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Research on the influence of difference cash flows origin upon bargaining power

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ABSTRACT

This article took the M&A premium as the proxy variable of negotiations with the Utility Theory, and used the listed M&A events data from 2000 to 2012, and analyzed the influence of difference cash flows origin to bargaining power. The return result indicated that the cash origin had being segmented, When the major businesses are stronger than the target businesses in financial independence, we find that takeover premiums are positively related to fundraising capacity and negatively related to the degree of M&A financial independence.

KEYWORDS

Financial independence; Bargaining power; Takeover premium; Fundraising capacity.

INTRODUCTION

The cash holding level is the most important financial decision-making for financial manager. Especially for protocols mergers and acquisitions on both sides, when the enterprise has cash inflows, managers can use the form of dividend payments or stock buybacks to distribute cash to shareholders, and can choose investment or reserve funds to meet the demand for investment in the future, too. Jensen (1986)[1]proposed the free cash flow hypothesis for he thinks that the presence of free cash flow of the company and assigned to the shareholders to increase the value of the enterprise, however managers will thus weaken the hands of the right, so managers tend to use free cash flow to buy other assets or carry out mergers and acquisitions to expand the scope of power, rather than as a dividend distribution to shareholders. Therefore, in the M&A market, the cash-rich party for the choice of projects is not strict, and the price is also wealth, even with the integration of the target company does not bring to the company value will pay higher premium of mergers and acquisitions.

This article's main research purpose is to study premium as a result of negotiation power implementation degree variables, and as the main object of negotiations to participate, in response to the financial constraints, especially the negotiations both sides differences between cash holdings, whether to have an effect on the rate of negotiating power implementation, thus influence on the pricing function of purchase price. The main characteristic of this paper differs from other studies is that it uses the difference of cash flow of the company for the first time to study the factors that influence the merger talks and segment the source of the cash flow, in-depth source whether affect negotiation power, can effectively reveal the company's cash flow source differences on negotiation power plays a different support or weaken the implementation degree, thus affect the price of mergers and acquisitions

In this paper, the research results show that after subdivision sources of cash, on the contrary the major business are bigger than the target business in financial independence, financial independence is negatively related to the premium, the company's operating and investing cash available for M&A premium pay formation inhibition, showing the main company have stronger negotiation power; But due to the ability to raise funds' contribution to the enterprise cash flow, support the acquisition premium increases, and the support effect is obvious.

The remaining parts of the paper are as follows: The second part introduces literature review of the domestic and foreign related research and my supposition. The third part includes the data origin and the research technique, especially M&A premium, and some variables' explanation such as the degree of financial freedom etc; the fourth part is main result and model confirmation; the fifth part is the conclusion and the policy suggestion.

THE LITERATURE REVIEW AND THE SUPPOSITION PROPOSED

The theoretical about value creating deems that M&A premium is based on future M&A synergy effect of target enterprise a payment in advance, Such as Varaiya (1987)[5]thinks M&A premium is expected after the mergers and acquisitions create value and the buyer bargaining power two aspects.

Agreement of mergers and acquisitions as a result, nature is the gaming result of the negotiation price, reflect the relative strength of the forces of the negotiations between the parties. Muezler and sirower (2003)[6]that target company scale of M&A premium may have two opposite effects: when the target company size is small, on the one hand, acquiring companies have stronger negotiation power, can pay lower premiums; On the other hand, it may be due to buy-out firms now have the ability to pay a higher premium, managers due to factors such as "arrogant" raise premium instead, so the final bid premium depends on both the dominant effect, particular case is particular analysis. Also, principal and company scale of M&A premium may have both the opposite effect, will be mergers and acquisitions both sides of the two size, financial conditions such as source of cash flow in the comparison, should be to explain China's agreement negotiation skills in a way to influence the result of the premium.

Enterprise cash ability may influence merger talks at different levels and leads to excessive pay. But single cash holdings, cannot explain the source of the funds will affect different merger talks, direct influence the acquisition premium. Corporate governance theory is that, due to the liability part may be managers abuse of cash flow can be transferred to the creditor, thus moderate debt is helpful to enhance the level of corporate governance, which can effectively reduce the management control of free cash flow and increase the supervision of managers[8], especially when the company is facing financial trouble, creditors will be asked to take over the control of the company, even leading to the improvement of corporate governance and finally realize the value of the company's promotion, this is the so-called debt governance effect[9]. If a company raised readily available, for management, as long as it can get support from external borrowing money, realize the purchase payment is still feasible, this article will easy access to external capital as a factor analysis, the "Financial Independence" as affecting management negotiation power implementation degree of influence factors are analyzed.

