Accounting Conservatism, Information Asymmetry, andCorporate Governance: Evidence from Block Acquisitions

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ABSTRACT: Using a large sample of block share acquisitions in the U.S. from 1980 to 2007, we examine the effect of target accounting conservatism on block acquirers' monitoring activities. Wefind that acquirers of targets with higher conservatism are more likely to have their representatives on the targets' boards after block share purchasesthan are block acquirers of targets with lower conservatism. Moreover, there is a positive and significant relation between target conservatism and target abnormal announcement returns (post-acquisition operating performance). These results are more pronounced when acquirers do not hold any equity ownership in the targets prior to the block acquisitions,or whenacquirers purchase targets withgreater ex ante information asymmetry. To the extent that accounting conservatism reduces information asymmetry between managers and outside investors,and reduced information asymmetry results in lower monitoring costs, our results suggest that target conservatism increases block acquirers' incentives to monitor the target.

Keywords: Accounting conservatism; Information symmetry; Corporate governance; Block acquisitions; Outside director.

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1.Introduction

Accounting conservatism, defined as the asymmetric verifiability required for the recognition of accounting gains versus losses, has receivedsignificant attention from both academicsand regulatory bodiesfor decades. Yet, although previousliteraturehas extensively examined the role of accounting conservatism in reducing agency conflicts between managers and shareholders and between debtholders and shareholders,[1] relatively little is known about the role of accounting conservatism in the market for corporate control, particularly from information asymmetry perspective. We seek to fill this gap in the literature by examining the effect of target accounting conservatism on block acquirers' monitoring activities. We hypothesize that by reducing information asymmetry,targetaccounting conservatism increases acquirers' incentives to engage in active monitoring activities and therefore adds value to the target.

Our hypothesis is based on two important streams of literature on accounting conservatism and corporate governance. A large body of literature on accounting conservatism suggests that conservative accounting reduces information asymmetry between managers and outside investors by reining in managerial proclivity to favorably skew reported performance (Watts, 2003a; Lafondand

Watts, 2008; Kahn and Watts, 2009; Armstrong, Guay, Weber, 2010; Kothari, Ramanna, and Skinner, 2010). At the same time, several recent studies on corporate governance show that reduced information asymmetry lowers investors' monitoring costs and thus increases investors' incentives to engage in active monitoring activities (Lerner, 1995; Sussman and Zeira, 1995; Petersen and Rajan, 2002; Degryse and Ongena, 2005; Kang and Kim, 2008). Taken together, these two streams of literature serve as important building blocks for our hypothesis and suggest that accounting conservatism facilitates outside investors' monitoring by reducing a firm's information asymmetry problems.[2] To the best of our knowledge, this study is the first to examine the effect of accounting conservatism on corporate governance from the perspective of the role of accounting conservatism in reducing information asymmetry.

To examine the relation between accounting conservatism and investors' monitoring activities, we use a large sample of block share acquisitions (acquisitions in which acquirers purchase more than 5% but less than 100% of target firms' outstanding shares) in the U.S. from 1980 to 2007 as our event of interest. We focus on partial block share acquisitions for two reasons. First, as argued by Shleifer and Vishny (1986), large shareholders may have strong incentives to monitor management because the benefits that they receive from their monitoring activities are likely to exceed the costs of monitoring that they have to bear. Supporting this argument, previous studies show that block shareholders play an important role in monitoring management.[3] Thus, block acquisitions provide a fruitful setting to test the effect of accounting conservatism on investors' monitoring activities. Second, unlike mergers, where target firms are delisted from stock exchanges after the transaction, targets involved in partial block acquisitions survive on stock exchanges and thus more detailed information on post-acquisition target performance and governance activities is publicly available for these acquisitions. This detailed information allows us to empirically evaluate the predictions of our main hypothesis.

We test several important implications of the link between accounting conservatism and block acquirers' monitoring activities. First, we examine the relation between target accounting conservatism and monitoring activity that block acquirers initiate after the acquisitions, namely, board representation activity. We examine board representation of block acquirers because previous studies show that outside directors perform an important role in internal governance. For example, Brickley and James (1987), Weisbach (1988), and Byrd and Hickman (1992) show that independent outside directors protect the interests of shareholders when there exist agency problems between managers and shareholders. Given that the board members represented by block acquirers are independent outside directors, we expect that they are effective in monitoring target management. If target accounting conservatism facilitates blockholder monitoring by reducing target information asymmetry problems, we expect that block acquirers are more likely engage inboard representation activities in targets with more conservative accounting than in other targets.[4]

Second, we examine the effect of targets' conservative accounting policies on their acquisition announcement returns and post-acquisition operating performance. To the extent that block acquirers' monitoring activities add value to the targets and this value addition manifests itself in ex post performance improvement in targets, we expect acquisition announcement returns and changes in post-acquisition operating performance to be higher for targets with higher conservatism than those with lower conservatism.

Third, we examine how the above predicted effects of accounting conservatism on governance activities and target performance differ depending on whether acquirers have private information about the targets at the time of block acquisitions. To the extent that acquirers who already hold equity ownership in the targets prior to the block acquisition have access to targets' private information through their existing shareholdings, the role of accounting conservatism in reducing information asymmetry is likely to be less important for these acquirers than for other acquirers. We therefore expect that the effects of target conservatism on governance activities and target returns/performance are more pronounced for targets in which acquirers do not have any pre-acquisition ownership.

Finally, we investigate whether our hypothesized effects of accounting conservatism on governance activities and target performance differ across targets with different levels of information asymmetries. Since the benefits of monitoring are likely to be especially valuable for firms perceived by the market as having higher inherent information asymmetry, we expect the effects of target conservatism on governance activities and target returns/performance to be more pronounced for targets with greater inherent information asymmetry.

Using a firm-year measure of financial reporting conservatism (C_Score) developed by Khan and Watts (2009), we find results consistent with our predictions above. Specifically, the average board representation ratio of block acquirers is 3.7% for targets in the lowest conservatism quintile, while it is 10.4% for targets in the highest conservatism quintile. The difference in board representation ratios between these two groups is significant at the 1% level. Results from multivariate regressions further confirm that there is a positive and significant relation between C_Score and board representation ratio of block acquirers after controlling for firm and deal characteristics. Furthermore, a one-standard deviation increase inC_Scoreis associated with a 10.6% increase in board representation ratio, suggesting that the conservatism effect is economically large and significant. However, the positive relation between C_Score and board representation ratio of block acquirers is evident only for a subsample of targets in which acquirers do not hold any equity ownership prior to the block acquisitions, suggesting that the role of conservatism in facilitating corporate governance is particularly important when investors do nothave previous access to firm information.

Our key hypothesis that accounting conservatism reduces a firm's information asymmetry and increases the effectiveness of corporate governance is also supported in our analysis of target acquisition announcement returns. We find that the mean cumulative abnormal return from 10 days before to 10 days after the acquisition announcement date is almost 16.2% for targets with a C_Score above the sample median while the corresponding return is only 10.6% for targets with a C_Score below the sample median. The test of mean differences between the two groups strongly rejects the null hypothesis of equality. We also find that the positive effect of target C_Score on its announcement returns is evident only when acquirers do not have any ownership in the targets prior to the block acquisitions and is more pronounced when the method of payment used in the acquisition is stock financing. Since stock financing is more likely to be used when there is higher valuation uncertainty in the acquisition (Loughran and Vijh, 1997), the latter result further shows the importance of accounting conservatism in alleviating information asymmetry concerns.

The results for the analyses of post-acquisition target operating performance further support the view that the increase in monitoring facilitated by accounting conservatism translates into better target performance. We find that target C_Score is positively and significantly related to the industry-adjusted change in target operating performance from the year before to the year after the acquisition, but only when acquirers do not hold equity in targets prior to the block acquisitions.

Given that our main findings are evident only in the subsample of targets in which acquirers do not have any pre-acquisition ownership, we focus on this subsample to examine how the predicted effects of accounting conservatism on governance activities and target performance differ across targets with different levels of information asymmetries. We find that the effects of target conservatism on governance activities and announcement returns/operating performanceare only evident when targets are perceived by the market as having high ex ante information asymmetry problems, such as when targets (1) are small, (2) have high stock return volatility, (3) have high earnings volatility, (4) have high bid-ask spreads, and (5) have high analyst forecast dispersion. To the extent that firms with greater inherent information asymmetry have more unverifiable information and the role of accounting conservatism in reducing information asymmetry is particularly important for these firms, these results suggest that accounting conservatism alleviates a firm's information asymmetry concerns (i.e., enhances the information transparency of the target), thereby providing the acquirer strong incentives to engage in active governance activities.

To check the robustness of our primary results above, we conduct several additional tests. First, we examine whether our main results are sensitive to using an alternative measure of conservatism developed by Basu (1997) and find that they are not.

Second, we examine whether our results are robust to controls for potential endogeneity of accounting conservatism. Watts (2003a) identifies four explanations for accounting conservatism: contracting, litigation, regulation, and taxation. Qiang (2007) further shows that conditional conservatism, which is our focus in this paper, is primarily driven by contracting and litigation explanations. Thus, it is possible that some unobservable firm characteristicsrelated to these explanations simultaneously affect both accounting conservatism and acquirers' governance activity, resulting in a spurious correlation between these two variables. For example, highly levered firms may choose conservative accounting policies to satisfy the demands of debt holders and at the same time these firms may be subject to tight monitoring by blockholders because these firms face high default risk.[5] We address this endogeneity issue using the standard instrumental variable approach. Specifically, we use the implementation of the SEC's Staff Accounting Bulletin No. 101 (SAB 101) as an instrumental variable to capture exogenous variations in accounting conservatism. Both popular press and academic literature show that SAB 101 requires less timely revenue recognition and thereby increases accounting conservatism for a wide cross section of listed firms (Vogt, 2001; Moffeit and Eikner, 2003; Watts, 2003a; Crawford, Price, and Rountree, 2010), suggesting that it can serve as a relevant instrument for accounting conservatism. The results from the instrumental variable approach show that our main findings are robust to controlling for the endogeneity concern.

