ABSTRACT OF THE DISSERTATION

A QUANTITATIVE CORRELATION STUDY: THE RELATIONSHIPS AMONG CAPITAL STRUCTURE, TAKEOVER LIKELIHOOD AND TAKEOVER PREMIUMS

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This study examines the relationships among capital structure, takeover likelihood and takeover premiums. Prior research has shown both excess cash and leverage to be an impediment against a takeover, but no prior study compared the two types of capital structures in terms of takeover likelihood. Based on a Z-test involving 680 takeover transactions between 2011 and 2015, this study finds that firms holding excess cash are significantly more likely to be a takeover target as compared to firms that use leverage. Prior research found a negative correlation between cash and takeover premiums, and a positive correlation between leverage and takeover premiums. However, based on a regression analysis of 422 cash-based takeover transactions from 2011 to 2015, this study finds that these intuitive relationships do not exist. This study finds a strong negative correlation between capital structure and takeover premiums, expressed as a percentage of enterprise value. Therefore, shareholders of target firms that retain excess cash experience an

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abnormal gain. Contrary to conventional thinking, acquirers effectively pay a premium on excess cash balances. Conversely, shareholders of target firms that use leverage experience an abnormal loss. Leveraged firms do not receive a higher takeover premium that is necessary to compensate shareholders for assuming the additional risk that leverage entails. These findings provide a compelling reason for investors to seek out firms that retain excess cash to increase the likelihood of realizing an abnormal gain; given the higher likelihood of a takeover event, combined with the likelihood of receiving a higher-than-expected takeover premium. Contrary to academic theory, the findings also suggest that capital structure is irrelevant to percentage takeover premiums in the real world.