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Do Acquiring Firms Achieve Their Mergers and Acquisitions Objectives? —Evidence from Japan—

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Index

- Introduction
- Literature review and hypotheses development
- Research design
- Results
- Conclusions

IASB (2020) "Business combinations—disclosures, goodwill and impairment"

IASB (2020) “Business combinations—disclosures, goodwill and impairment”

- IASB proposed that acquiring firms disclose:

  - the strategic rationale behind their acquisitions, as well as management’s objectives for acquisitions

  - the metrics to monitor their post-acquisition performance

  - whether their projections are fulfilled several years after acquisitions

Reactions to IASB (2020)'s proposal

- It generated mixed reactions from practitioners:

  - The new requirements could be beneficial for users of financial statements (JICPA, 2020; SAAJ, 2020)

  - The proposed disclosures are highly costly and contain a large amount of confidential information (Keidanren, 2020)

Index

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Literature review
(1) M&A objectives

- A primary reason for M&A is to create synergies such as improvements in management efficiency

- Financial factors such as stock overpricing can also drive M&A

- Managers conduct M&A to achieve personal goals such as maximizing their compensation

Literature review
(2) M&A performance

- Acquiring firms earn small or no announcement returns, while acquired firms earn significant positive returns

- Mixed results have been reported regarding long-term stock/accounting performance after M&A

- It is unclear whether the stock market is sufficiently efficient when a M&A is announced

Literature review
(3) Effects of narrative disclosure

- Narrative disclosure conveys new information to investors

- Narrative disclosure in financial statements is sometimes criticized as being “boilerplate”

- JICPA (2020) expressed concern that the new requirements could simply lead firms to present superficial information

Hypothesis 1: Operating performance

- A primary reason for M&A is the creation of synergy
- Managers sometimes conduct M&A for self-gain
- Rational managers are likely to disclose concrete M&A objectives

When acquiring firms mention profitability, efficiency, or growth as M&A objectives, their financial indicators show greater improvements, compared with firms that do not.

Hypothesis 2: Stock returns

- M&A do not necessarily result in positive outcomes for acquiring firms
- If managers mention concrete M&A objectives, those can be interpreted as a good indicator that the deal is not conducted for managers' self-gain
- Therefore, concrete narrative disclosure is likely to be evaluated more positively by investors

When acquiring firms mention profitability, efficiency, or growth as M&A objectives, they experience higher stock returns, compared with firms that do not.

Index

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Sample

- 232 M&A transactions in Japan were extracted

- Japan can be considered a desirable research site for several reasons:

  - Japanese stakeholders' preference for conservatism in goodwill amortization

  - M&A transaction volume has rapidly increased in Japan

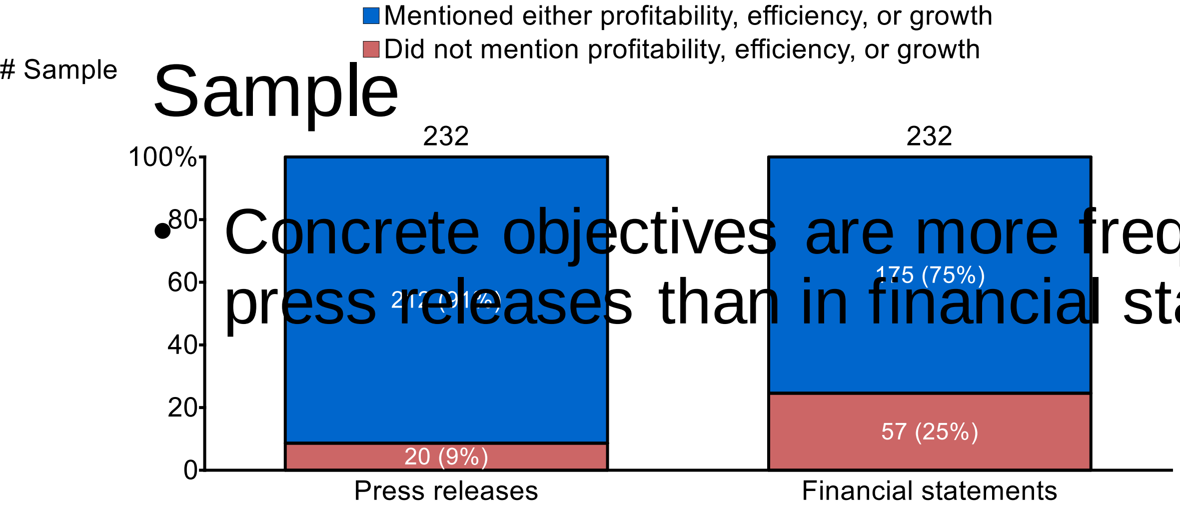
  - Therefore, detailed disclosures about M&A objectives are likely of interest to many conservative Japanese stakeholders