Third, we examine whether our results are driven by the potential endogeneity bias caused by reverse causality in the relation between target conservatism and the board representation ratio. For

example, it is possible that block acquirers seeking to improve target governance are more likely to acquire firms with higher accounting conservatism, while other block acquirers do not have such a preference. This reverse causality explanation predicts that 1) the frequency of control-motivated acquisitions is higher for targets with high conservatism than for targets with low conservatism, 2) corporate governance is poorer for targets with more conservative accounting than for targets with less conservative accounting, and 3) a dummy variable representing the control intention of the acquirer in the regressions subsumes the explanatory power of target C_Score. Our empirical analyses to test these predictions and those using an instrumental variable approach yield results inconsistent with the reverse causality explanation.

As a final robustness test, we examine whether our results are driven by acquirer conservatism instead of target conservatism. In untabulated tests, we find that including both acquirer C_Score and target C_Score in the same regression does not change our key conclusions.

In evaluating the role of accounting conservatism in acquisition decisions, we extend the literature at least in three important ways. First, we contribute to the literature by examining how target conservatism affects investors' incentives to engage in corporate governance. Previous studies show that accounting conservatism mitigates agency problems between shareholders and debtholders (Ahmed et al., 2002; Ball, Sadka, and Ashok, 2008; Zhang, 2008) and reduces agency conflicts between shareholders and managers (Francis and Martin, 2010), but no prior study to our knowledge examines the role of accounting conservatism in facilitating corporate governance from the perspective of the firm's information asymmetry. We show that accounting conservatism reduces information asymmetry, thereby facilitating active governance by block acquirers.

Second, our paper sheds light on the controversy regarding the relation between conservatism and information asymmetry. We show that the role of accounting conservatism in reducing information asymmetry is particularly important for firms with higher ex ante information asymmetry. In this regard, our results corroborate those of Lafond and Watts (2008), who show that conservatism increases in response to increases in information asymmetry in equity markets. Given the recent policy debate on fair value accounting, these results should help academics and security regulators better understand the circumstances under which accountingconservatism is more beneficial.

Third, our paper provides new evidence on the effect of accounting conservatism on firm value. We show that target conservatism affects the target's market value of equity and post-acquisition operating performance. Thus, our results offer evidence on how accounting conservatism is related to the source of value gains in block share acquisitions.

Our paper is closely related to a recent study by Francis and Martin (2010), who examine the effect of conservatism on acquisition investment decisions. Using a sample of 17,202 acquiring firms from 1980 to 2006, Francis and Martin (2010) examine whether timely loss recognition is associated with the profitability of acquisitions. They find that more conservative acquirers make better acquisitions, as measured by acquirers' announcement returns and changes in post-acquisition operating performance. Francis and Martin (2010) also find that bidders with more conservative accounting are less likely to make post-acquisition divestitures, and if they do, they do so more quickly. These results are consistent with the view that conservatism serves as an important internal corporate governance mechanism by reducing managerial incentives to engage in negative NPV

projects (Ball, 2001; Watts, 2003a; Ball and Shivakumar, 2005). Our paper is different from Francis and Martin (2010) at least in three important aspects. First, while their research is motivated by examining the role of bidder accounting conservatism in reducing agency conflicts of its management, our study focuses on the role of target accounting conservatism in reducing its information asymmetries between managers and investors. Second, while Francis and Martin (2010) use mergers and acquisitions events as their sample and examine the quality of the acquisition decision from the perspective of bidder accounting conservatism, we use partial block share acquisitions events as our sample and investigate the information asymmetry issue from the perspective of target accounting conservatism. Third, while Francis and Martin (2010) focus on bidder returns as their key measure of analyses, we focus on bidder governance activities in the target and target returns as our key measure of analyses.

The rest of the paper is organized as follows. In Section 2 we develop the main hypotheses. In Section 3 we discuss the methodology we use to measure accounting conservatism. We also describe the data and present summary statistics. Section 4 provides results from theTobit regression of the board representation ratio. In Section 5 we examine targets' abnormal announcement returns and post-acquisition changes in operating performance. In Section 6 we examine whether the results in the previous two sections are different depending on information asymmetry of the target. Section 7 presents the results from our robustness tests. Finally, Section 8 summarizes and concludes the paper.

2. Hypotheses development

The manager has the incentive to report favorable firm performance. A strong performance not only increases the manager's current compensation via its impact on bonuses and stock options awarded but also benefits the manager in the long run through the reputation effect. Recognizing this, investors have long demanded accounting to be conservative (Watts, 2003a). By imposing a higher verification standard for recognizing gains, accounting conservatism counteracts the managerial incentive to bias earnings upwards, resulting in more credible accounting information and therefore reduced information asymmetry between insiders and outsiders. This insight is widely recognized in the accounting literature (Watts, 2003a; Lafond and Watts, 2008; Kahn and Watts, 2009; Armstrong, Guay, andWeber, 2010; Kothari, Ramanna, and Skinner, 2010). In addition, by serving as an authoritative benchmark, accounting conservatism encourages information production by other sources, as other sources can establish a reputation for reliability through comparison with this benchmark and to profit from the reputation thereby established (Ball, 2001; Watts, 2006; Lafond and Watts, 2008; Kahn and Watts, 2009). Lafond and Watts (2008) and Kahn and Watts (2009) provide empirical evidence in support of the view that accounting conservatism reduces information asymmetry among investors.

Several recent studies on the link between corporate governance and information asymmetry show that reduced information asymmetry lowers investors' monitoring costs and thus increases investors' incentives to engage in active monitoring activities. For example, Lerner (1995) examines the role of venture capitalists as monitors of private biotechnology firms and shows that venture capitalistswith offices within five miles of the firm's headquarters are twice as likely to be board members as those with offices more than 500 miles away. This result suggests that venture capitalists' oversight involves substantial monitoring costs and that these costs increase with their

distance from the firm. Similarly, Kang and Kim (2008) find that information asymmetry that arises from geographic proximity is an important determinant of block acquirers' governance activities in targets. They show that geographically proximate block acquirers are more likely to have their representatives on the target's board and to replace target management after block share purchases than are remote acquirers. To the extent that geographically proximate acquirers enjoy significant information advantages with respect to local targets, these results suggest that lower monitoring costs arising from reduced information asymmetry provide geographically proximate investors with stronger incentives to monitor their firms.

Taken as a whole, these streams of literature suggest that accounting conservatism leads to a richer information environment and thus reduces information asymmetry between managers and investors, which enables investors in conservative firms to have an information advantage in monitoring their firms over those in non-conservative firms. Since investors need to spend less time and effort to collect information about firms with more conservative accounting, investors in conservative firms will bear lower information acquisition costs in monitoring their firms than investors in non-conservative firms. For example, conservative accounting restricts the manager's ability to manipulate financial reporting and thus reduces investors'costsin detecting and undoing earnings distortions. The lower information acquisition costs provide investors with stronger incentives to monitor their firms.

We empirically evaluate the above arguments for the link between accounting conservatism and corporate governance as follows. First, we investigate whether the board representation ratio of block acquirers on the target's boardvary with targets' policies of accounting conservatism. According to the arguments above, targets' conservative accounting policies reduce block acquirers' information asymmetry and thus provide block acquirers with strong incentives to engage in active monitoring activities. We therefore expect targets with more conservative accounting to experience greater board representation by acquirers. This constitutes our first hypothesis:

H1: The board representation ratio of block acquirers on the target's board is higher in targets with more conservative accounting than those with less conservative accounting.

Second, we examine whether target conservatism has an impact on its abnormal announcement returns and post-acquisition operating performance. If accounting conservatism facilitates more active monitoring and more active monitoring translates into better target performance, we expect targets with more conservative accounting to experience higher abnormal announcement returns and better post-acquisition operating performance than targets with less conservative accounting. These arguments lead to our second and third hypotheses.

H2: Target abnormal announcement returns increase with their accounting conservatism.

H3: Post-acquisition target operating performance increases with their accounting conservatism.

The effects of target accounting conservatism on governance activities and target performance depend on whether acquirers have access to targets' private information at the time of block acquisitions. Since the acquirers who already have equity ownership in the targets prior to the block acquisitions can supplement target accounting information with private information that they have obtained through their prior target ownership, the usefulness of targets' accounting conservatism to these acquirers is expected to be small. We therefore expect the effects of accounting conservatism

on governance activities and target performance to be less pronounced in the subsample of targets in which acquirers have equity ownership in the targets prior to the block acquisitions.

Moreover, the relative importance of accounting conservatism in fostering corporate governance activities likely varies with the extent of a firm's information asymmetry. Since it is more costly for investors to obtain information about firms with higher inherent information asymmetry, the role of accounting conservatism in reducing information asymmetry is likely to be more valuable when targets have greater information asymmetry. We therefore expect that the positive relation between accounting conservatism and governance activities/target performance is more pronounced for targets with greater inherent information asymmetry.

We use five proxies for the extent of a target's information asymmetry. Our first proxy is target size (log (market value of equity)). It can be argued that large firms have less informational asymmetry and are more established than small firms. Firm size also measures the rate of information diffusion. For example, Hong, Lim, and Stein. (2000) argue that information travels more slowly for small firms because the fixed costs of information acquisition reduce investors' willingness to spend resources to learn about small firms, suggesting that larger firms have less information asymmetry.

The second and third information asymmetry variables are stock return volatility and earnings volatility, respectively. The more volatile a firm's stock returns (earnings), the greater the uncertainty about the firm's prospects. Thus, firms that have more volatile stock returns (earnings) are likely to have greater information asymmetry.

The fourth variable we consider as a proxy for the extent of information asymmetry is the bid-ask spread. Many studies including Wittenberg-Moerman (2008) and Brown, Hillegeist, and Lo (2008) use the bid-ask spread as a proxy for information asymmetry and show that high bid-ask spread is associated with low liquidity. These results suggest that firms with higher bid-ask spreadhavegreater information asymmetry.

The last information asymmetry variable is analyst forecast dispersion. Prior literature shows that higher information asymmetry is associated with lower precision of public information, which results in greater forecast dispersion(Barron et al., 1998;Bowen, Davis and Matsumoto, 2002). Thus, firms with higher dispersion are perceived to have greater information asymmetry.

In sum, we expect the effects of accounting conservatism to be more pronounced for small targets, targets with high earnings volatility, targets with high stock return volatility, targets with high bid-ask spread, and targets with high analyst forecast dispersion.