As can be seen from the cash flow statement, enterprises in the same year the net increase in cash from operating, investing and financing of three parts.

$$\text{Casht-cash}_{t-1}=\text{capital raised}_{t}+\text{ operating cash flows}_{t}+\text{ investing cash flows}_{t} \quad \textbf{(1)}$$

Financing is net cash flow, because the stock repurchase or to repay debt, financing cash flow may be negative, investment cash flow is negative in general. Equation (2) can show a company's capital source to what extent depend on external, namely:

Cash t-capital raised $_t$= cash$_{t-1}$+ operating cash flows $_t$+ investing cash flows $_t$ **(2)**

If equation (2) is negative, the firm could not have funded its operations from internal sources of cash. Without raising capital, it would have run out of money. We define target financial independence as:

Financial Independence$_t$ = (Cash$_t$- capital raised$_t$)/assets **(3)**

It can be seen above analysis that financial independence shows that company does not consider financing can use funds, the level of substance is mainly operating and investing activities of enterprises cash flow. Because the management of foreign borrowing and the uncertainty of internal equity financing, financing and external financing of the out-of-pocket cost, formed a certain degree of constraint to management in merger talks, showed a positive negotiation strategy; As a takeover target company, strong negotiation opponent forcing themselves to give up the premium under the normal financial conditions, and are regarded as the target company to raise money and need to pay fees.

Financial independence is that both of their companies steady capital source ability strong or weak in negotiations,, the ratio is greater than 1, Suggest that the main than the target enterprise and have stronger and steady source of cash flow,the difference is bigger, the main enterprise gets more negotiation power, lower the premium level. Conversely, financial independence ratio less than 1, which indicates that the main enterprises regardless of the financing, weak in the target enterprise cash flow source, the difference is bigger, the target enterprise have more negotiating power, make the premium levels rise.

Assumption 1: the main enterprise financial independence is stronger than the target enterprise, difference between financial independence is positively related to the forces of merger talks.

Hypothesis 2: the main enterprise financial independence is weaker than the target enterprise, differences between financial independence is negatively related to the forces of merger talks.

Financial independence shows that a company by financing constraints, the enterprise operation ability of high and low cash flow. Under the M&A payment of cash payments to give priority to, if the main enterprise financing ability is stronger, will make up for a lack of financial independence. So in merger talks, even if the financial independence is low, but due to the increase of the ability to raise funds would still choose premium payments for mergers and acquisitions. If the target enterprise financing ability, based on the potential target enterprise financing ability, can obtain higher premium. These two forces will eventually push up M&A premium, and the greater the difference, can make the premium level is higher, the difference in approach, can make the bargaining power is balanced, premium reduction.

Hypothesis 3: The main enterprise financing ability is stronger than the target enterprise; difference of the financing ability is negatively related to the forces of merger talks.

Hypothesis 4: The main enterprise financing ability is weaker the target enterprise, difference of the financing ability is positively related to the forces of merger talks.

DATA GAIN AND RESEARCH TICHNIQUE

Date

This article has first selected all agreement transfer stockholder's rights and the assets M&A event which SSE and SZSE to be listed 2000--2011 year occurs, altogether has 188 events; Then in these 188 events according to below standard screening sample:

Consider the procurability of the financial target, get rid of the samples which one side is not listed company.

The M&A scale is too small, get rid of the event that the M&A scale of both sides is below 10%.

Get rid of the event that unable to obtain the M&A transaction total price.

Get rid of the samples that the target of trade does not have the book value or the appraisal value.

According to above standard, at last, this article selected 65 M&A events as samples to analysis. The sample data originates from Guotai jun'an database, using SPSS19.0 and the EXCEL software carries on processing for the data.

Variable explanation and definition

TABLE 1 : Variable explanation and definition

	Variable explanation		
	Variable definition	***Variable count***	***expect***
Expland variable	M&A premium rate	(price-book value)/book value	
Explaning variable	financial independence ratio	Buyer financial independence /seller financial independence	-
	fundraising capacity ratio	Buyer fundraising capacity /seller fundraising capacity	+,
Control variable	Buyer income	Net income/capital	+
	Seller income	Net income/capita	+

	Variable explanation		
	Variable definition	*Variable count*	*expect*
	Buyer net assets	Net income/total assets	-
	Seller net assets	Net income/total assets	+
	Buyer debt to assets ratio	Debt/asset	-
	Seller debt to assets ratio	Debt/asset	+

Model Set

In order to examine the supposition, construct following model:

Ln(premium)=α_0+ $\alpha_1$ln(financial independence ratio)+ $\alpha_2$ln(Buyer income)+ $\alpha_3$ln(Seller income)+ α_4(Buyer debt to assets ratio) +α_5(Seller debt to assets ratio) +ε

Ln(premium)=α0+ $\alpha_1$ln(fundraising capacity ratio)+ $\alpha_2$ln(Buyer income)+ $\alpha_3$ln(Seller income)+ α_4(Buyer debt to assets ratio) +α_5(Seller debt to assets ratio) +ε

RESULT AND DISSCUSS

Descriptive statistical analysis

Grouping samples statistical results show that cash holdings rich the main enterprise, its weak financial independence in the target enterprise, but the ability to raise more formed the strong support for negotiation to pay, and pay the higher premium; And relatively insufficient cash holdings of companies, although financial independence is stronger than the target enterprise, but limited ability to raise funds, pay lower premiums; Results compared two groups of sample statistics, suggests that merger talks, ability to raise funds for the negotiations both sides influence is greater. Financial independence form inhibitory effect of M&A premium, but the ability to raise funds is pushed up the premium level. Financial independence conforms to the power difference theory, and the ability to raise funds difference hubris hypothesis conforms to the managers.

