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The French SMEs and their Financial Performance at the Launch of the Corporates Acquisition Programs

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I. INTRODUCTION

Knowledge gleaned on the French case regarding corporates acquisition all are almost reserved to the big companies, especially for the valuation of the acquisition programs gain. Recent empirical research has shown that, the aim objective of merger and acquisition (M&A) operations for the acquiring firms is to operate an external expansion with the aim of getting bigger and developing. A competitive market of corporates acquisition implies that the earnings of the acquirers during no successful acquisitions have a negative price of bid; shareholders of the target firm will accept this price. Ruback (1983) tested this implication in a study using data on takeovers desired by several acquiring firms. The results confirm the hypothesis of market competition concerning acquisition operations.

From this perspective, the problem, which we try to deal and to analyze, is to demonstrate how to measure, analysis and explain the profitability of the acquisition operations within the framework of the acquisition programs launched by French firm's directors.

As it is noted in the research of Aktas, N., De Bodt, Roll, R. (2009)¹, why would firms undertake acquisitions if not to create value? The problem we

cleared up the possible ways being able to help to answer a fundamental question, which is why the directors launch programs of acquisition while the present value of the program is negative?

The second case is when the acquisition programs are positive, that is generate profits for the acquirers. In this case, our question, which is secondary, is to know why then the acquirers do not launch them in a continual way? This question is justified by the fact that there are very precise periods when the directors make this complex kind of investment.

From this perspective, our empirical study in which we evaluate the profitability of corporates acquisition programs, try to specify stocks price reactions at the announcement of M&A operations. It is a question particularly to verify if the partially anticipated events by the French acquirers generates consistent returns, which can be compared with those of the American case.

The actual financial literature about this subject largely try to calculate the gains associated to the acquisition operations for both, acquirers and target firms. Another point treated in this literature focus on the identification of the impact of these operations on the shareholders wealth.

Malatesta and Thompson (1985) provide evidence on the acquisition programs profitability for American case. Both researchers are the first ones who established an econometric model, allowing estimating the value of an acquisition program. Previously, Schipper and Thompson (1983) realized an empirical study in which they measure the impact of acquisitions activity on firm value by differentiating between specific merger events and programs of acquisition activity. Through a sample of conglomerate acquirers, they find significantly positive abnormal returns associated with the announcement of acquisitions programs and significantly negative returns associated with certain institutional laws.

In another type of studies published in the 11 volume of the "Journal of Financial Economics", Asquith, Bruner and Mullins (1983) examines the effect of mergers on the wealth of bidding firms' shareholders. They clarifies some interesting points about acquisitions activity. They feel that the bidding firms gain significantly during the twenty-one days leading to the

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¹Aktas, N., De Bodt, E., Roll, R., 2009. Learning, hubris and corporate serial acquisitions. *Journal of Corporate Finance* 15, 543-561.

announcement of each of their first operation within four merger bids. These results have not a support to the capitalization hypothesis that acquirers' gains are capitalized at the beginning of merger programs.

In the same volume of the journal reserved to the wealth effects of mergers and the market for corporate control, Malatesta (1983) examines the net effects of the long-run sequence of events leading to merger, and of merger per se, on shareholder wealth. The author find that the long-run wealth effect of the event sequence culminating in merger is significantly negative for acquiring firms.

This study examines the profitability of corporates acquisition programs by distinguishing between types of effects. Specifically, an acquisition program has an announcement effect and an economic impact for each acquisition attempt made by the acquiring firm. The study determines the value of the both effects and the abnormal returns for the acquisition attempts on the non-event periods, for the total sample of big and SME French companies. The results shows that for the total sample which account 46 French acquirers, acquisition programs are losing. However, by considering the subsamples of the study, we find that the French SME perform better than, the big companies, and create value expressed in positive returns generated from their programs.

The next section explores theoretical considerations about the hypothesis studied within the framework of the estimation of corporates acquisition programs. I then describe the methodology used to evaluate reaction to acquisition programs announced by French acquirers. In this section, we try to present the mathematical development of the model that I apply on a sample of French acquirers in order to determine if corporates acquisition programs at the announcement date have a positive net present value or no. The following section is reserved to a discussion on the results of a number of SME, which are included in the initial sample. Through these results, I demonstrate that this type of firms are more profitable than, the other firms. The final section summarizes the results of the study.