3. Methodology and data

3.1.Measuring accounting conservatism

Following Khan and Watts (2009), we use C_Score to measure the accounting conservatism of the target. To obtain C_Score, we first estimate the following annual cross-sectional regression:

$$X_{i,t} = \beta_{1,t} + \beta_{2,t} D_{i,t} + R_{i,t}(\mu_{1,t} + \mu_{2,t} Size_{i,t} + \mu_{3,t} M/B_{i,t} + \mu_{4,t} Lev_{i,t}) + D_{i,t} R_{i,t}(\lambda_{1,t} + \lambda_{2,t} Size_{i,t} + \lambda_{3,t} M/B_{i,t} + \lambda_{4,t} Lev_{i,t}) + e_{i,t},$$

where i indexes the firm, t indexes the year, X is earnings per share (Compustat item 18) deflated by price at the end of the prior fiscal year(Compustat item 199), R is the 12-month return for the window starting from the fourth month after the beginning of fiscal year t (Basu, 1997), D is a dummy variable equal to one if R < 0 and zero otherwise, Size is the logarithm of the market value of equity (Compustat item 25*Compustat item 199),M/B is the market-to-book ratio ((Compustat item 25*Compustat item 199)/Compustat item 60)), and Lev is the sum of long-term debt and current liabilitiesdeflated by the market value of equity ((Compustat item 9+Compustat item 34)/(Compustat item 25*Compustat item 199)).

Using $\hat{\lambda}_{1,t}$, $\hat{\lambda}_{2,t}$, $\hat{\lambda}_{3,t}$, and $\hat{\lambda}_{4,t}$ that are obtained from equation (1), we estimate C_Score as follows:

$$C\_Score = \hat{\lambda}_{1,t} + \hat{\lambda}_{2,t} Size_{i,t} + \hat{\lambda}_{3,t} M/B_{i,t} + \hat{\lambda}_{4,t} Lev_{i,t}, \quad (2)$$

whereSize,M/B, and Lev are as defined in equation (1).

Throughout the paper, we use C_Score for the year prior to the announcement of a block acquisition to ensure that it is an ex ante measure of accounting conservatism that is not influenced by the block acquisition.

3.2.Sample

Our sample consists of block share acquisitions in the U.S. between 1980 and 2007. The initial sample of block share acquisitions is obtained from Thomson Financial's Security Data Corporation (SDC) Platinum database. We first identify block share acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares.[6] We then exclude transactions in which targets are in the utilities (SIC 4900-4939) and financial (SIC 6000-6999) industries as these firms are highly regulated and their accounting policies may significantly differ from those of industrial firms. We also exclude deals in which the acquirer is either an Employee Stock Ownership Plan or an Employee Benefits Trust. Finally, we require that stock return and accountingdatafor targets be available in CRSP and COMPUSTAT, respectively. These restrictions result in a final sample of 545 targets. We identify public announcement dates of acquisitions from the SDC database.

Table 1 reports the distribution of the 545 sample targets by year and industry. We find that almost 80% of the sample targets come from the following three industries: manufacturing (48.3%),service (20.4%), and whole sale retail trade (10.8%). The table also shows a significant increase in the frequency of acquisitions after the middle of 1980s and a decline in the frequency of acquisition during the 2000s.

Table 2 presents summary statistics for the sample targets. All target characteristics are measured as of the fiscal year-end that immediately precedesthe announcement date of a block share acquisition. We first report summary statistics for several measures of target information asymmetry. The mean and median C_Scorefor our sample targets are 0.127 and 0.116, respectively. In comparison, the mean and median C_Scorereported in Khan and Watts (2009) for the universe of firms in CRSP and COMPUSTAT over 1962 to 2005 are much lower at 0.093 and 0.082. These results suggest that firms with higher conservatism are more likely to become targets in block share acquisitions. The mean market value of equity is $298 million, with a median of $74 million. The

mean stock return volatility, computed as the standard deviation of monthly returns over the 12 months before the month of acquisition, is 16.5%. The mean value of earnings volatility, computed as the standard deviation of past ten year ROAs before the acquisition, is 0.09. The bid-ask spread, measured as the monthly bid-ask spread deflated by midpoint of bid and ask prices in the 12 months before the month of acquisition, has a mean (median) value of 4.94% (3.36%). The mean analyst forecast dispersion is much higher than the median analyst forecast dispersion (0.339 versus 0.102), suggesting that the distribution of analyst forecast dispersion is skewed to the right. We measure analyst forecast dispersion as the standard deviation of analysts' forecasts deflated by the meanconsensus analyst forecast at the end of the fiscal year prior to the block acquisition announcement.

Turning to other target and transaction characteristics, the mean and median operating income ratios, computed as operating income divided by total assets, are, respectively, 0.011 and 0.085. The third quartile of dividend yield (cash dividend / share price) is equal to zero, indicating that more than 75% of targets do not pay dividends. The mean (median) leverage ratio, measured by the ratio of total debt to total assets, is 24.5% (23.1%). The mean and median Tobin's q (market value of equity plus book value of debt / book value of total assets) are 1.79 and 1.29, respectively. The mean (median) buy-and-hold industry-adjusted return for the12 months before the acquisitionannouncementis 9.9% (-3.8%). We also find that about 1.5% of our sample targets are acquired in a hostile takeover. The mean and median equity ownership purchased by block acquirers are about19.6% and 13.1% of targets' outstanding shares, respectively. The mean of an open market purchase dummy indicates that 32.7% of our sample targets are acquired through open market purchases. The fraction of targets that operate in the same industry as the block acquirers (measured using the first two digits of the SIC code) is 39.8%. Finally, the fraction of acquisitions that are financed entirely by stock is 2.4%.

4.The post-acquisition governance activities

To examine the link between target accounting conservatism and corporate governance, in this subsection we use the board representation ratio of block acquirers on the target's boardas a measure of acquirers' governance activities. The board representation ratio is computed as the ratio of the number of directors appointed by acquirers to the total number of directors on the target's board one year after the block acquisition. We obtain information on acquirers' board representation from Compact Disclosure.

We first examine the distribution of the board representation ratio across different quintiles of target accounting conservatism. Panel A of Table 3 reports the results. We find that the mean board representation ratio increases monotonically from the lowest quintile to the highest quintile. The mean ratio is 0.037 for the lowest quintile and 0.104, for the top quintile. Thus, blockholders who acquire the targets in the highest quintile of accounting conservatism are about three times as likely to be involved in board representation as are blockholders who acquire the targets in the lowest quintile of accounting conservatism. The difference in the board representation ratios between the highest and lowest quintiles of C_Score is significant at the 1% level.

To examine further the role of target accounting conservatism in block acquirers' board representation activity, we perform multivariate Tobit regressions using the board representation

ratio as a dependent variable. The results are reported in Panel B of Table 3. In the first three regressions, we use the full sample. We find that the coefficient on C_Score is positive and significant in all three regressions, indicating that the acquirer's board representation ratio in targets is greater for acquisitions involving targets with high accounting conservatism than for acquisitions involving targets with low accounting conservatism. We also find that the coefficient on ownership purchased by acquirers is positive and highly significant, suggesting that acquirers are more likely to appoint representatives onto the targets' boards if they purchase a larger proportion of target equity.[7]

In the fourth (fifth) regression, we use a subsample of targets in which acquirers hold (do not hold) equity ownership in the targets prior to the block acquisitions. Since the Tobit regression cannot be estimated for the subsample of targets in which acquirers have pre-acquisition ownership stake due to its small sample size, we estimate both regressions (4) and (5) using ordinary least squares (OLS) regressions. We find that the coefficient on C_Score is positive and significant only in the subsample of targets in which acquirers do not have any pre-acquisition ownership (regression (5)).

Overall, the results in Tables 3 suggestthat target accounting conservatism has a significant influence on block shareholders' incentives to perform an active governance role in targets, lending support to H1.

5.Announcement returns and post-acquisition operating performance of targets

In this section we examine whether the role of target conservatism in reducing information asymmetry and facilitating corporate governance translates into better target performance. Specifically, we examine how target conservatism affects its acquisition announcement return and the change in its post-acquisition operating performance.

5.1. Announcement returns for targets: Test of H2

We assess the announcement returns for targets by employing a standard event study methodology. Market model parameters are estimated by using daily returns from days -260 to -10 relative to the acquisition announcement date (day 0).We use the value-weighted CRSP index as the market portfolio. The cumulative abnormal return, CAR (t_1, t_2), is computed by cumulating the daily abnormal return from day t_1 to day t_2.

Table 4 reports abnormal announcement returns for targets with low conservatism and those with high conservatism, where the classification of low and high conservatism is based on the sample median of target C_Score. The average CAR (-10, 10) for targets with low (high) conservatism is 10.6% (16.2%), both of which are statistically significant at the 1% level. The difference in average CARs between these two target groups is significant at the 1% level. The mean CAR for other event windows such as CAR (-3, 3), CAR (-5, 5), and CAR (-10, 1) shows a similar pattern. Thus, announcements of acquiring targets with high conservatism are greeted more positively by investors, suggesting that a rich information environment at the target that is induced by conservative accounting policies creates value in block acquisitions.

Following Allen and Phillips (2000) and Kang and Kim (2008), our subsequent regression analysis uses CAR(-10, +10) as the dependent variable becauseinvestors who acquire more than 5% of any class of a company's voting equity is required to file Schedule 13D atthe Securities and

Exchange Commission within 10 days of the acquisition (Mikkelson and Ruback, 1985). Since the Schedule 13D filing usually occurs after actual purchases of shares are made, it is possible that information about the acquisition may be leaked before the acquisition announcement date. Thus, using a longer event window such as CAR (-10, 10) in the analysis ensures that announcement returns fully capture the information content of acquisition announcements.[8]

Table 5 shows the results from OLS regressions. We use the same explanatory variables as used in Table 3. In the first four regressions, we use the full sample. In regression (1), we use information asymmetry variables as well as industry and year dummy variables as the independent variables. The coefficient on target C_Score is 0.237 with a p-value of 0.03. Thus, more conservative targets realize higher announcement returns, which is consistent with H2.[9]

In regression (2), we drop the information asymmetry variables and include target and transaction characteristic variables. The coefficient onC_Scoreis 0.382, significant at the 1% level.

In regression (3), we include all variables used in regressions (1) and (2). C_Score has a coefficient of 0.422, significant at the 1% level. The magnitude on this coefficient suggests that the target abnormal return increases by 7.4% when C_Score increases from the 1st quartile (0.035) to the 3rd quartile (0.211).