Sample

- M&A objectives are disclosed twice
  - (1) Press releases
  - (2) Financial statements
- Keywords related to M&A objectives were extracted and classified into three categories:
  - Profitability
  - Efficiency
  - Growth

Sample

- Concrete objectives are more frequently mentioned in press releases than in financial statements

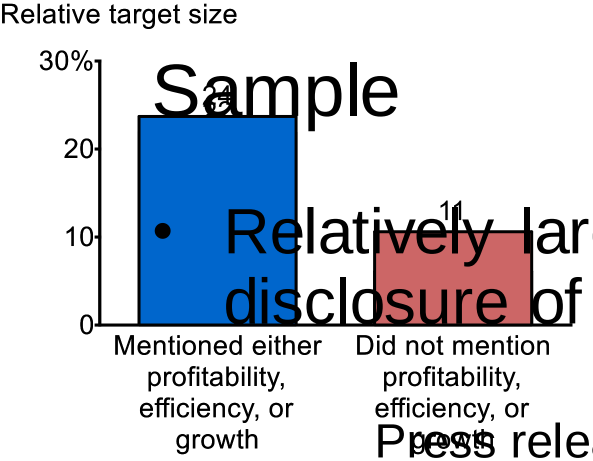


Detail

Summary

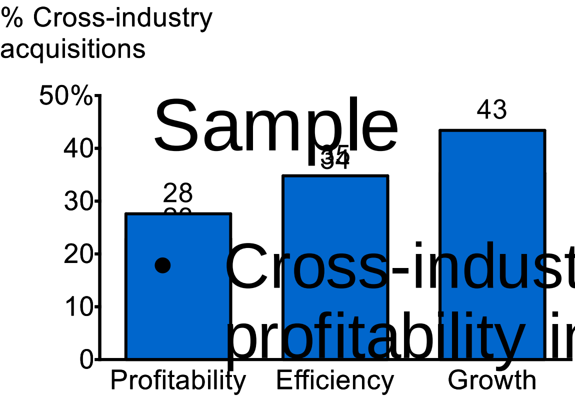
Sample

- Relatively large deals are more likely to include disclosure of concrete objectives



Press releases

Financial statements



Sample

- Cross-industry deals are less likely when firms pursue profitability improvements

Press releases

Financial statements

Methodology
H1: Operating performance

- This study assessed whether acquiring firms' financial indicators showed improvements

Profitability	• Operating profit on sales • Ordinary profit on sales
Efficiency	• Total assets turnover • Fixed assets turnover
Growth	• Sales growth • Total assets growth

