MARKET VALUATION EFFECTS OF BANK ACQUISITIONS
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1. Introduction

As intrastate and interstate bank merger laws have relaxed, the number of bank mergers and acquisitions has risen sharply. The shareholders of acquired firms benefit from mergers because they are able to sell their stock at a higher price than would otherwise be the case. Whether the shareholders of the acquiring firm benefit from the transaction is less clear. Acquirers may have superior management or be able to obtain economies of scale or find other methods to increase expected profits and reduce risk to offset the premium paid to shareholders of the acquired organization. However, a recent study by Shome, Smith, and Heggestad (1986) suggests that bank managers are less concerned about maximizing shareholder wealth than managers of nonfinancial firms because the regulatory process...
for merger approval tends to protect managers from hostile takeovers. They suggest that banking organizations are maintaining suboptimal amounts of capital in order to achieve higher growth rates. If their analysis of bank capital decisions and managerial motives is correct, then it may also be true that some bank acquisitions are undertaken for reasons other than shareholder value.

The purpose of this study is to determine the effect of bank mergers on shareholder wealth and to identify factors that are associated with cross-sectional differences in abnormal returns. The following section surveys the evidence on wealth effects of takeovers of nonfinancial corporations as well as recent studies of bank mergers. The third section discusses methodology. The fourth section reviews the data, and the fifth presents the results. The chapter concludes with a summary.

2. Previous Studies

Stephen Rhoades (1987) examined the purchase price to book value premium (a common measure of bank merger prices) for 1,835 of the 2,717 bank mergers and acquisitions that took place from 1973 to 1983. He considered a number of explanatory variables including return on assets of the target, growth of target, market share of target, capital-to-assets ratio of target, market concentration in target’s market, market growth, size of acquiring firm, return on assets of acquiring firm, and growth of acquiring firm. His annual cross-section regressions revealed only three variables that are significant and carry a consistent sign: 1) the coefficients on the three-year asset growth rate of target are positive; 2) the coefficients on the three-year growth in deposits of the target’s market are also positive; and 3) the coefficients on the target’s capital-to-assets ratio are significantly negative. He concluded by suggesting that acquirers are willing to pay a premium for growth but not profitability.

The effect of nonbank mergers on shareholder wealth is the subject of numerous studies. Dennis and McConnell (1986) provided recent evidence on mergers that do not involve banks, railroads, and public utilities. They found that shareholders of acquiring firms tend to benefit from acquisitions. However, a recent survey of the merger literature by Roll (1986) reached the opposite conclusion, that acquirers on average overbid for their targets.

Several studies also examine takeovers of nonfailing banks. Born, Eisenbeis, and Harris (1983) examined the effect of geographical and product expansion in the financial services area. Most of their study dealt