Regression

In TABLE 2, regression coefficient of the strong company buy weak company is negative, consistent with the expected; R^2 was 0.629, respectively, show the fit of the model, but there are many factors influence to the results of the negotiations both sides; Analysis of variance table, the results show that P value significance level is less than 0.01, shows that the model is statistically significant, the company's financial independence and negotiation power between the linear relationship is significant. Main negotiators enterprises based on its operating cash flow and investment incomes, reduces the degree of M&A premium, the main enterprise relative performance advantage out of the negotiations, hypothesis 1 is verified.

Model may suggest that the sample regression as a result of the main enterprise financial independence is weaker than the target enterprise, the regression coefficient significance level table probability P value is greater than 0.10, no significant statistical significance, hypothesis 2 is not verified.

TABLE 3 shows regression results of the main enterprise financing ability is stronger than the target, regression coefficient is positive; R^2 was 0.963; Analysis of variance table shows that the ability to raise funds than probability P value significance level is less than 0.01, shows that the model is statistically significant, namely the company ability to raise funds than with the negotiation power is significant, the linear relations between the description in merger and acquisition negotiations, the main enterprise financing ability is stronger as one of the factors that promote merger talks premium rise.

TABLE 2 : M&a premium return result

Variable definition		**Model 1: Strong company buy weak company**		**Model 2: weak company buy strong company**	
		coefficient	*T*	*coefficient*	*T*
constant		18.979	9.718***	21.064	9.613***
Explaning variable	financial independence ratio	-.072	-2.448**	0.557	0.691
	Buyer income	1.326	3.311***	0.220	0.438
	Seller income	0.490	0.925	0.969	2.511**
Control variable	Buyer net assets	-0.447	-1.562	-.213	-.906
	Seller net assets	-0.342	-0.339	-1.910	-1.984*
	Buyer debt to assets ratio	2.483	1.244	-0.196	-0.068

Variable definition	Model 1: Strong company buy weak company		Model 2: weak company buy strong company	
	coefficient	*T*	*coefficient*	*T*
P	0.003		0.224	
Adjusted R^2	0.629		0.368	

(Notes:*,,*** expressed separately the level of significance is 10%,5% and 1%)**

In the sample regression results of the main enterprise financing ability is weaker than the target enterprise, analysis of variance table probability P value is 0.585, so the model is not statistically significant, hypothesis 4 was not verified.

TABLE : 3 Premium return result of the financing ability sample

Variable definition		Model 1: Strong company buy weak company		Model 2: weak company buy strong company	
		coefficient	*T*	*coefficient*	*T*
constant		0.319	0.366	1.379	0.509
Explaning variable	financing ability ratio	0.029	8.245***	0.52	1.444
Control variable	Buyer income	0.215	1.341	0.057	0.189
	Seller income	-0.308	-1.744	0.083	0.195
	Buyer net assets	-0.186	-1.910*	0.244	1.138
	Seller net assets	-0.198	-0.305	0.686	0.651
	Buyer debt to assets ratio	0.419	0.451	-2.131	-1.111
	Seller debt to assets ratio	0.454	0.370	-0.302	-0.127
P		0.000		0.585	
Adjusted R^2		0.963		0.199	

(Notes:*,,*** expressed separately the level of significance is 10%,5% and 1%)**

Due to the ability to raise funds' contribution to the enterprise cash flow, support the acquisition premium rises, and the support role, behavior of mergers and acquisitions of listed companies in China, ability to raise funds as the main negotiating factor (master and enterprise financing ability stronger than the samples fit of the regression results of the target enterprise is 0.963, the probability P value is 0.000), it is because of the management too confident of their ability to raise funds, and lead to talks too much to pay a premium.

In the sample regression results of the main enterprise weak in the enterprise cash flow indicators show that of the target enterprise are not statistically significant, and explain the main and enterprise to pay a premium and are not related to cash flow.

CONCLUSIONS

This segmentation source of cash flow influence nomad premium, suggests that managers hubris hypothesis in the negotiations both sides financing ability is significant difference on the performance, control of the resource cash ability represents power theory played a premium inhibition role in merger talks, the overall game relation shows that managers "arrogant" dominant. In this paper, the empirical results of the theoretical significance is to supplement the free cash flow hypothesis, usually initiate the main enterprise has the strong cash flow, will pay a premium; In this paper, empirical research shows that, under agreement acquisition method, the source of the cash flow have different effect on M&A premium, master and enterprise investment and operating net cash flow is higher than the target enterprise, the negotiations offers advantages, suppresses the premium level; At the same time, managers too "confident" instead of the ability to raise funds in support the premium level, in the end, the premium depends on the ability to raise funds and operating and investment ability strong and the weak relationship.

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