II. THEORETICAL CONSIDERATIONS ON ACQUISITION PROGRAMS

The corporates acquisition programs were little handled by researchers because they are a very specific subject in finance. Indeed, directors must publicly announce the acquisition programs in order to be able to capitalize the gains, which are associated to it, at the time of their launch. The public announcement of this type of information, which is the launch of acquisitions programs, is very important for shareholders of acquiring firms. It allows their enrichment by the increase in share prices.

In this case, the very important assumption implied that acquisitions operations as mergers and tender offers are comprised partly of individual events undertaken within structured acquisitions programs. However, the empirical studies shows that the results of acquiring firms are expected by acquirers to gain from acquisitions activity, although some of the evidence is without supports.

The effect of an acquisition program must be profitable to the acquiring firm and to these shareholders at the same moment of the launch of said program. For example, if a firm were to announce an event concerning the structure of its capital, by then the reaction of its shares should take place at the announcement of the event, not at any later date.

There is a difference between individual acquisitions and programs of acquisition activity. Generally, for individual acquisition operations, the methodology used in the estimation of the returns of the shareholders and the variation in the firm value of the both target and bidding companies is the "event study methodology". Fama, Fisher, Jensen and Roll (1969) developed this technique in order to capture the effect of an event on stock prices by calculating the abnormal returns caused by this event. Studies that have examined the gains of mergers and tender offers applies the method based on the estimation of abnormal stock returns at the time of the specific event and surrounding this event date.

One of the preliminary hypothesis on which is based the evaluation of an acquisition program is relative to the value-maximizing behavior. Within the same framework, several hypothesis have been put forward in empirical studies, which estimate the value of the acquisition programs. In Malatesta and Thompson (1985), the capitalization hypothesis were treated and they find that is consistent with constant announcement effects for successive acquisition attempts. The net present value of all the acquisition attempts made by the acquiring firm within the program is fully capitalized in firm value at the time of the initiation of the program. The frequency of acquisition attempts influences the net present value of the program, also the expected economic impact imputed to future attempts raise the acquisition program value, and the fixed costs are attributed to the program.

The estimation of the capitalized value of acquisitions programs is very important for two reasons. First, as Malatesta (1981) have pointed out, the fixed costs of an acquisition program will not affect the price reaction around an acquisition event. Further, if acquisition program requires any initial expenses, price reactions to individual event announcement as take-over or merger could indicate a positive return to those expenses. For that purpose, the price reaction to an acquisitions program will reflect the cost of the initial outlay as well as the expected return on it. The second

and equally important reason is that once the expected value of an acquisitions program is capitalized, variations in the value of an acquiring firm surrounding event announcements will reflect only the surprise associated with the terms of the individual event. This surprise is measured relative to the expectations, which were capitalized at the time the acquisitions program was publicly announced.

The two main studies of the profitability of corporates acquisition programs within the framework of M&A operations are the ones of Shipper and Thompson (1983) and, Malatesta, and Thompon (1985). The results of the first study indicate that the acquiring firms anticipate gains from acquisitions activity. The second study approve this result. Indeed, Malatesta and Thompson (1985) find that the average estimated economic impact of an acquisition attempt exceeds 4 million dollars, but they cannot conclude that an acquisition program is desirable for firms in general.

III. ANALYSIS OF FRENCH ACQUISITIONS PROGRAMS PROFITABILITY

Our questions relative to the profitability of the corporates acquisition programs were studied in the context of French M&A operations realized between 1997 and 2007. In this section, we describes our sample of firms involved in a process of acquisition operations in series called acquisition program, then we present the empirical methodology used and hypothesis. In the third part of this section, we present the results for the entire sample of 46 acquiring firms.

a) Data

The acquiring firms sample analyzed in this study comes primarily from the AMF² files, which, are on its Web site. During the observation period (1997-2011), the French acquirers made 1050 acquisition operations. These operations concern only four types of acquisition, which are takeover bid, public offer of exchange, mixed public offer and merger.

