

Determinants of the Payment Method in Acquisitions

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This study has sought to investigate determinants of the method of payment in acquisitions. The empirical approach was to test nine financial variables suggested by five hypotheses using a binominal logit model. Our results offer fairly strong support for the acquisition strategy theory. Bidders facing competing bids or resistance by incumbent management are more likely to use cash. The competition dummy is the single most significant variable in this study. There is similar strong support for Jensen's free cash flow theory. Firms with fewer profitable investment opportunities and large free cash flow tend to make cash acquisitions as Jensen (1986,1988) would predict. Problems of agency costs and asymmetric information due to free cash flow may be reduced by cash acquisitions. The significance of the repurchase variable provides direct evidence for the tax advantaged dividend substitute theory. That is, managements that have a history of seeking out tax advantaged methods of distributing funds (share repurchases) are more likely to use cash. However, the positive sign of the stock issue variable which is opposite to our expectation somewhat mitigates support for the theory. Finally, in case of the optimal capital structure theory and Hansen model, the suggested variables are not significant and in the case of Hansen's model variables do not carry the predicted signs.