Methodology
H2: Stock return

- This study assessed acquiring firms' stock returns by comparing:
  - (1) M&A where the keywords profitability, efficiency, or growth were mentioned to
  - (2) M&A where none of these keywords were mentioned

$$CAR_i = \sum_t AR_{i,t}$$

$$BHAR_i = \prod_t (1 + R_{i,t}) - \prod_t (1 + R_{m,t})$$

Index

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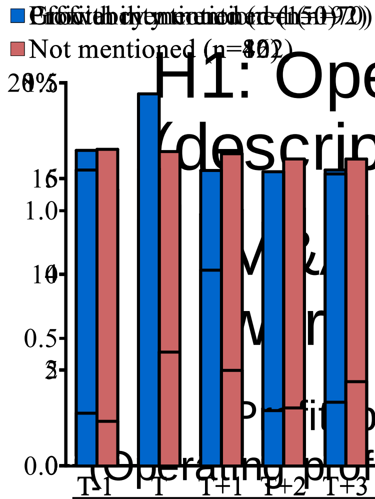
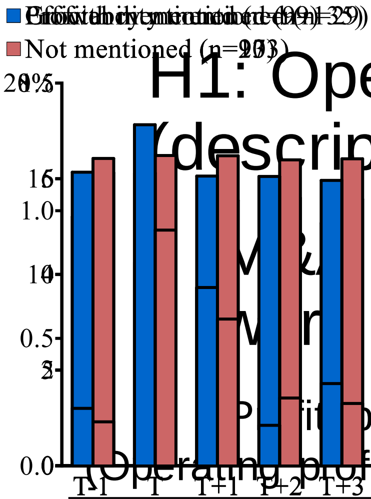
H1: Operating performance (description in press releases)

M&A objectives presented in their press releases were not realized on average



Profitability (Operating profit on sales)	Efficiency (Total assets turnover)	Growth (Sales growth)

: Statistically significant difference



H1: Operating performance (description in financial statements)

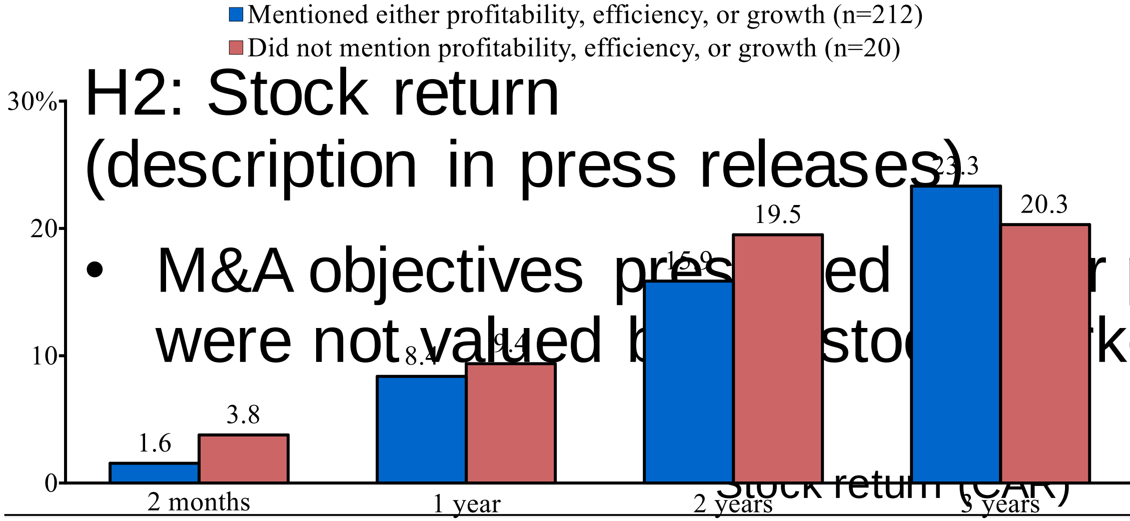
M&A objectives presented in their financial statements were not realized on average

Profitability (Operating profit on sales)	Efficiency (Total assets turnover)	Growth (Sales growth)

: Statistically significant difference

H2: Stock return (description in press releases)