The basic selection criterion is concerning the number of acquisition attempts made by the acquirer. Every acquiring firm having made at least an acquisition attempt during the eleven years of the study period is held in the sample. We strictly apply this selection criterion because it is impossible in this case (French case) to verify the real public announcement of the acquisition programs in the financial press.

Two firms are concerned in every acquisition operation, the acquiring firm and the acquired (target) firm. Our empirical analysis touches only the French acquiring firms. In final our sample study covers over 11 years, from 1997 to 2007 and they contains 46 French frequently acquirers. These firms represents practically all the economic sectors of France. The entire 46 firm

sample which announced and subsequently carried out acquisition programs launched a total of 97 acquisition operations, they represents on average 2.11 attempts by firm during the study period. This represents 95% of all the acquisition attempts counted during observation period (1997-2011) as it shown in table 1 and figure 1. We consider the acquisition operations made by the acquiring firms as acquisition attempts since they can be successful or unsuccessful.

All the financial and stock exchange data concerning the 46 French acquirers about which we evaluate the profitability of their acquisition programs are obtained from *Datastream* database. This data ranges from stock price, dividend, CAC 40 stock index, market value and FRANCE TREASURY BILL 1 MONTH for interest rate. These data is gathered every month and we calculate the zero beta portfolio return after having calculate the monthly stock return for each firm. We use the zero beta return to calculate the stock and market risk premium and it instead of interest rate.

b) Empirical methodology and assumptions

The fundamental idea according to which Malatesta and Thompson (1985) have developed their econometric model for assessing profitability of an acquisition program is diverted from estimation of a classical investment. In the launch of an acquisition program, the acquiring firm has fixed costs that she hope to cover with future cash flows generated by their acquisition attempts. The net present value of the acquisition program for an acquiring firm j , NPV_j is given by

$$NPV_j = \frac{q_j \cdot v_j}{r} - F_j \quad (1)$$

² AMF : Autorité des Marchés Financiers, www.amf-france.org

Table 1
Summary of the sample elements for empirical study

The sample elements	Rough description
<p>Data :</p> <ul style="list-style-type: none"> - Choice of firms - dates of the first announcement - Stock exchange and financial data - Types of acquisition attempts <p>The periods :</p> <ul style="list-style-type: none"> - Observation period - Studyperiod - Periodicity of the data - Length of the study period <p>The acquisition attempts :</p> <ul style="list-style-type: none"> - Number of firms - Number of firms without acquisition attempts - Sum of acquisition attempts during study period <p>Average of the attempts :</p> <ul style="list-style-type: none"> - Sum of attempts per firm - Sum of annual attempts per firm 	<p>Source of data :</p> <ul style="list-style-type: none"> - www.amf-france.org - www.amf-france.org - Datastream database - Take-over (cash, exchange, mixte) and mergers <p>Delimitation of periods :</p> <ul style="list-style-type: none"> - 1/1997 to 12/2011 - 1/1997 to 12/2007 - Monthly - 132 months <p>Statistical data :</p> <ul style="list-style-type: none"> - 46 - 0 - 97 <p>Statistical data :</p> <ul style="list-style-type: none"> - 2.11 - 0.19

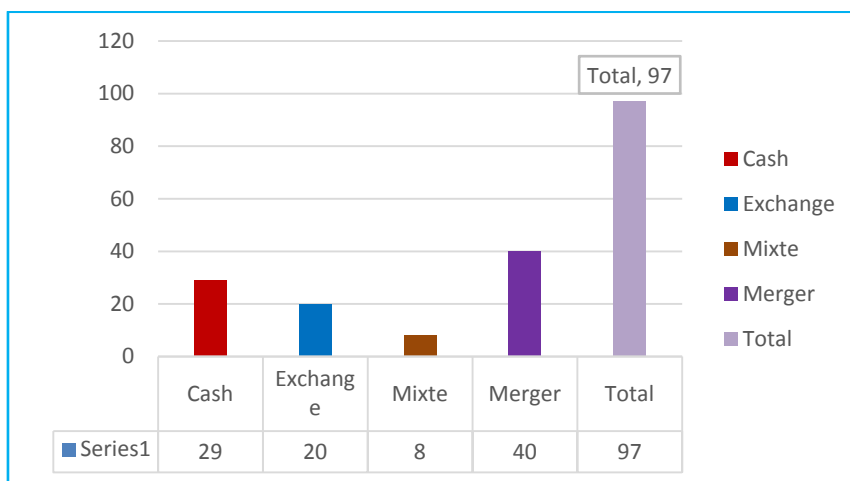


Fig. 1

Number of acquisition attempts by type 1997-2007

Where F_j denotes the program's fixed cost that contains all kinds of expenses in order to prolong the program. In addition, for each individual future attempt, the economic impact is indicated by v_j . Acquisition attempts within the program have a constant frequency q_j per period, the risk free interest rate equal to r .