In regression (4), we add the interaction between a stock financing dummy and target C_Score. Stock financing signals possible misvaluation of the acquirer's stock price and thus introduces significant uncertainty into the outcome of block acquisitions (Loughran and Vijh, 1997). Thus, if target accounting conservatism plays an important role in alleviating information uncertainty, we expect the positive effect of accounting conservatism on announcement returns to be more pronounced for stock-financed deals. Consistent with this view, we find that the coefficient on the interaction term between a stock financing dummy and target C_Score is positive and significant.

To more closely investigate the informational role of target C_Scorein explaining target value, we examine whether the effect of C_Scoreon announcement returns is particularly pronounced in targets whose acquirers do not have any pre-acquisition ownership. We find that the coefficient on C_Score is positive and significant only in thesubsample of targets without the toehold (regression (6)). Thus, the effect of target accounting conservatism on its announcement returns is particularly pronounced when acquirers have less private information about the targets.

Overall, our results indicate that acquisition announcement returns for targets increase with targets' accounting conservatism, lending support to H2.

5.2. Changes in operating performance of targets: Test of H3

To measure the change in operating performance, we use industry-adjusted change in earnings. Change in earnings is computed as earnings before extraordinary items from one year before to one year after the block acquisition, divided by total assets in the year prior to the block acquisition. Industry-adjusted change in earnings is calculatedby subtracting the industry (defined according to the first two digits of the SIC code) median change from the target change.[10]

Table 6 reports the regression results. The industry-adjusted change in earnings is the dependent variable. The explanatory variables are the same as those used in Table 5. The full

sample is used to estimate the first three regressions. We find that the coefficients on C_Score are positive and significant in regressions (2) and (3). These results suggest that targets with higher conservatism experience larger post-acquisition increases in operating performance, supporting H3.

In regressions (4) and (5), we reestimate regression (3) separately for subsamples of targets in which acquirers do and do not have pre-acquisition ownership. Consistent with finding in previous sections, we find that the positive association between C_Score and change in the operating performance is only evident in the subsample of targets whose acquirers do not have any pre-acquisition ownership.

In sum, our results in Table 6 suggest that more conservative targets experience higher post-acquisition operating performance, which is supportive of H3.

6.Subsample analysis based on target information asymmetry

Our results so far suggest that the effects of target accounting conservatism on acquirers' post-acquisition governance activities and target abnormal announcement returns (post-acquisition operating performance) are only evident in targets whose acquirers do not have any pre-acquisition ownership. In this section we further examine whether the relative importance of accounting conservatism in fostering corporate governance activities varies with the extent of a target's information asymmetry. To address this issue, we use the subsample of targets in which acquirers do not have any equity ownership prior to the block acquisitions and divide it into two subgroups, targets with high- and low-information asymmetry, according to the sample median of each information asymmetry variable.We then reestimate the last regressions of Tables 3, 5, and 6 separately for these two subgroups. The results are presented in Table 7.

Panel A of Table 7 reports the Tobin regression estimates of the board representation ratio. Consistent with our prediction, the coefficient on C_Score is higher for smaller targets, targets with higher stock return volatility, targets with higher earnings volatility, targets with higher bid-ask spread, and targets with higher analyst forecast dispersion. The differences in coefficients on C_Score between targets with high- and low-information asymmetryare significant for size, stock return volatility, and analyst forecast dispersion.

Panel B reports the results from the OLS regression estimates of target announcement returns. The relation between C_Score and announcement returns is positive and significant only for small targets, targets with high stock return volatility, targets with high earnings volatility, targets with high bid-ask spread, and targets with high analyst forecast dispersion. The differences in coefficients on C_Score are significant for all five information asymmetry variables except earnings volatility.

Panel C reports the results from the OLS regression estimates of post-acquisition operating performance. The coefficient on C_Score is positive and significant only for targets with higher stock return volatility, targets with higher earnings volatility, targets with higher bid-ask spread, and targets with higher analyst forecast dispersion. The differences in coefficients on C_Score are significant for stock return volatility, earnings volatility, and analyst forecast dispersion.

Overall, the results in Table 7 shows that the effects of target accounting conservatism on acquirers' governance activities in targets and target performance are more pronounced for targets with high information asymmetry than for targets with low information asymmetry, suggesting that

the role of accounting conservatism in reducing information asymmetry is more valuable for targets with greater inherent information asymmetry.

7.Robustness tests

To check the robustness of our key results, we conduct several additional tests. Below, we briefly summarize the findings from these sensitivity tests.

7.1.Alternative measure of accounting conservatism

We use the Basu (1997) model as an alternative method to estimate conservatism. Following Ahmed and Duellman (2007) and Francis and Martin (2010), our models are specified as follows:

$$X_{i,t-1} = \beta_1 + \beta_2 D_{i,t-1} + \beta_3 R_{i,t-1} + \beta_4 D_{i,t-1} R_{i,t-1} + \beta_5 Board\ Rep\ Ratio_{i,t} + \beta_6 Board\ Rep\ Ratio_{i,t} D_{i,t-1} + \beta_7 Board\ Rep\ Ratio_{i,t} R_{i,t-1} + \beta_8 Board\ Rep\ Ratio_{i,t} D_{i,t-1} R_{i,t-1} + e_i, \quad (3)$$

$$X_{i,t-1} = \beta_1 + \beta_2 D_{i,t-1} + \beta_3 R_{i,t-1} + \beta_4 D_{i,t-1} R_{i,t-1} + \beta_5 CAR_{i,t} + \beta_6 CAR_{i,t} D_{i,t-1} + \beta_7 CAR_{i,t} R_{i,t-1} + \beta_8 CAR_{i,t} D_{i,t-1} R_{i,t-1} + e_i, \quad (4)$$

$$X_{i,t-1} = \beta_1 + \beta_2 D_{i,t-1} + \beta_3 R_{i,t-1} + \beta_4 D_{i,t-1} R_{i,t-1} + \beta_5 Change\ in\ EARN_{i,t+1} + \beta_6 Change\ in\ EARN_{i,t+1} D_{i,t-1} + \beta_7 Change\ in\ EARN_{i,t+1} R_{i,t-1} + \beta_8 Change\ in\ EARN_{i,t+1} D_{i,t-1} R_{i,t-1} + e_i \quad (5)$$

where i indexes the firm, t indexes the fiscal year in which the block acquisition is announced, Board Rep Ratio is the board representation ratio of block acquirers on the target's board, CAR is the CAR (-10, 10), Change in EARN is the industry-adjusted change in earnings from the year before acquisition to the year after acquisition,and the other variables are as defined in equation (1).

If we eliminate all terms involving Board Rep Ratio, CAR, and Change in EARN, respectively, from equations (3), (4),and (5), these equations are reduced to the Basu (1997) model in which the coefficient on D*R represents conditional conservatism. The higher the coefficient on D*R, the more conservative a firm's accounting policies. For example, in equation (3), the coefficient on D*R is a function of Board Rep Ratio. A positive and significant coefficient on Board Rep Ratio*D*Rsuggests that targets with higher board representation ratio are more conservative or, alternatively, more conservative targets have higher board representation ratio. Similarly, a positive and significant coefficient on CAR*D*Rand Change in EARN*D*R suggests that targets with announcement returns and post-acquisition operating performance are more conservative or, alternatively, more conservative targets experience higher announcement returns and post-acquisition operating performance.

We conduct the tests above using the subsample of targets whose acquirers do not have any pre-acquisition ownershipin the targets. Results from estimating equations (3), (4), and (5) are reported, respectively, in Panels A, B, and C of Table 8.Each panel reports results from two regressions. In the first regression, we use only variables included in each equation. In the second regression, we add firm size, market-to-book ratio, leverage, and their interaction with D, R and D*R as control variables.

In Panel A, we find thatthe coefficient estimate on Board Rep Ratio*R*D is positive and significant at the 5% and 1% levels in regressions (1) and (2), respectively, indicating that the board representation ratio is higher for more conservative targets.

In Panel B, we find thatthe coefficient estimate on CAR*R*D is positive and significant at the 5% level in both regressions, indicating that the announcement returns are higher for more conservative targets.

In Panel C, we find similar results for the coefficient estimate on Change in EARN*R*D. It is positive and significant at the 1% level in both regressions. These results suggest that more conservative targets experience better operating performance after the acquisition.

In sum, our results in Table 8 show that our main findings reported in previous sections are robust to the alternative measure of accounting conservatism.

7.2.Endogeneity bias: Reverse causality

Thus far, we have not considered the potential reverse causality in the relation between target conservatism and acquirers' governance activity in targets. For example, it could be the case that acquirers seeking to improve target governance are more likely to purchase stocks of companies with high conservatism while other acquirers do not have such a preference. To alleviate this concern, using the subsample of targets whose acquirers do not have any pre-acquisition ownershipin the targets, we perform several tests. First, we compare the frequency of control-motivated acquisitions between targets with low and high conservatism. Investors who accumulate more than 5% of any class of a firm's voting equity are required to indicate the purpose of their acquisitions (i.e., whether the deal is control-motivated or not) in their 13D filings. Acquirers that seek to improve target governance are more likely to be control motivated, so the reverse causality explanation suggests that the frequency of control-motivated acquisitions is higher for targets with high conservatism than for targets with low conservatism.

The results are reported in Panel A of Table 9. Contrary to the reverse causality explanation, we find that the frequency of control-motivated acquisitions is lower for targets with high conservatism (11.1%) than for targets with low conservatism (12.5%). However, the difference in the frequency of control-motivated acquisitions between the two groups is not significant. Thus, it appears that ex ante governance incentives of block acquirers are statistically indistinguishable across targets with low and high conservatism.

Second, we examine whether the need for target oversight differs between targets with low and high conservatism. To the extent that acquirer governance activities are more intense when the need for oversight in the target is greater, the reverse causality explanation suggests that corporate governance is poorer for targets with more conservative accounting than for targets with less conservative accounting. We use two variables to measure the quality of corporate governance in targets: the G-index constructed by Gompers, Ishii and Metrick. (2003) and board independence (percentage of outside directors on the board).