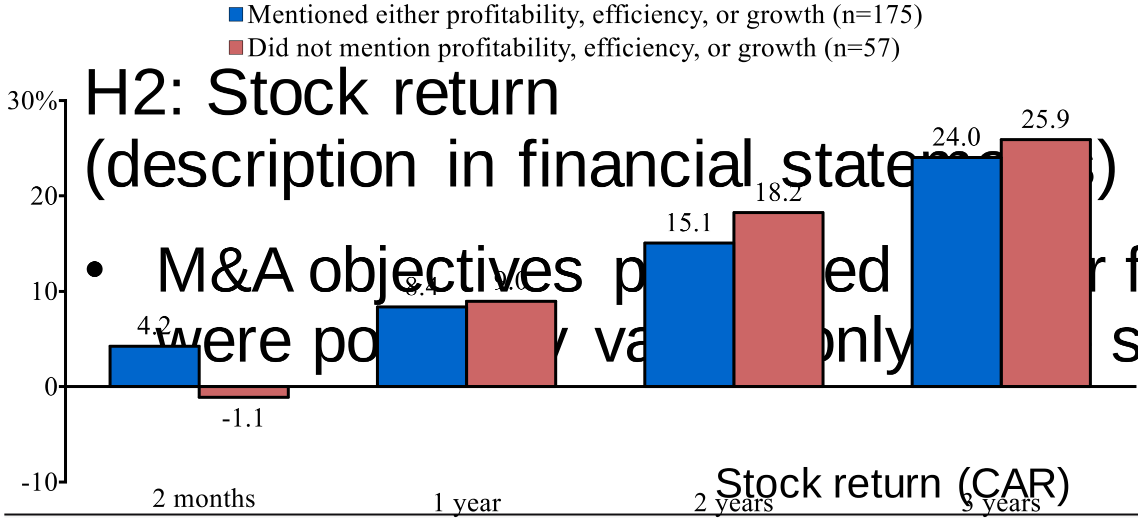
- M&A objectives pres ed r press releases were not valued b stoc rket



Stock return (CAR)

H2: Stock return (description in financial state… s)

- M&A objectives p… ed … r financial statements were po… y va… only … short term



: Statistically significant difference

Discussion

- Short-term higher stock returns after submission of financial statements, but not after press releases

Press releases	Financial statements
• Concrete objectives are more frequently used • Mentioning M&A objectives that apply to most M&A? • Obscuring the objectives specific to each deal?	• Succinct description better conveys the specific objectives? • Related information (e.g. overall performance, future investment plan) helps investors?

Additional analyses

- No significant difference in stock returns “1 year” after the M&A or later

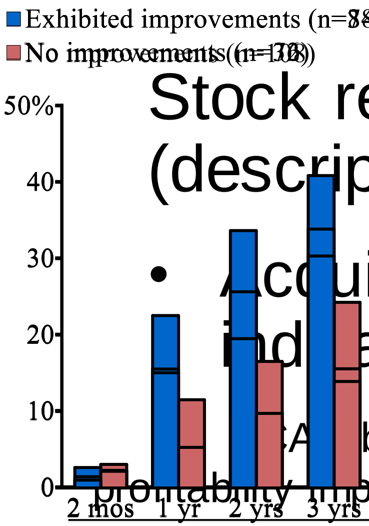
- To examine this point further, the group of firms that included either of the keywords was divided into a subgroup of firms:

  - (1) those that saw improvements in their financial indicators

  - (2) those that did not

Stock returns by improvements in operating performance (description in press releases)

- Acquiring firms that saw improvement in their financial indicators earned higher long-term returns



CAR by profitability improvements	CAR by efficiency improvements	CAR by growth improvements

: Statistically significant difference

Stock returns by improvements in operating performance (description in financial statements)

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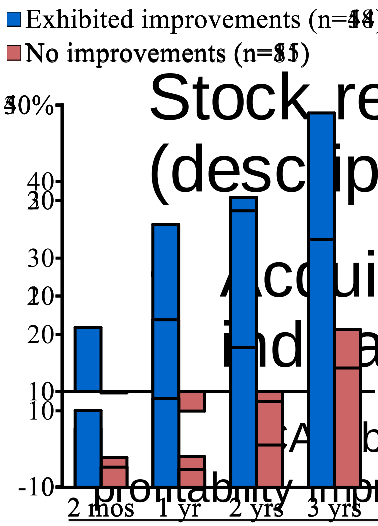