The approach that I use in our empirical study in order to determines if French acquisitions programs are profitable or not begin by the estimation of the stock rate of return for each firm within the sample and the market return

$$R_{it} = \frac{P_{it} - P_{it-1} + D_{it}}{P_{it-1}} \quad (2)$$

where R_{it} is the realized rate of return to stock i at time t , P_{it} and P_{it-1} are the stock price as they are taken from *Datastream* database at time t and $t - 1$ successively, and D_{it} represents the dividend on the stock at time t .

$$R_{mt} = \frac{I_{CAC 40_t} - I_{CAC 40_{t-1}}}{I_{CAC 40_{t-1}}} \quad (3)$$

in which R_{mt} is the return on the market at time t , and I_{CAC40_t} , $I_{CAC40_{t-1}}$ are the stock index CAC 40(Paris Stock Index) at time t and $t - 1$ successively.

These two calculations allow us to begin the estimation of the multiple regression coefficients of the principles four models. The basic model serving to verify

the hypotheses of the study is in the form of a multiple regression with two independent variables, the first one is the market risk premium weighted by firm value V_{jt-1} at the time $t-1$. The second variable is a binary, d_{jt} equal to one for a firm j , which makes an acquisition attempt during period t and zero otherwise

$$(\tilde{r}_{jt} - r_t)V_{jt-1} = \alpha_j + \beta_j V_{jt-1}(\tilde{r}_{mt} - r_t) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt} \quad (4)$$

where $(\tilde{r}_{jt} - r_t)V_{jt-1}$ is the stock risk premium weighted by the firm value expressed by the market capitalization at the time $t-1$. The market risk premium $V_{jt-1}(\tilde{r}_{mt} - r_t)$ is one of the two independent variables of the regression equation; this one also is weighted by the firm value. The second independent (explanatory) variable of the multiple regression is the binary variable d_{jt} , which is equal to one if the firm take an acquisition attempt and zero when the firm does not take attempt during given period.

The main objective of our study is to estimate the gains or the losses of the French corporates acquisition programs, which spread out over several years. This evaluation is completed by the calculation of three coefficients α_j, γ_j and $\alpha_j + \gamma_j$ of the eq. (1). The analysis on which is based our empirical study is applied through four regressions, among which the three coefficients of two of them are expressed in

excess euro returns, and the two other regressions are in excess rate of return form, as it is shown below

$$(\tilde{r}_{jt} - r_t)V_{jt-1} = \alpha_j + \beta_j V_{jt-1}(\tilde{r}_{mt} - r_t) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt} \quad (5)$$

$$(\tilde{r}_{jt} - r_t) = \alpha_j + \beta_j (\tilde{r}_{mt} - r_t) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt} \quad (6)$$

$$(\tilde{r}_{jt} - \tilde{r}_{zt})V_{jt-1} = \alpha_j + \beta_j V_{jt-1}(\tilde{r}_{mt} - \tilde{r}_{zt}) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt} \quad (7)$$

$$(\tilde{r}_{jt} - \tilde{r}_{zt}) = \alpha_j + \beta_j (\tilde{r}_{mt} - \tilde{r}_{zt}) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt} \quad (8)$$

Both equations in which appear the variable defining the firm value V_{jt-1} are the ones which give the results in excess euro returns, and the two others which are without this variable, their results are in excess rate of returns. Another specification concern both risk premium. Two equations eq (5) and eq. (6) are expressed in interest rate and the two others eq. (7) and eq. (8) use the zero beta return to calculate both risk premium, that of the stock and that of the market.

