THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Department of Accounting

The Effect of SFAS 141 and 142 on the Market for Corporate Control

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Abstract

We investigate the effect of the elimination of the pooling method (SFAS 141) and goodwill amortization (SFAS 142) on the market for corporate control. Prior literature finds there are strong incentives for managers to structure transactions to qualify for the pooling method. The proposal of these standards was followed by considerable debate and concern that these standards would affect acquisition activity. We examine the effect of SFAS 141 and 142 on both the form of financing and takeover probability.

In order to qualify for the pooling method the transaction must be a stock-for-stock exchange. After elimination of the pooling method the level of stock-for-stock exchanges among all acquisitions decreased. We find that before the elimination of the pooling method target firms' step-up value is positively associated with the probability of using a stock-for-stock exchange versus partial stock financing. After the elimination of the pooling method we find this association significantly decreases and is not significantly different from zero which is consistent with SFAS 141 reducing the incentive to use stock-for-stock exchanges.

With respect to the takeover probability of firms with greater step-up values, elimination of the pooling method is expected to decrease takeover probability while elimination of goodwill amortization is expected to have the opposite effect. We find that the probability of takeover for firms with greater step-up values decreases after SFAS 141 and 142. When the step-up value is more likely to be composed of goodwill, this effect is attenuated suggesting elimination of goodwill amortization does counteract the effect of eliminating the pooling method.

Overall, our results suggest that the new accounting standards, SFAS 141 and 142, significantly affected the form of financing and the takeover probability in the market for corporate control.