally the percentage of transactions according each method of payment (All Cash, All Stock and Mixed). The acquirer and the target size are determined by it's values 4 weeks before the announcement of the acquisition. The relative size is given by the ratio of the transaction value and the acquirer size. Premium is calculated by dividing the transaction value over the target's market value 4 weeks before the announcement. I considered the payments "All stock" if the payment is done 100% in stock, "All Cash" if the payment is done 100% in cash or "Mixed" if the payment is partially done in stock and the other part in cash. All the values below are displayed in millions of dollars.

	(1) All	(2) Most competitive industries	(3) Least competitive industries	(3)-(2)
TV				
Mean	1141,6	934,4833	1542,015	607,532
Median	88,266	94,388	66,328	-28,060
Acquirer Size				
Mean	5201,6	3656,7886	8320,8346	4664,046
Median	628,09	560,095	788,0175	227,923
Target Size				
Mean	1152,1	1052,8195	1332,7005	279,881
Median	76,322	83,836	61,689	-22,147
Relative Size				
Mean	0,9368	1,0594	0,7006	-0,359
Median	0,2216	0,2412	0,1924	-0,049
Premium				
Mean	1,2948	1,2617	1,3549	0,093
Median	1,3035	1,2706	1,3487	0,078
Payment				
% All Cash	0,3792	0,3842	0,4457	0,062
% All Stock	0,342	0,3446	0,2609	-0,084
% Mixed	0,2788	0,2712	0,2935	0,022

*p<0,05, **p<0,01, ***p<0,001

The table above shows some descriptive statistics about the acquirer and target firms, their size, their relative size, the premium of the transactions and also the method of payment of each transaction.

The sample is composed by all the acquisitions of listed targets reported in the Thomson Financial SDC platform from 1999 to 2018 that meet all the criteria specified in the Data section and that have the method of payment data available, are domestic, and are undertaken by public acquirers. After excluding all the transactions that didn't meet all

the criteria of selection for the sample or didn't have all the descriptive information available in Thomson Financial SDC platform, 269 observations available remained.

By analysing the results displayed in the table, it's possible to conclude that deals involving more competitive industries have a higher value of transaction than deals involving less competitive industries. The lower competition deals present higher acquirer and target sizes, but a lower relative size. The differences corresponding to the other variables are very small.

However, it's not possible to draw any conclusions about that differences, because they are not statistically significant.

4.1-Acquirer

4.1.1-CARs – competition

Table 5 contains the coefficients of acquirer CAR's and also of the competition in the market for corporate control in a univariate and in a multivariate regression.

Considering the previous literature, it's expected the competition will have a negative effect on the acquirer returns. This scenario is verified in this case, except for the higher corporate competition level in the multivariate regression.

However, these results are not statistically significant, so they are inconclusive. Taking this into account, it's not possible to confirm or deny the Hypothesis 1.

Table 3:

The impact of the competition in the acquirer's firms returns

The following table shows the effect of the competition in the market for corporate control in the returns of the acquirer firms. This table contains both the univariate and the multivariate analysis for all the firms and also presents the results dividing them according to their competition in the market for corporate control: the ones who belong to the most competitive industries and the ones who belong to the least competitive industries.

The univariate analysis just contemplates the effect of the competition in a regression where competition is the only variable. The multivariate analysis shows the impact of competition in a regression that includes also control variables: the acquirer size, the relative size and also premium. Acquirer size is given by the market value of the acquirer firm 4 weeks before the moment of the announcement of the acquisition. Relative size is given by the ratio between the transaction value and the acquirer size. Finally, premium is calculated by dividing the transaction value over the target's market value 4 weeks before the moment of acquisition announcement.

	Univariate analysis			Multivariate analysis		
	All	Most competitive industries	Least competitive industries	All	Most competitive industries	Least competitive industries
Competition	-.00005 (.00111)	-.0001 (.0012)	-.14263 (.1413)	.0088 (.01193)	.03231 (.0014)	-.1222 (.0448)
Acquirer size				.0128 (.0336)	.0025 (.0163)	.0117 (.0098)
Relative size				.0024 (.0073)	.0184 (.0357)	.0265 (.0199)
Premium				.0137 (.0179)	.0021 (.0041)	.0033 (.0293)

t statistics in parenthesis
(* p<0.05, ** p<0.01, *** p<0.001)

4.1.2-CARs – Payment method

In this sample, acquisitions whose payment is done 100% in cash are associated with positive and higher returns when compared to acquisitions done in equity, independently from the level of the competition in the market for corporate control. The returns for the payments done 100% in stock are lower, but still positive. The returns associated to the transactions where the payment is done partially in cash but also in stock are always negative, no matter the level of competition in the market for corporate control.

This conclusion matches the one from (Travlos, 1987; Fuller et al., 2002; Moeller et al., 2004, Alexandridis et al., 2010) that also found that the returns for the acquirer firms are higher when the transaction is done in cash rather than the situations when the acquisition is done in equity.

Table 4:**Medium returns of the acquirer firms according the competitiveness and the method of payment:**

The following table shows the medium returns derived from the acquisitions to the acquirer firms. The results are divided according the competitiveness of the industry that which firm belongs (All, Most competitive industries and Least Competitive Industries) and also according to the method of payment that was used in the moment of the acquisition (*All, Cash, Stock and Mixed*). The method of payment is considered to be Cash if the transaction is done 100% done in cash or Stock if the transaction is 100% done in Stock. Otherwise, the method of payment is considered to be Mixed.

