Independent Expert Reports and Takeovers

by

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Certificate of Originality

This thesis contains no material which has been submitted for the award of any degree or diploma in any university, or any material previously published unless due reference to that material is made.

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Abstract

Target firms in Australian takeovers are required to obtain an independent assessment of the offer price in situations where the Corporations Law considers the bidder has a superior bargaining position. The intention of this requirement is to protect target shareholders from being offered a lower takeover premium. The only empirical study of expert reports, Eddey (1993), is consistent with expert reports achieving their purpose, as the results indicate no difference in target firm premiums in offers with and without an expert report. Eddey also reports that a revision in offer price is more likely where an expert indicates the bid is "not fair and reasonable."

Using all takeovers from 1990 to 2000, this thesis aims to re-examine and substantially extend the findings in Eddey. As the sample includes all bids, irrespective of the form of payment consideration, the thesis will assess whether the results in Eddey can be extrapolated from cash-based bids to all takeover bids. In addition, the analysis will extend Eddey's results by investigating whether expert reports result in a higher probability of a revision in offer price relative to takeovers without an expert report.

This study also investigates the impact of the expert report on bidder announcement abnormal returns and examines the returns to both bidders and targets when the expert report is released. This will add to the limited current knowledge on the impact of expert reports on the capital market.

This thesis also tests the validity of public criticisms of expert independence. Firstly, experts have been publicly criticised on the basis that they are not independent from the target firm. It has been suggested that such experts will be more likely to provide an opinion that agrees with the recommendation of target directors. Secondly, it has been alleged that experts who are also the target auditor provide their reports at a lower fee by cross-subsidising the reports' preparation from other fees received from the client. The concern with this practice is that these reports may be of lower quality. This criticism is tested by developing an expert fee model. This fee model is then used to assess whether, similar to evidence in the auditing field, 'quality' experts earn a fee premium.

The results indicate that the need for an expert report does not affect bidder abnormal returns at either the announcement of the takeover or release of the expert report. On the other hand, target shareholders earn significantly lower abnormal returns at the announcement of a bid where an expert report is required. This result is inconsistent with Eddey (1993) and raises doubt over whether experts prevent bidders from using their superior bargaining position to offer target shareholders a lower premium. Consistent with Eddey, the probability of an alteration in offer price is greater where an adverse expert opinion is given. The results also show that the presence of an expert increases the likelihood of a bid revision relative to takeovers in general.

Target abnormal returns on the release of an expert report are positive and significant, irrespective of the type of expert opinion. This result however, is sensitive to any association between the author of the report and the target. In the case that an expert discloses any prior or current business dealings with the target, abnormal returns are insignificant. The conclusion from this finding is that the market perceives expert reports prepared by an associate of the target as lacking credibility. In light of this lack of information content it is recommended corporate regulators review those experts permitted to prepare reports.

Contrary to the published criticisms, experts who have business dealings with the target are just as likely as other experts to provide an opinion that agrees with the recommendation of directors. The tests of a fee reduction by experts associated to the target indicate significant lower fees where the expert is the target auditor. Further analysis shows this result is only significant where the auditor is also a non-Big 6/5 firm. These auditors are also found to provide reports that are significantly shorter than other experts, suggesting the cut in fee is achieved by reducing the amount of effort.

The results also find that the top two experts, Grant Samuels and Associates and Price Waterhouse Coopers, earn a fee premium over other experts. The finding of a fee premium for a large accounting firm indicates that such firms may receive a premium for both auditing and non-audit services.