CAR by profitability improvements	CAR by efficiency improvements	CAR by growth improvements

: Statistically significant difference

Robustness tests
(1) Heckman's two-stage treatment effect approach

- Factors that can affect the firms' decision to mention concrete objectives are controlled

$$MENTION$$
$$= Probit\ (\beta_0 + \beta_1 CROSS + \beta_2 SIZE + \beta_3 RELSIZE$$
$$+\beta_4 OPSALES + \beta_5 TATRUN + \beta_6 GROWTH$$
$$+Industry\ dummy + Year\ dummy)$$

Robustness tests
(1) Heckman's two-stage treatment effect approach

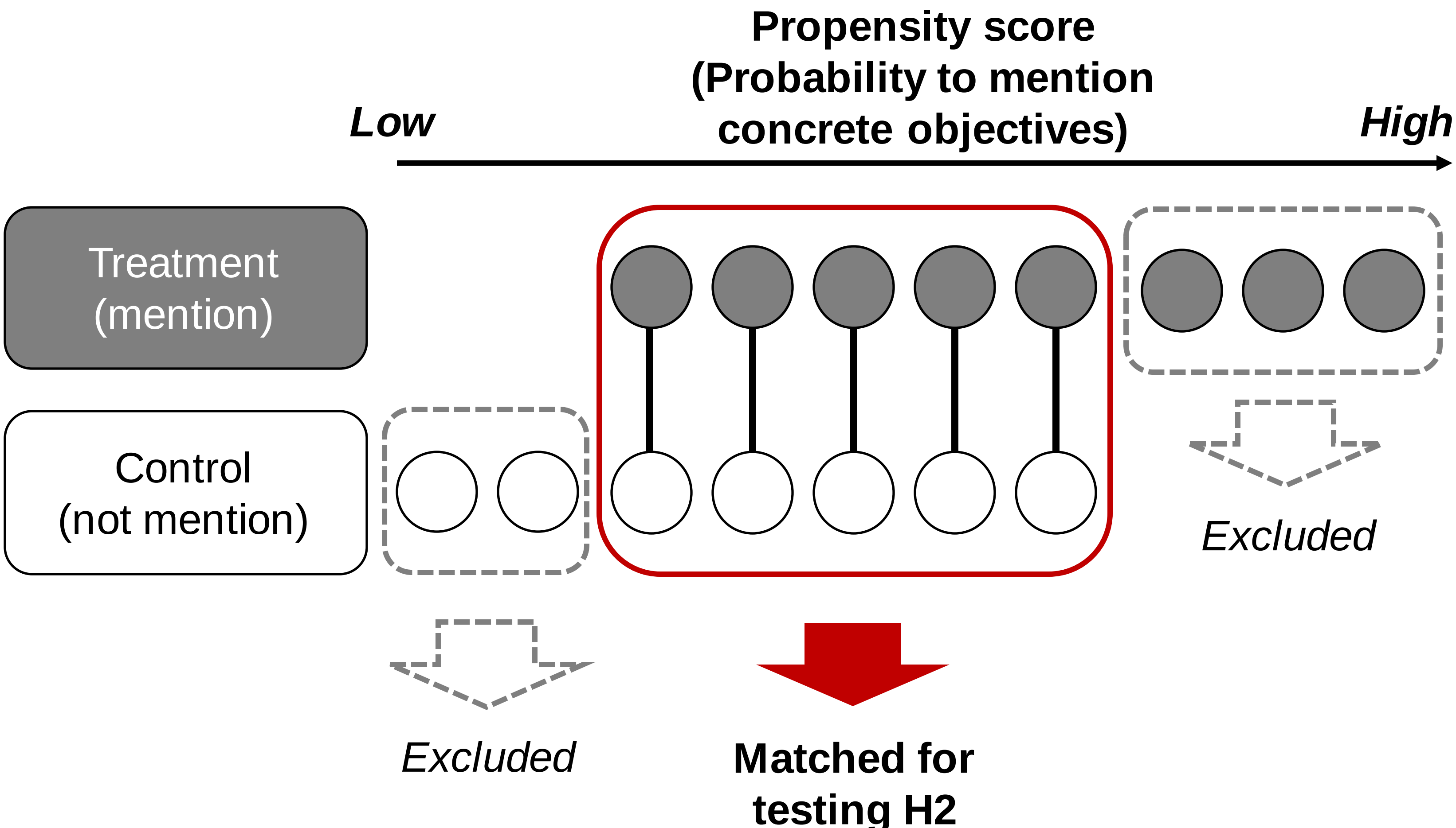
- Results in the main analysis hold when controlling self-selection bias