Industries	Payment method			
	ALL	Cash	Stock	Mixed
(1) All	0,0015*** (7,5289) 269	0,0037*** (10,9454) 115	0,008*** (4,2756) 71	-0,0125*** (-6,3617) 83
(2) Most competitive	0,0045*** (4,4999) 176	0,0018*** (3,0399) 69	-0,0007*** (-7,5409) 38	-0,0038*** (-5,4388) 69
(3) Least competitive	-0,0042*** (-4,0694) 93	0,0067*** (6,5434) 46	-0,0032*** (-7,2274) 33	-0,0271*** (-3,3425) 14

t statistics in parenthesis

*p<0.05, **p<0.01, ***p<0.001

4.2-Target

4.2.1-CARs – competition

Table 7 contains the coefficients of target CAR's and also of the competition in the market for corporate control in a univariate and a multivariate regression.

Taking into account the existing literature, it's expected that competition will influence positively the acquirer returns. This situation is verified for both univariate and multivariate analysis except for the case of the least competitive industries in the multivariate analysis.

However, the results are not statistically significant again, so they are also inconclusive. For this reason, it's not possible to confirm the hypothesis.

Table 5:

The impact of the competition in the target's firms returns

The following table shows the effect of the competition in the market for corporate control in the returns of the target firms. This table contains both the univariate and the multivariate analysis for all the firms and also presents the results dividing them according to their competition in the market for corporate control: the ones who belong to the most competitive industries and the ones who belong to the least competitive industries.

The univariate analysis just contemplates the effect of the competition in a regression where competition is the only variable. The multivariate analysis shows the impact of competition in a regression that includes also control variables: the target size, the relative size and also premium. Target size is given by the market value of the acquirer firm 4 weeks before the moment of the announcement of the acquisition. Relative size is given by the ratio between the transaction value and the target size. Finally, premium is calculated by dividing the transaction value over the target's market value 4 weeks before the moment of acquisition announcement.

	Univariate analysis			Multivariate analysis		
	All	Most competitive industries	Least competitive industries	All	Most competitive industries	Least competitive industries
Competition	.0007 (.0037)	.1923 (.5598)	.0003 (.0041)	.0017 (.0168)	.0392 (.1788)	-.1269 (.0401)
Acquirer size				.0912 (.0025)	.0025 (.0163)	.0117 (.0518)
Relative size				.0081 (.0027)	.0184 (.0357)	.0214 (.0749)
Premium				.0189 (.0955)	.0022 (.0541)	.0091 (.0163)

t statistics in parenthesis
(* p<0.05, ** p<0.01, *** p<0.001)

4.2.2-CARs – Payment method

The previous literature indicates that the returns from the target firms derived from the acquisitions tend to be positive independently the method of payment that is used in the transaction.

The transactions in cash present, as the acquirer firms, higher returns comparatively to the other methods of payment. The payment in equity is associated with lower returns for the target firms. Despite that, the returns associated to mixed way of payment are even lower, as in the returns of the acquirers case.

Nevertheless, it's not possible to reach any conclusions about casual effects of the method of payment in the returns of the targets, because all the coefficients are not statistically significant.

Table 6:**Medium returns of the target firms according the competitiveness and the method of payment:**

The following table shows the medium returns derived from the acquisitions to the acquirer firms. The results are divided according the competitiveness of the industry that which firm belongs (*All, Most competitive industries and Least Competitive Industries*) and also according to the method of payment that was used in the moment of the acquisition (*All, Cash, Stock and Mixed*). The method of payment is considered to be Cash if the transaction is done 100% done in cash or Stock if the transaction is 100% done in Stock. Otherwise, the method of payment is considered to be Mixed.

Industries	Payment method			
	ALL	Cash	Stock	Mixed
(1) All	0,1443 (0,4783) 261	0,0061 (0,2078) 99	-0,0077 (-0,3501) 70	-0,0113 (-0,1278) 92
(2) Most Competitive	0,0054 (0,6891) 170	0,0037 (0,5947) 62	0,0116 (0,7124) 64	-0,0287 (-0,7555) 44
(3) Least competitive	-0,0043 (-0,8251) 91	0,0102 (0,2599) 41	-0,0032 (-0,8992) 25	(-0,0287) (-0,4044) 25
t statistics in parenthesis				
*p<0.05, **p<0.01, ***p<0.001				

5-Conclusions

The main goal of this dissertation is to study if acquisitions in the United Kingdom has a positive or a negative impact in the returns of the acquirer and target firms. Besides that, I also wanted to study if the level of competition in the market for corporate control in the United Kingdom has some kind of influence in the returns for both acquirer and target firms, as well as the method of payment used in the transaction.

It was not possible to conclude that the level of competition in the market for corporate control influences the returns of both acquirer and target firms.

Regarding the influence of the method of payment in the returns of the acquirer firms, it was found a positive effect of payments done with cash and a negative effect of payments done with equity. This conclusion is the same that (Travlos, (1987); Fuller et al., (2002); Moeller et al., (2004), Alexandridis et al., (2010)) reached in their studies. Regarding the target firms, it was not possible to any effect of the method of payment.

Not having a big sample of acquisitions to analyse, essentially due to lack of data available in SDC Platinum about the method of payment used in the transactions, has limited my study.

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