Three hypotheses are treated in this study. The first one concern the variations of the abnormal returns that should be negative in non-event period. The second one predicts that the expected economic impact is positive and the last one it is about the expected announcement effect that should be positive. An overview on these hypotheses is presented in table 2 below:

Table 2

Hypotheses of the empirical study

Hypothesis	Coefficient	Coefficient sign	Definition of the hypotheses
$H_1 : \alpha_j = -q_j v_j < 0$	α_j	(-)	Expected abnormal return of an acquisition attempt for a non-event period
$H_2 : \gamma_j = v_j > 0$	γ_j	(+)	Economic impact of an acquisition attempt
$H_3 : \alpha_j + \gamma_j = (1 - q_j)v_j > 0$	$\alpha_j + \gamma_j$	(+)	Announcement effect of an acquisition attempt

The first hypothesis H_1 implies that the non-event period is the non-announcement period this means that is the time when the acquirer do not launch acquisition attempt. In every period, the frequency of acquisition attempt is positive q_j and because the expected economic impact of an acquisition attempt v_j is positive, then the variation of the abnormal returns in non-announcement periods α_j must be negative. In the second hypothesis H_2 , since γ_j is equal to v_j it follows that γ_j that measure the economic impact must be positive. The announcement effect of acquisition attempts is tested by the hypothesis H_3 , which states that the announcement effect must be positive if the expected economic impact is positive.

c) Results

For each of 46 companies constituting our sample, the parameters of every model 1, 2, 3 and 4 are considered by the ordinary least squares approach (OLS) applied to 132 months of study period (01/01/1997 to 31/12/2007).

Table 3 reports the main results of our study. In this table, I present for the four models, the average estimation of the coefficients, the average of t-student test and the significant percent different from zero of the coefficients.

In the panel A, the model 1 test the first hypothesis that $\alpha_j < 0$, I find that only one case on 46, this result was obtained and which is significant at the level of 0.05. This unique negative alpha is the one of the firm Unibel, an SME company specializes in the food

industry. On the other hand, in 32 cases we reject the null hypothesis in favor of the alternative $\alpha_j > 0$ for a significance level of 0.1. The number of non-significant cases is 13 cases on 46 studied what represents approximately 28% of the total sample.

The average of $\tilde{\alpha}_j$ for the entire sample is 169.033 million € what is against the hypothesis which predicts a negative sign. The explanation of this result according to which the French financial market is not efficient is not plausible, but there are other factors, which can explain this, as for example the competitiveness in the French corporates acquisition or what the launch of acquisition programs is expensive to the French acquiring firms.

The results given in panels B, C and D confirm the result of the basic model shown in panel A for both types, results expressed in excess euro returns or results in excess rate of return form.

IV. THE ACQUISITIONS PROGRAMS PROFITABILITY OF FRENCH SME

All the results on the profitability of the French corporates acquisition programs presented above are relative to the entire sample of French companies. Bouzgarrou and Navatte (2012)³ find positive significant CARs (Cumulative Abnormal Retrns) for French acquirers of private targets and negative insignificant CARs for French acquirers of listed targets. This result

my help us to complete our study. Indeed, to seize well the firms, which are more successful than others are, we distributed the 46 companies making up our sample study on subsamples. This work allowed us to constitute eight subsamples of industry: real estate, industrial services, chemistry and oil, technology, banks, media, distribution and health. For example, in the sector of the real estate, we have Vinci, Bouygues and especially Saint-Gobain which is a leader in his domain and very successful. Note that, in our sample there is also a small and medium enterprises "SME" as by example in the sub-sample of the Healthcare sector. This sub-sample consists of two companies only, Sartorius and Guerbet. Indeed, for this sector and for both firms together the sign of both coefficients γ_j and $\alpha_j + \gamma_j$ is positive. This is in line with the signs waited in both hypotheses, that of the economic impact and the announcement effect. The value of these two parameters, are estimated at 3.57 and 5.28 million €. Thus, there is at least one sector among eight branches of industry, which verified both hypotheses H_2 and H_3 . This is also an obvious result of the performance of the French EMS within the framework of French corporates acquisition programs.

Guerbet and Sartorius, together has significant results and their acquisition programs are slightly profitable but their financial performance are better than other big firms. Sartorius is listed at the SBF 120 stock index and Guerbet at the CAC SMALL 90 index.

