WHAT'S IN A 13D? AN EMPIRICAL STUDY ON MERGERS AND MARKET EFFICIENCY

Billy Wang, (Michael Lemmon)
Department of Finance

In a mergers & acquisitions transaction the bidding firm makes an offer to buy all the outstanding shares of the target firm. It is often the case that the acquiring firm will begin to start buying stock in the target firm before any mergers announcement is made. This allows the bidding firm to acquire some portion of the target firm for cheaper than when the merger is finally announced. If the acquiring firm has less than a 5% position in the target firm (visible toehold) then the acquiring firm is immune from filing with the Securities and Exchange Commission (in accordance to schedule 13D of the Securities and Exchange Act of 1934) regarding the amount and intent of such holding. In turn it is hypothesized that the market will be more surprised to such a deal taking place and will result in a higher premium on announcement date to target firm's stock price without any visible toeholds by the acquiring firm. We looked at a sample of 1661 completed mergers in a five year period between July 1999 and July 2004. The database of merger transactions is acquired from CRSP (Center for Research in Securities Prices). Note that the data set is only applicable to target firms that are publicly traded in the US. We find there is material difference in acquisitions made with a toehold position versus an acquisition made without a toehold position. The amount of premium realized four weeks prior to the announcement date of the merger for acquisitions made without a visible toehold is double that of acquisitions made with a visible toehold. This leads us to conclude that the market is actively seeking out all possible merger opportunities in the use of the schedule 13D filing and is valuing stocks with a potential merger announcement higher than their counterparts accordingly, despite the fact that a 13D filing does not guarantee a potential merger.