Panel A of Table 9 shows thatthe mean G-index and the mean percentage of outside directors for firms with high C_Score are not significantly different from those for firms with low C_Score. These results suggest that the need for corporate governance activism in targets with high

conservatism is not different from that in targets with low conservatism. In untabulated regression analyses, we find further that including board independence in the regressions does not change the significance of the coefficients on target C_Score. These results suggest that our findings are not driven by the quality of corporate governance in targets.

7.3.Endogeneity bias: Unobservable omitted firm characteristics

There is also another endogeneity concern that some unobservable firm characteristicssimultaneously affect both accounting conservatism and acquirers' governance activity. To address this concern, we resort to the standard instrumental variable approach. The instrumental variable approach also allows us to account for potential reverse causality in the relation between corporate governance activity and accounting conservatism in a more formal way.

Our instrumental variable for accounting conservatism is a dummy variable that takes the value of one for fiscal years after the implementation date of the SEC's Staff Accounting Bulletin (SAB) No. 101, and zero otherwise. By reducing the timeliness of revenue recognition, SAB 101 results in an exogenous increase in accounting conservatism for a broad cross-section of listed firms. Consistent with this view, Vogt (2001) finds that SAB 101 requires revenue recognition to be less timely than implied by contracting law and Watts (2003a) suggests that the implementation of SAB 101 is evidence for the SEC'S appreciation of the benefits of accounting conservatism. Using a sample of 10-Q filings, Crawford, Price, and Rountree (2010) provides empirical evidence that SAB 101 increases accounting conservatism. These results suggest that our SAB 101 dummy variable serves as a valid instrument for accounting conservatism.

We use a standard 2SLS regression. Specifically, in the first stage regression, we estimate an OLS regression of target C_Score on a SAB 101 dummy variable and variables used in the second-stage regression, which are those used in Panel B of Table 3. In the second stage, we estimate a Tobit regression of the board representation ratio using the predicted value of target C_Score and other variables used in Panel B of Table 3as independent variables.

The results from the second-stage regressions are presented in Panel B of Table 9. In untabulated first-stage regression, the coefficient on our instrumental variable is positive and significant at the 1% level, suggesting that the implementation of SAB 101 increase a firm's accounting conservatism. In the second-stage regressions, the coefficient estimate on the instrumented value of target C_Score is positive and significant at the 5% level in the Tobit regression. Thus, our key finding that high target C_Score increases acquirers' governance activities in targets is robust to this control for endogeneity.[11]

7.4. Bidder accounting conservatism

Francis and Martin (2010) show that bidders with more conservative accounting realize higher acquisition announcement returns and better post-acquisition operating performance. They also find that this positive relation is stronger when the bidders have more pronounced agency problems. These results suggest that a potential alternative explanation for the positive relation between target conservatism and performance is that conservative bidders acquire conservative targets and thus target conservatism used in our previous analyses simply captures bidder conservatism effects.

To investigate this alternative explanation, in untabulated tests we reestimate the regressions in Tables 3 through 6 by including bidder conservatism as an additional explanatory variable. We find that even after including bidder C_Score in the regressions, target C_Score is still positively and significantly related to the board representation ratio, announcement returns, and post-acquisition operating performance. In addition, bidder C_Score is negatively and positively related to target announcement returns and the board representation ratio, respectively, and insignificantly related to target post-acquisition operating performance. To the extent that target announcement returns capture the extent of the premium paid by the bidder, the negative relation between bidder C_Score and target announcement returns indicates that more conservative acquirers pay a lower premium for their targets. This result is consistent with that of Francis and Martin (2010), who show that accounting conservatism alleviates agency problems in bidders. Overall, these results suggest that our main findings are not driven by bidder accounting conservatism.

7.5. Alternative measure of acquirers' governance activity

To examine whether our results are robust to using an alternative measure of block acquirers' governance activities, we use the nonroutine top executive turnover that block acquirers initiate after the acquisitions as another experiment.We examine nonroutine top executive turnover at targets since removal of the top executive can be considered as one of the most aggressive governance actions taken in the course of corporate governance and prior research shows that blockholders play an important governance role in top executive turnover (Denis.Denis, and Sarin, 1997; Bethel, Liebeskind, and Opler, 1998; Kang and Shivdasani, 1995). We obtain information about top executive turnover events by searching proxy statements and Factiva for the one year from the date of the acquisition.[12]Following Denis, Denis, and Sarin (1997) and Kang and Kim (2008), we define the CEO as the top executive of the firm. If a firm has no CEO, we take the chairman of the board (or president if there is no chairman) to be the top executive. We refer to turnover events in which the top executive is removed due to death, illness, retirement, or other nongovernance-related reasons as routine turnover. We classify a management change as normal if the stated reason for the change is retirement and the retiring manager is above the age of 64.[13]We consider all other turnover events asnonroutine turnover.

We find that the frequency of nonroutine top executive turnover at targets after block share acquisitions is 6% for targets in the lowest conservatism quintile while it is 32.6% for targets in the highest conservatism quintile. This difference in the frequency of nonroutine top executive turnover between targets in the highest and lowest quintiles of conservatism is significant at the 1% level. Consistent with the regressions results using a board representation ratio, we find that that there is a positive and significant relation between C_Score and the likelihood of top executive turnover, particularly for a subsample of targets in which acquirers do not hold any equity ownership prior to the block acquisitions. Furthermore, a one-standard deviation increase inC_Scoreis associated with a 4.6% increase in the probability of nonrountine target top executive turnover, suggesting that the conservatism effect is economically significant.These results corroborate our findings in the paper that target conservatism increases block acquirers' incentives to monitor the target.Echoing the results using the board representation ratio, we also find that target C_Score is positively and significantly related to its announcement returns and the industry-adjusted change in its operating performance from the year before to the year after the acquisition, but only when acquirers do not

hold equity in targets prior to the block acquisitions. Finally, we find that these results areonly evident when targets are perceived by the market as having high ex ante information asymmetry problems.

8.Summary and Conclusion

We investigate how target accounting conservatism affectsinvestors' incentives to engage in governance activities in targets. We hypothesize that target conservatism reduces information asymmetry between managers and investors and thus facilitateseffective monitoring by investors. To the extent that enhanced monitoring translates into better target performance, target conservatism is also expected to be positively associated with the target's abnormal announcement returns and post-acquisition operating performance.We find results that are consistent with these hypotheses.

Specifically, we find that acquirers of targets with higher conservatism are more likely to have their representatives on the targets' boards after block share purchasesthan are block acquirers of targets with lower conservatism.Our further robustness test shows thatthis relationship isnot due to the reverse causality or omitted unobservable firm characteristics affecting both target conservatism and acquirers' governance activities.We also find that targets with higher conservatism realize higher acquisition announcement returns and better post-acquisition operating performance than those with lower conservatism. Consistent with the notion that accounting information is less useful to the investors who already possess private information about the firms,these resultsare evident onlyfor targets in which acquirers do not have any equity ownership prior to the block acquisitions.

Our further analysis shows that the above results are more pronounced when targets are perceived by the market as having higher inherent information asymmetry, such as when targets are small, have high earnings volatility, have high stock return volatility, have high bid-ask spreads,and have high analyst forecast dispersion. To the extent that the role of accounting conservatism in reducing information asymmetry is particularly important for these targets, our results suggest that accounting conservatism alleviates a firm's information asymmetry concerns, thereby providing block acquirers strong incentives to engage in active governance activities.

In robustness tests we examine whether our findings are sensitive to using an alternative measure of conservatism developed by Basu (1997), and whether they are driven by acquirer conservatism. We find that our results are robust to these tests.

Overall, our results suggest that target accounting conservatism has a positive effect on block acquirers' post-acquisition governance activities in targets, target acquisitionannouncement returns, andpost-acquisition target operating performance. We conclude that accounting conservatism reduces information asymmetry and thus facilitates more effective monitoring byinvestors.

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Table 1

Distribution of block acquisition activity by year and industry

The sample consists of 545 block share acquisitions between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively.

Target industry (first two digits of the SIC code)	Agriculture, forestry, and fishing (01-09)	Mining and construction (10-17)	Manufacturing (20-39)	Transportation (40-49)	Wholesale and retail trade (50-59)	Services (70-89)	Total
1980	0	0	1	0	0	0	1
1981	0	0	3	2	1	2	8
1982	0	1	8	0	1	2	12
1983	0	2	12	0	0	2	16
1984	1	4	15	2	4	1	27
1985	0	3	17	3	2	5	30
1986	0	3	10	2	2	4	21
1987	0	0	15	4	11	12	42
1988	0	1	20	9	2	8	40
1989	0	3	10	3	1	8	25
1990	1	1	12	2	1	5	22
1991	0	4	12	2	3	7	28
1992	1	1	13	1	0	1	17
1993	0	3	8	4	3	1	19

1994	0	4	11	1	8	5	29
1995	2	2	13	3	1	4	25
1996	2	6	11	3	5	5	32
1997	0	3	14	2	2	10	31
1998	0	2	17	4	5	5	33
1999	1	1	17	5	4	14	42
2000	0	0	10	2	0	4	16
2001	0	0	3	2	1	3	9
2002	0	0	2	1	1	1	5
2003	0	1	2	1	0	0	4
2004	0	1	3	0	0	1	5
2005	0	0	2	0	0	0	2
2006	0	0	1	0	1	1	3
2007	0	0	1	0	0	0	1
Total	8	46	263	58	59	111	545

Table 2

Descriptive statistics

The sample consists of 545 block share acquisitions between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. Appendix A provides a detailed description of the construction of the variables.