Panel B: Second stage

	Dependent variable							
	CAR (2 months)	CAR (1 year)	CAR (2 years)	CAR (3 years)	BHAR (2 months)	BHAR (1 year)	BHAR (2 years)	BHAR (3 years)
MENTION	0.042**	0.010	0.000	-0.007	0.042**	0.024	0.040	0.071
	(0.016)	(0.042)	(0.048)	(0.033)	(0.017)	(0.049)	(0.069)	(0.078)
LAMBDA	-0.028	0.041	0.081	0.029	-0.034	0.081*	0.086	0.129
	(0.034)	(0.040)	(0.052)	(0.080)	(0.038)	(0.044)	(0.070)	(0.089)
Intercept	0.009	0.060	0.124**	0.239***	0.014	0.020	0.100	0.146*
	(0.026)	(0.036)	(0.041)	(0.042)	(0.029)	(0.039)	(0.061)	(0.069)
N	232	232	232	232	232	232	232	232
Adjusted R-square	0.010	-0.007	-0.004	-0.008	0.008	-0.003	-0.008	-0.006

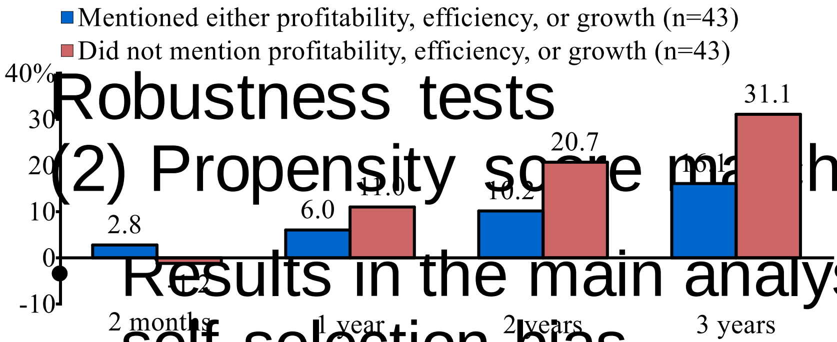
Robustness tests
(2) Propensity score matching

- Treatment group is matched with control group based on propensity score



Robustness tests
(2) Propensity score matching

- Results in the main analysis hold when controlling self-selection bias



	2 months	1 year	2 years	3 years
Difference	4.0%	-5.0%	-10.6%	-15.0%
(p-value)	(0.048)	(0.404)	(0.166)	(0.100)

Panel A: CAR

: Statistically significant difference

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Conclusions

- Disclosed M&A objectives were not realized on average in terms of financial indicators related to profitability, efficiency, and growth

- In the short period, acquiring firms earned higher stock returns when concrete M&A objectives were mentioned in the financial statements

- In the long run, the stock market adjusted firms’ valuation based on their actual performance

Implications

- Results partially support the IASB’s proposal
  - The M&A objectives presented in narrative disclosure statements are rarely realized
  - Narrative disclosure might mislead investors in the short term, resulting in the overpricing of acquiring firms
- Concern that the IASB’s proposal could lead to more “boilerplate” disclosures remains valid
  - More discussion is needed regarding how to develop effective requirements for narrative disclosure to reflect firms’ actual performance

Thank you!