Is High Cash Flow a Blessing or a Curse? Evidence from Bidder’s Long-term Performance

This study examines the impact of a bidder’s free cash flow (FCF) on its long-term, post-acquisition performance. Instead of taking FCF as a proxy for agency problem, we argue that free cash flow can reflect managerial ability to run a firm, which is central to the picking of high quality targets in acquisitions. Consistent with such argument, we find targets acquired by low-FCF bidders have inferior quality. They tend to have lower operating performance but higher financial leverage than those acquired by high-FCF bidders. Irrespective of the quality of the target acquired, low-FCF bidders perform poorly in the stock market subsequently. In addition, their operation deteriorates, with a significant number of them becoming bankrupt or acquired by other firms following the acquisitions. In contrast, high-FCF bidders significantly outperform their control firms following the acquisitions if they acquire low-leverage targets and perform poorly if they acquire high-leverage targets. Our results remain robust after controlling for the agency problems, financial constraints, and growth opportunities of the acquirers.

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*** All are Welcome ***