Variables	N	Mean	Q1	Median	Q3
Target C_Score	545	0.127	0.035	0.116	0.211
Information asymmetry variables:					
Size(market value of equity: in $million)	545	298.314	25.301	74.291	208.761
Return volatility	545	0.165	0.104	0.144	0.197
Earnings volatility	545	0.090	0.023	0.044	0.097
Bid-ask spread (%)	373	4.94	1.71	3.36	5.86
Analyst forecast dispersion	305	0.339	0.039	0.102	0.261

Other target and transaction characteristics:					
Operating income	545	0.011	-0.021	0.085	0.144
Dividend yield	545	0.007	0.000	0.000	0.000
Leverage	545	0.245	0.084	0.231	0.375
Tobin's q	545	1.790	0.995	1.288	1.916
Prior year stock return	545	0.099	-0.286	-0.038	0.262
Hostile (dummy)	545	0.015	0	0	0
Ownership purchased	545	0.196	0.072	0.131	0.250
Open market purchase (dummy)	545	0.327	0	0	1
Same industry (dummy)	545	0.398	0	0	1
Stock financing (dummy)	545	0.024	0	0	0

Table 3Board representation ratio bytarget accounting conservatism (C_Score) andTobit regression estimates of the board representation ratio

The sample consists of 483 block share acquisition in which data on target board structure are available between 1980 and 2007. We obtain the initial sample of block share acquisitions from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. We obtain information on acquirers' board representation from Compact Disclosure. The board representation ratio is measured as the ratio of the number of directors appointed by acquirers to the total number of directors on the target's board one year after the block acquisition.In Panel B, the dependent variable is the board representation ratio.Stock financing does not have any variations in the subsample of targets in which acquirers hold equity ownership prior to the block acquisitions and therefore its coefficient and the coefficient on its interaction term cannot be estimated. Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Panel A: Board representation ratio ranked by target C_Score	
Target C_Score ranking	Board representation ratio
Lowest	0.037
2	0.038
3	0.060
4	0.083

Highest			0.104		
Highest-Lowest			0.067***		
(p-value)			(<0.01)		
Panel B:Tobit (OLS) regression estimates of board representation ratio					
Variables	Full sample (Tobit regression)			Subsample of acquirers with the toehold (OLS regression)	Subsample of acquirers without the toehold (OLS regression)
	(1)	(2)	(3)	(4)	(5)
Intercept	-1.687	-2.612	-3.062	0.025	-0.091
	(0.69)	(0.98)	(0.98)	(0.64)	(0.11)
Target C_Score: a	0.645**	0.413*	0.686*	0.324	0.223**
	(0.05)	(0.10)	(0.08)	(0.17)	(0.05)
Size	0.010		0.043	0.020	0.010
	(0.76)		(0.27)	(0.17)	(0.15)
Return volatility	-0.591		-0.401	-0.106	-0.044
	(0.27)		(0.47)	(0.47)	(0.49)
Earnings volatility	0.077		0.081	0.059	-0.003
	(0.78)		(0.79)	(0.75)	(0.96)
Operating income		-0.050	0.008	0.134	0.014
		(0.75)	(0.97)	(0.23)	(0.61)
Dividend yield		0.453	-2.768	-0.350	0.149
		(0.90)	(0.44)	(0.44)	(0.83)
Leverage		0.007	-0.146	-0.094	-0.072
		(0.97)	(0.52)	(0.27)	(0.19)
Tobin’s q		-0.017	-0.045	-0.024	-0.008*
		(0.58)	(0.25)	(0.20)	(0.08)
Prior year stock return		-0.036	-0.033	-0.016	0.001
		(0.52)	(0.58)	(0.32)	(0.88)

Hostile (dummy)		0.487	0.27	0.031	0.022
		(0.17)	(0.21)	(0.57)	(0.62)
Ownership purchased		0.742***	0.761***	0.174	0.114***
		(0.01)	(0.01)	(0.26)	(0.01)
Open market purchase (dummy)		-0.151*	-0.197**	-0.080	-0.015
		(0.10)	(0.03)	(0.19)	(0.20)
Same industry (dummy)		-0.085	-0.063	-0.036	-0.009
		(0.27)	(0.39)	(0.19)	(0.46)
Stock financing (dummy)		0.076	0.412	-	-0.015
		(0.84)	(0.18)		(0.79)
Stock financing * a		-0.104	-0.905	-	0.187
		(0.96)	(0.66)		(0.70)
Industry dummy	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES
McFadden PseudoR^2	0.31	0.39	0.39	0.11	0.11
Sample size	483	483	483	60	423

Table 4

Cumulative abnormal returns (CARs) for targets around the announcement date

The sample consists of 545 targets in block share acquisitions between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. Abnormal announcement returns are estimated by a standard event study methodology. Market model parameters are estimated from daily returns over the period -260 to -10, using the value-weighted CRSP index as the market portfolio. The daily abnormal return is cumulated to get the CAR from day t_1 before the acquisition announcement date to day t_2 after the acquisition announcement date. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Event windows	Full sample (N=545)	Subsample with low conservatism (N=273)	Subsample with high conservatism (N=272)	Test of difference
CAR (-1, 1)	0.089***	0.077***	0.098***	0.021
	(<0.01)	(<0.01)	(<0.01)	(0.14)

CAR (-3, 3)	0.103***	0.080***	0.122***	0.042***
	(<0.01)	(<0.01)	(<0.01)	(<0.01)
CAR (-5, 5)	0.118***	0.088***	0.147***	0.059***
	(<0.01)	(<0.01)	(<0.01)	(<0.01)
CAR (-10, +1)	0.138***	0.114***	0.163***	0.049***
	(<0.01)	(<0.01)	(<0.01)	(<0.01)
CAR (-10, +10)	0.133***	0.106***	0.162***	0.056***
	(<0.01)	(<0.01)	(<0.01)	(<0.01)

Table 5

Regression of cumulative abnormal returns (CARs) for targets on target characteristics

The sample consists of 545 targets in block share acquisitions between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. Abnormal announcement returns are estimated by a standard event study methodology. Market model parameters are estimated from daily returns over the period -260 to -10, using the value-weighted CRSP index as the market portfolio. The daily abnormal return is cumulated to get the CAR from day t_1 before the acquisition announcement date to day t_2 after the acquisition announcement date. The dependent variable is the CAR (-10, 10). Stock financing does not have any variations in the subsample of targets in which acquirers hold equity ownership prior to the block acquisitions and therefore its coefficient and the coefficient on its interaction term cannot be estimated. Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Variables	Full sample				Subsample of acquirers with thetoehold	Subsample of acquirers without the toehold
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	-0.058	-0.201	-0.233	-0.231	3.239***	-0.362*
	(0.71)	(0.17)	(0.17)	(0.17)	(<0.01)	(0.06)

Target C_Score: a	0.237**	0.382***	0.422***	0.420***	-3.326***	0.497***
	(0.03)	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(<0.01)
Size	-0.007		0.004	0.005	-0.363***	0.014
	(0.50)		(0.75)	(0.68)	(<0.01)	(0.42)
Return volatility	0.001		0.165	0.147	0.566	0.219
	(0.99)		(0.31)	(0.36)	(0.67)	(0.20)
Earnings volatility	-0.075		-0.079	-0.087	-1.660	-0.120
	(0.44)		(0.45)	(0.40)	(0.23)	(0.27)
Operating income		0.037	0.033	0.025	-0.610	0.040
		(0.50)	(0.60)	(0.69)	(0.18)	(0.55)
Dividend yield		0.908	1.033	1.011	-0.521	1.102
		(0.33)	(0.29)	(0.30)	(0.85)	(0.32)
Leverage		-0.098	-0.109	-0.120	1.005***	-0.149*
		(0.17)	(0.16)	(0.13)	(0.01)	(0.08)
Tobin's q		-0.010	-0.017	-0.011	0.133	-0.003
		(0.27)	(0.34)	(0.33)	(0.17)	(0.81)
Prior year stock return		-0.042***	-0.046***	-0.046***	0.074	-0.056***
		(0.01)	(0.01)	(0.01)	(0.69)	(<0.01)
Hostile (dummy)		0.225**	0.228**	0.223**	0.410	0.202
		(0.02)	(0.02)	(0.02)	(0.15)	(0.13)
Ownership purchased		0.106	0.112	0.105	-0.480	0.141*
		(0.13)	(0.11)	(0.13)	(0.31)	(0.06)
Open market purchase (dummy)		0.069***	0.068**	0.067**	-0.007	0.067**
		(0.01)	(0.02)	(0.02)	(0.96)	(0.04)
Same industry (dummy)		0.046**	0.047**	0.050**	-0.052	0.062**
		(0.05)	(0.05)	(0.04)	(0.65)	(0.02)
Stock financing (dummy)		-0.045	-0.049	-0.328**	-	-0.351**
		(0.60)	(0.57)	(0.03)		(0.02)
Stock financing* a				1.981**	-	2.077***
				(0.02)		(0.01)

Industry dummy	YES	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES	YES
Adjusted-R^2	0.07	0.11	0.11	0.12	0.42	0.13
Sample size	545	545	545	545	68	477

Table 6

Regressions of changes in post-acquisition target operating performance

This sample consists of 451 targets in block share acquisitions in which post-acquisition operating performance can be estimated between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. The dependent variable is the industry-adjusted change in earnings, defined as the change in the target's earnings before extraordinary items from one year before to one year after the block acquisition, divided by the target's total assets in the year prior to acquisition, minus the median value of the industry (using the first two digits of the SIC code). Stock financing does not have any variations in the subsample of targets in which acquirers hold equity ownership prior to the block acquisitions and therefore its coefficient and the coefficient on its interaction term cannot be estimated. Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Variables	Full sample			Subsample of acquirers with thetoehold	Subsample of acquirers without the toehold
	(1)	(2)	(3)	(4)	(5)
Intercept	-0.039	0.158	-0.046	0.895	0.054
	(0.94)	(0.55)	(0.94)	(0.36)	(0.89)
Target C_Score: a	0.136	0.506*	0.781**	-1.215	0.808*
	(0.68)	(0.06)	(0.05)	(0.38)	(0.07)
Size	-0.021		0.058	-0.106	0.062
	(0.52)		(0.14)	(0.35)	(0.16)
Return volatility	-0.605		-0.370	-0.670	-0.391
	(0.22)		(0.47)	(0.73)	(0.49)
Earnings volatility	0.444		0.500	1.814	0.570
	(0.14)		(0.13)	(0.24)	(0.11)

