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The Value Creation Potential of High-Tech Mergers

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Abstract

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The rapid growth of technology-based industries suggests that targets from these sectors may be able to provide greater shareholder wealth benefits for acquiring companies than slower-growth target companies. In addition to their high-growth potential, however, another feature of high-tech industries is the uncertainty associated with any company whose value relies on future outcomes or developments in unproven, uncharted fields. For example, the value of a biotechnology company may depend on the success or failure of a single new drug or medical device. Furthermore, some high-tech companies are not expected to generate any cash flow in the near future, which makes the valuation process notably riskier for the bidder in a high-tech valuation. Thus, from the perspective of a bidder's shareholders, the attractive growth prospects offered by a high-tech target may come with a high price tag.

Given such risk factors, we expected that the bidders that engage in these transactions would have confidence in their ability to successfully manage the acquisition. Furthermore, these acquirers would need to instill such confidence in their investors. To find out, we studied 1,634 mergers in the various high-tech areas that occurred from January 1987 through April 1996. We found that the average performance of the acquirers prior to the merger was significantly higher than that of their industry-matched competitors, which would help to convince investors that these acquirers are capable of creating value through the acquisition.

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We found that the factors that influenced bidder returns in the study are as follows: the time period in which the merger was announced (with higher abnormal returns in more recent acquisitions); the high-tech affiliation of the acquirer; the growth stage of the target (with takeovers of private targets generating higher bidder abnormal returns than takeovers of public targets); the bidder ownership structure (with moderate levels of insider ownership having a positive relationship and institutional ownership having a negative relationship with bidder returns); and the size of the transaction relative to the bidder (with larger transactions associated with larger bidder returns).

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