Table 3

Summary of results for the four models

For each firm j the rates of return is indicated by \tilde{r}_{jt} and the market return by \tilde{r}_{mt} . Riskless interest rate is noted by r_t and in some cases, this interest rate is replaced by the zero beta portfolio return denoted by \tilde{r}_{zt} . The d_{jt} take two value: (1) if firm j firm j at period $t - 1$ is expressed by V_{jt-1} .

For each of 46 acquiring firms, estimates of α, γ and $\alpha + \gamma$ from 1/1/1997 through 31/12/2007, while α measures the acquisition attempts abnormal return on non-periods, γ measures the economic impact of acquisition attempts and $\alpha + \gamma$ measures the announcement effect.

Coefficient	Number of Estimates (J)	Average Estimate	Percent Positive (%)	Average t-statistic	Percent significant (0.1 level of significance)	
					(+)	(-)
Panel A Model 1 : $(\tilde{r}_{jt} - r_t) V_{jt-1} = \alpha_j + \beta_j V_{jt-1} (\tilde{r}_{mt} - r_t) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt}$						
α	46	169.033 ^a		2.48 ^d	69.57	2.17
β	46	1.20		7.55 ^d	97.83	0.00
γ	46	-40.901 ^a		-0.25 ^d	2.17	10.87
$\alpha + \gamma$	46	128.131 ^a		0.04	58.7	37.00

³ Bouzgarrou, H., Navatte, P., 2012. Short Term Wealth Creation Sustainability of French Acquirers of Unlisted Versus Listed Firms. Bankers, Markets & Investors N° 121, November-December, 47-58.

<i>Panel B Model 2: $(\tilde{r}_{jt} - r_t) = \alpha_j + \beta_j(\tilde{r}_{mt} - r_t) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt}$</i>						
α	46	0.0240	97.8	3.02 ^c	79.09	2.17
β	46	0.8332	100.0	6.71 ^b	96.65	0.00
γ	46	-0.0101	45.7	-0.11 ^c	4.35	2.17
$\alpha + \gamma$	46	0.0140	58.7	0.07	56.5	41.30
<i>Panel C Model 3: $(\tilde{r}_{jt} - \tilde{r}_{zt})V_{jt-1} = \alpha_j + \beta_j V_{jt-1}(\tilde{r}_{mt} - \tilde{r}_{zt}) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt}$</i>						
α	46	147.01 ^a	82.6	1.80 ^d	56.52	2.17
β	46	0.92	100.0	9.13 ^b	97.83	0.00
γ	46	-69.09 ^a	41.3	-0.27 ^d	2.17	10.87
$\alpha + \gamma$	46	77.92 ^a	56.5	-0.03	54.35	41.30
<i>Panel D Model 4: $(\tilde{r}_{jt} - \tilde{r}_{zt}) = \alpha_j + \beta_j(\tilde{r}_{mt} - \tilde{r}_{zt}) + \gamma_j d_{jt} + \tilde{\epsilon}_{jt}$</i>						
α	46	0.0218	91.3	2.41 ^d	69.56	2.17
β	46	0.8732	100.0	9.18 ^b	100.00	0.00
γ	46	-0.0107	43.5	-0.13 ^{n-s}	4.35	4.35
$\alpha + \gamma$	46	0.0111	54.3	0.04	52.17	45.65

^a In million €^b Significant at the 1% level

^c Significant at the 5% level

^d Significant at the 10% level

^{n-s} No Significant

V. SUMMARY AND CONCLUSIONS

By examining acquisitions programs, launched by frequently French acquiring firms from half of the 90s until the middle of the 2000s, I find that only the announcement effect hypothesis appears to apply to French acquisitions programs. Indeed, our results are a little limited by the weakness of the frequency of the acquisition attempts launched by the French acquirers.

Finally, proved evidence through the four regressions results supports partially the hypothesis that acquisition programs can be perceived as profitable investment projects for the French acquirers essentially those of "SME". This conclusion is justified by the individual results of firms. Otherwise, the sample which consists of 46 French companies considered as frequent acquirers on French acquisition market indicate clearly that firm's acquisition programs during the last decade were destructive of value. It means they do not maximize the value of the firm nor the stockholder's wealth.

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