Operating income		-0.323*	-0.258	-0.038	-0.327
		(0.08)	(0.19)	(0.95)	(0.13)
Dividend yield		0.500	-1.844	0.101	-2.365
		(0.86)	(0.55)	(0.98)	(0.52)
Leverage		-0.132	-0.228	0.556	-0.164
		(0.56)	(0.34)	(0.23)	(0.55)
Tobin's q		-0.112***	-0.140***	0.026	-0.167***
		(<0.01)	(<0.01)	(0.76)	(<0.01)
Prior year stock return		-0.037	-0.038	0.401	-0.039
		(0.44)	(0.44)	(0.17)	(0.47)
Hostile (dummy)		-0.051	-0.066	0.530	-0.023
		(0.92)	(0.90)	(0.27)	(0.98)
Ownership purchased		-0.535**	-0.475**	-0.382	-0.511**
		(0.02)	(0.03)	(0.55)	(0.04)
Open market purchase (dummy)		-0.082	-0.084	0.064	-0.078
		(0.35)	(0.34)	(0.70)	(0.46)
Same industry (dummy)		0.080	0.071	0.066	0.111
		(0.28)	(0.33)	(0.71)	(0.67)
Stock financing (dummy)		-0.221	-0.198	-	-0.193
		(0.60)	(0.64)		(0.67)
Stock financing * a		0.559	0.710	-	0.537
		(0.84)	(0.79)		(0.87)
Industry dummy	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES
Adjusted-R^2	-0.03	0.01	0.02	0.29	0.02
Sample size	451	451	451	57	394

Table 7

Reestimation of regressions according to information asymmetry variables: using a subsample of acquirers without toehold

The sample consists of 477 targets whose acquirers do not own target shares before the block share acquisition between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. We divide the sample targets into two subsamples, targets with high- and low-information asymmetry, according to the sample median of each information asymmetry variable. The number of observations differs across regressions due to the requirement that the information asymmetry variable is non-missing. Panel A reports the Tobit regression results of the board representation ratio. PanelsBandCreport the OLS regression results of the CARs and post-acquisition operating performance, respectively. "IA" denotes "information asymmetry." Hostile does not have any variations in some of the subsamples and therefore its coefficient cannot be estimated. Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Panel A:Tobitregression estimates of the board representation ratio

Variables	Size >= median (low IA)	Size < median (high IA)	Return volatility < median (low IA)	Return volatility >= median (high IA)	Earnings volatility< median (low IA)	Earnings volatility>= median (low IA)	Bid-ask spread< median (low IA)	Bid-ask spread >= median (high IA)	Analyst forecast dispersion <median (low IA)	Analyst forecast dispersion >= median (high IA)
Intercept	-1.540***	0.312***	-2.319***	0.294***	-0.465	0.307***	-3.424***	0.346***	-1.037***	0.292***
	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(0.12)	(<0.01)	(<0.01)	(<0.01)	(0.01)	(0.01)
Target C_Score	-2.049***	0.116	0.434***	1.572***	0.064	0.851***	0.188**	0.265**	-2.294***	0.712***
	(<0.01)	(0.13)	(<0.01)	(<0.01)	(0.92)	(<0.01)	(0.03)	(0.02)	(0.01)	(0.01)
Size			0.062***	0.086***	-0.029	0.043***	0.031***	-0.081***	-0.009	0.007
			(<0.01)	(<0.01)	(0.56)	(<0.01)	(<0.01)	(<0.01)	(0.89)	(0.85)

Return volatility	0.642***	-0.473***			0.284	-1.412***	-0.837***	-0.594**	0.867	0.649
	(<0.01)	(<0.01)			(0.71)	(<0.01)	(<0.01)	(<0.01)	(0.17)	(0.27)
Earnings volatility	0.245*	1.163***	0.346***	-0.311			1.334***	-3.379***	-0.578	-1.329**
	(0.02)	(<0.01)	(<0.01)	(0.10)			(<0.01)	(<0.01)	(0.58)	(0.04)
Operating income	-0.646***	0.450***	-0.025	-0.177***	0.102	-0.266***	-0.252***	-0.722***	-0.406	-0.105
	(<0.01)	(<0.01)	(0.61)	(<0.01)	(0.88)	(<0.01)	(<0.01)	(<0.01)	(0.25)	(0.72)
Dividend yield	6.103***	-10.905***	-22.807***	2.020***	-10.401*	0.470	-8.907***	60.538***	-25.249*	7.083
	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(0.09)	(0.42)	(<0.01)	(<0.01)	(0.07)	(0.16)
Leverage	0.674***	0.179**	-0.398***	-0.574***	-0.288	0.016	-0.137*	0.471***	1.189***	-0.170
	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(0.40)	(0.75)	(0.03)	(<0.01)	(0.01)	(0.61)
Tobin-q	0.007	0.003	-0.048***	-0.028**	0.010	-0.044***	-0.070***	-0.106***	0.143***	-0.036
	(0.29)	(0.81)	(<0.01)	(0.01)	(0.91)	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(0.42)
Prior year stock return	-0.179***	-0.137***	-0.048***	-0.131***	0.044	-0.005	-0.104***	-0.127***	-0.195	-0.108
	(<0.01)	(<0.01)	(<0.01)	(<0.01)	(0.63)	(0.59)	(<0.01)	(<0.01)	(0.14)	(0.35)
Ownership purchased	0.658***	0.721***	0.792***	0.076	0.781***	0.653***	1.060***	0.325***	0.554**	0.591*
	(<0.01)	(<0.01)	(<0.01)	(0.25)	(0.01)	(<0.01)	(<0.01)	(<0.01)	(0.02)	(0.04)
Hostile (dummy)	0.233	-	0.580	-	1.107***	4.618	-	-	-	-
	(0.39)		(0.14)		(0.01)	(0.99)				
Open market purchase (dummy)	0.153***	-0.585***	0.031	-0.113***	0.029	-0.236***	0.121***	-4.248	0.295***	-0.191
	(<0.01)	(<0.01)	(0.17)	(<0.01)	(0.79)	(<0.01)	(<0.01)	(0.90)	(0.01)	(0.33)
Same industry	-0.096***	-0.003	-0.043*	0.069*	0.009	-0.151***	-0.092***	0.018	-0.135	-0.085

(dummy)	(<0.01)	(0.93)	(0.08)	(0.03)	(0.93)	(<0.01)	(<0.01)	(0.64)	(0.24)	(0.49)
Stock financing (dummy)	-0.790***	1.364***	0.036	-0.118***	0.481	0.383***	2.249***	-0.221***	-0.007	0.639***
	(<0.01)	(<0.01)	(0.65)	(<0.01)	(0.16)	(<0.01)	(<0.01)	(<0.01)	(0.93)	(<0.01)
Stock financing * a	-0.071	-2.538***	0.438	6.566***	-0.504	-0.562	-89.639***	7.936***	-0.059	-5.016
	(0.98)	(<0.01)	(0.28)	(<0.01)	(0.79)	(0.19)	(<0.01)	(<0.01)	(0.93)	(0.12)
Chow test p-value of coefficient difference in a	<0.01		<0.01		0.22		0.59		0.04	
Industry dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
McFadden Pseudo R^2	0.85	0.58	0.51	0.57	0.55	0.54	0.70	0.59	0.49	0.39
Sample size	212	211	211	212	211	212	156	156	115	116

Panel B:OLS regression estimates of CARs

Variables	Size >= median (low IA)	Size < median (high IA)	Return volatility < median (low IA)	Return volatility >= median (high IA)	Earnings volatility< median (low IA)	Earnings volatility>= median (high IA)	Bid-ask spread< median (low IA)	Bid-ask spread>= median (high IA)	Analystforecast dispersion < median (low IA)	Analyst forecast dispersion>= median (high IA)
Intercept	-0.110	-0.277	0.065	-0.839**	-0.146	0.120	-0.742***	-0.041	-0.127	-0.918*
	(0.57)	(0.26)	(0.74)	(0.05)	(0.53)	(0.61)	(<0.01)	(0.85)	(0.67)	(0.06)
Target C_Score: a	0.054	0.550***	0.193	0.609***	0.078	0.498**	-0.160	0.565**	0.455	1.134***
	(0.75)	(<0.01)	(0.40)	(0.01)	(0.70)	(0.02)	(0.59)	(0.05)	(0.26)	(<0.01)

Size			-0.000	0.002	-0.002	-0.000	0.006	-0.023	0.031	0.109***
			(0.99)	(0.95)	(0.92)	(0.99)	(0.82)	(0.52)	(0.40)	(<0.01)
Return volatility	0.147	0.428*			0.392	-0.034	0.844***	0.583	-1.003**	0.761
	(0.52)	(0.10)			(0.11)	(0.90)	(<0.01)	(0.11)	(0.03)	(0.11)
Earnings volatility	-0.223	-0.180	-0.142	-0.277*			0.082	-0.371*	-0.290	-0.008
	(0.19)	(0.26)	(0.46)	(0.09)			(0.65)	(0.08)	(0.40)	(0.98)
Operating income	-0.068	0.143	-0.012	0.021	0.163	0.056	-0.062	-0.023	-0.178	0.089
	(0.41)	(0.19)	(0.89)	(0.83)	(0.17)	(0.52)	(0.61)	(0.86)	(0.25)	(0.58)
Dividend yield	0.045	1.756	0.828	1.640	0.975	-0.998	3.914	6.139	0.194	-2.603
	(0.97)	(0.44)	(0.37)	(0.77)	(0.31)	(0.74)	(0.14)	(0.26)	(0.92)	(0.23)
Leverage	-0.015	-0.235*	0.000	-0.256*	0.103	-0.310**	0.140	-0.276	-0.170	-0.594***
	(0.87)	(0.08)	(0.99)	(0.08)	(0.31)	(0.02)	(0.35)	(0.19)	(0.35)	(<0.01)
Tobin's q	-0.009	0.002	0.014	-0.012	-0.021	0.017	0.000	-0.004	-0.025	-0.061***
	(0.44)	(0.93)	(0.41)	(0.53)	(0.38)	(0.28)	(0.99)	(0.88)	(0.30)	(<0.01)
Prior year stock return	0.012	-0.116***	-0.024	-0.033	0.012	-0.064***	-0.002	-0.151***	-0.017	0.019
	(0.57)	(<0.01)	(0.48)	(0.17)	(0.67)	(<0.01)	(0.95)	(<0.01)	(0.71)	(0.59)
Hostile (dummy)	0.185**	-	0.230**	-	0.191**	-0.019	0.163	-	0.132	0.052
	(0.04)		(0.03)		(0.03)	(0.95)	(0.45)		(0.48)	(0.87)
Ownership purchased	0.083	0.072	0.035	0.260*	0.075	0.055	0.369***	0.061	0.407**	-0.136
	(0.37)	(0.56)	(0.69)	(0.06)	(0.36)	(0.67)	(<0.01)	(0.74)	(0.02)	(0.45)
Open market purchase	0.073**	0.061	0.054	0.142**	0.044	0.068	0.073	-0.009	0.162**	0.113*
	(0.05)	(0.21)	(0.12)	(0.03)	(0.16)	(0.20)	(0.19)	(0.91)	(0.03)	(0.10)

