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Abstract proposal: A new perspective on diversification and value creation in M&A deals

Candidate: Pietro De Ponti (Dottorato di ricerca in Economia, Statistica e Data Science, Università degli Studi di Milano-Bicocca, XXXV ciclo)

Mergers and acquisitions (M&As) are vital strategic decisions for firms, offering avenues for market expansion, enhanced competitiveness, and achieving growth objectives. Acquisitions can diversify a firm's portfolio, reducing market-specific risks and capitalizing on synergies. However, diversification poses challenges, including inefficiencies in resource allocation and potential managerial opportunism. As far as the relationship between corporate diversification and short-term acquisition gains is concerned, the literature argues diversifying deals are less favourably welcomed by the market. However, traditional measures of diversification (i.e. whether bidder and target firms share any industry of activity or not) may fail to adequately consider relevant facets of diversification and oversimplify the strategic connotations of M&A deals.

To address this, we propose to employ two alternative measures of diversification. First, we use the Entropy index as a measure of corporate diversification: thanks to its properties, it allows to capture both the scope of diversification (i.e. how wide the number of industries of activity is), and the relative importance of each sector and industry of activity within the firm. In particular, by analysing changes in Entropy pre- and post-acquisition, we aim to understand market reactions more comprehensively. Second, we formulate a measure of bidder-target corporate coherence, assessing whether the new mix of industry activities within the consolidated entity aligns with those of other firms operating in the same industry.

Our study covers M&A data from 1994 to 2019, focusing on US companies. Preliminary results validate the existence of a diversification discount, but highlight relevant dimensions of heterogeneity across different types of acquisitions.