

Informational releases in diversifying takeovers

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Abstract

This study attempts to reconcile two seemingly conflicting empirical findings: takeovers are efficient restructuring events, but they not seem to benefit the shareholders of the acquiring firms. We suggest that the poor abnormal returns to acquiring firms' shareholders in diversifying takeovers are in part due to negative informational releases regarding the acquirer's main industry. In a sample of 816 diversifying takeovers, we test this hypothesis by analyzing the effects of takeover announcements on the rivals of the acquiring firm. We focus our analysis on homogenous rivals, which are rivals that are more likely to be affected by the same economic shock that may result in the acquirer's decision to diversify. We identify homogenous rivals by using pre-takeover correlations in the stock returns of the acquirer and each rival firm.

We find that homogenous rivals experience statistically and economically significant negative abnormal returns at the takeover announcement. We also find that the revisions in analysts' forecasts of homogenous rivals' earnings per share are significantly negative around the takeover announcements. Taken as a whole, our results imply that a large part of the acquirer adverse price effect at the announcement of diversifying takeovers is due to negative informational releases about its principal industry. Thus, previous estimates of takeover wealth effects that use announcement period abnormal returns are likely to be biased downward.

This draft: January 2006

Preliminary and incomplete: please do not cite without permission

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