(dummy)										
Same industry (dummy)	0.008	0.104***	0.028	0.072	0.010	0.067	0.077*	0.102	0.100*	0.055
	(0.77)	(0.01)	(0.34)	(0.13)	(0.70)	(0.13)	(0.09)	(0.12)	(0.07)	(0.34)
Stock financing (dummy)	-0.601***	-0.451	0.281	-0.406*	0.957	-0.275	-0.623***	-0.485	0.064	-1.324**
	(<0.01)	(0.19)	(0.29)	(0.09)	(0.70)	(0.13)	(0.01)	(0.31)	(0.86)	(0.03)
Stock financing * a	5.079***	2.001	-8.578	2.078	-7.165	2.040**	3.292**	2.412	-0.816	9.670**
	(<0.01)	(0.23)	(0.19)	(0.12)	(0.66)	(0.06)	(0.02)	(0.26)	(0.79)	(0.05)
Chow test p-value of coefficient difference in a	0.02		0.05		0.14		0.06		0.08	
Industry dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Adjusted-R^2	0.12	0.14	0.14	0.13	0.06	0.08	0.19	0.11	0.05	0.23
Sample size	239	238	238	239	238	239	163	163	128	129

Panel C:OLS regression estimates of post-acquisition operating performance

Variables	Size >= median (low IA)	Size < median (high IA)	Return volatility < median (low IA)	Return volatility >= median (high IA)	Earnings volatility< median (low IA)	Earnings volatility>= median (high IA)	Bid-ask spread< median (low IA)	Bid-ask spread>= median (high IA)	Analystforecast dispersion < median (low IA)	Analyst forecast dispersion>= median (high IA)
Intercept	0.518**	0.030	-0.178	-1.000	-0.032	0.340	4.095	1.358**	0.472	0.276
	(0.05)	(0.94)	(0.18)	(0.44)	(0.85)	(0.35)	(0.15)	(0.04)	(0.23)	(0.28)
Target C_Score: a	0.996	0.367	0.089	1.304*	0.225	2.281***	-0.622	3.620***	0.419	1.918*

	(0.13)	(0.42)	(0.69)	(0.08)	(0.14)	(0.01)	(0.67)	(<0.01)	(0.50)	(0.07)
Size			-0.006	0.121	0.006	0.167*	-0.136	0.094	0.038	0.068
			(0.75)	(0.15)	(0.76)	(0.07)	(0.13)	(0.32)	(0.61)	(0.18)
Return volatility	-0.765	-1.334			0.299	-0.629	-1.353*	-2.814**	-3.021**	-0.648
	(0.26)	(0.07)			(0.26)	(0.42)	(0.08)	(0.02)	(0.05)	(0.34)
Earnings volatility	-0.002	1.294***	1.451**	0.483			-0.247	-3.699	1.155***	1.334**
	(0.99)	(0.01)	(0.01)	(0.34)			(0.84)	(0.11)	(0.01)	(0.03)
Operating income	0.025	-0.927	0.095	-0.760	0.403	-0.379	0.325	1.213***	-0.837	0.200
	(0.91)	(0.12)	(0.44)	(0.23)	(0.19)	(0.18)	(0.48)	(0.01)	(0.17)	(0.55)
Dividend yield	-0.312	3.841	1.873	3.469	1.255	-8.302	3.718	3.776	12.120	2.963
	(0.87)	(0.59)	(0.06)	(0.78)	(0.36)	(0.32)	(0.25)	(0.40)	(0.69)	(0.33)
Leverage	-0.542*	0.117	0.135	-0.318	-0.147	-0.254	-0.244	-2.526***	0.589	-0.556*
	(0.10)	(0.72)	(0.21)	(0.38)	(0.14)	(0.63)	(0.57)	(<0.01)	(0.26)	(0.10)
Tobin's q	-0.097**	-0.238	-0.018	-0.251	-0.039	-0.228**	0.111**	-0.170***	-0.282*	-0.169***
	(0.05)	(0.15)	(0.42)	(0.09)	(0.33)	(0.02)	(0.05)	(<0.01)	(0.08)	(0.01)
Prior year stock return	-0.188	0.161	0.053	0.005	0.076*	-0.076	0.052	-0.365***	0.308*	-0.274*
	(0.16)	(0.20)	(0.19)	(0.98)	(0.06)	(0.54)	(0.43)	(<0.01)	(0.10)	(0.09)
Hostile (dummy)	-0.322	-	-	0.540	-0.070	-	-	-	-	-
	(0.76)			(0.51)	(0.82)					
Ownership purchased	-0.956***	-0.099	-0.316***	-1.174**	-0.072	-1.372***	-0.570	-0.515	-0.549*	-1.230**
	(0.01)	(0.64)	(<0.01)	(0.04)	(0.54)	(0.01)	(0.16)	(0.13)	(0.09)	(0.02)
Open market	-0.133	0.028	0.002	-0.012	0.008	-0.186	0.236	-0.543***	0.169	-0.129

purchase (dummy)	(0.07)	(0.78)	(0.97)	(0.95)	(0.87)	(0.31)	(0.31)	(0.01)	(0.30)	(0.24)
Same industry (dummy)	0.053	0.102	0.026	0.303	-0.004	0.101	-0.151	-0.022	0.149	-0.042
	(0.48)	(0.24)	(0.47)	(0.13)	(0.91)	(0.42)	(0.12)	(0.80)	(0.17)	(0.68)
Stock financing (dummy)	-0.675	-0.052	-0.104	-0.310	1.976	-0.055	1.613	1.426*	-0.081	-0.662*
	(0.07)	(0.91)	(0.27)	(0.37)	(0.15)	(0.87)	(0.70)	(0.07)	(0.90)	(0.08)
Stock financing * a	4.021	0.307	5.972*	1.008	-12.834	0.077	-10.525	1.754	1.754	4.555
	(0.22)	(0.89)	(0.06)	(0.58)	(0.17)	(0.96)	(0.71)	(0.82)	(0.54)	(0.12)
Chow test p-value of coefficient difference in a	0.43		0.10		0.02		0.22		0.03	
Industry dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year dummy	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Adjusted-R^2	-0.06	-0.00	-0.06	-0.23	-0.17	0.03	0.19	-0.06	0.50	-0.20
Sample size	197	196	196	197	196	197	133	134	84	84

Table 8Robustness check for conservatism measure: Using Basu (1997) model

The sample consists of 477 targets whose acquirers do not own target shares before the block share acquisition between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. The Basu (1997) model is estimated to examine the effect of target accounting conservatism on board representation ratio of block acquirers on the target's board(Panel A), target announcement returns (Panel B), and post-acquisition target operating performance (Panel C). Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses.Other control variables include firm size, market-to-book ratio, leverage, and their interaction with D, R and D*R. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Panel A:Board representationratio regression		
Variables	(1)	(2)
Intercept	0.014	0.032
	(0.52)	(0.69)
D (dummy variable that equals 1 if prior fiscal year return is negative and 0 otherwise)	-0.037	-0.009
	(0.14)	(0.92)
R (Buy-and-hold return in the previous fiscal year)	-0.083**	-0.229**
	(0.02)	(0.05)
D*R	0.091	-0.186
	(0.24)	(0.46)
Board rep ratio	-0.140	-0.079
	(0.52)	(0.73)
Board rep ratio*D	0.484	0.432
	(0.11)	(0.16)
Board rep ratio*R	0.265	0.178
	(0.48)	(0.65)
Board rep ratio*R*D	1.607**	1.653***
	(0.02)	(0.01)
Other control variables	No	Yes
Sample size	423	423

Panel B: Announcement return regression		
Variables	(1)	(2)
Intercept	0.043***	0.041
	(<0.01)	(0.56)
D (dummy variable that equals 1 if prior fiscal year return is negative and 0 otherwise)	-0.046**	0.014
	(0.02)	(0.92)
R (Buy-and-hold return in the previous fiscal year)	-0.096***	-0.224**
	(<0.01)	(0.03)
D*R	0.054	-0.159
	(0.37)	(0.50)
CAR (-10, 10)	-0.018	-0.010
	(0.82)	(0.91)
CAR (-10, 10) *D	0.170	0.149
	(0.13)	(0.20)
CAR (-10, 10) *R	-0.109	-0.145
	(0.16)	(0.20)
CAR (-10, 10) *R*D :c	0.447**	0.458**
	(0.03)	(0.04)
Other control variables	No	Yes
Sample size	477	477
Panel C: Post-acquisition operating performance regression		
Variables	(1)	(2)
Intercept	0.053	0.114
	(0.49)	(0.66)
D (dummy variable that equals 1 if prior fiscal year return is negative and 0 otherwise)	-0.087	-0.075
	(0.30)	(0.79)
R (Buy-and-hold return in the previous fiscal year)	0.015	0.631*
	(0.90)	(0.09)
D*R	0.336	1.529**
	(0.20)	(0.03)

Change in EARN	0.039	-0.043
	(0.84)	(0.83)
Change in EARN*D	0.776***	0.916***
	(<0.01)	(<0.01)
Change in EARN *R	-0.024	0.019
	(0.79)	(0.85)
Change in EARN *R*D: d	1.606***	1.807***
	(<0.01)	(<0.01)
Other control variables	No	Yes
Sample size	394	394

Table 9

Tests of reverse causality in the relation between target accounting conservatism and acquirers' governance activities and instrumental variable regressions

The sample consists of 423 targets whose acquirers do not own target shares before the block share acquisition between 1980 and 2007. We obtain the initial sample from Thomson Financial's Security Data Corporation Platinum database. We first identify block acquisitions in which the acquirer initially holds less than 5% of the target's outstanding shares and then purchases more than 5% but less than 100% of its outstanding shares. We then exclude transactions involving targets in utilities (SIC 4900-4939) and financial industries (SIC 6000-6999). Finally, we exclude transactions in which stock return and accounting data for targets are not available in CRSP and COMPUSTAT, respectively. In Panel A, information on the stated purpose of control-motivated acquisitions is obtained from a firm's 13D filing. G-index refers to Gompers,Ishii and Metrick (2003) governance index. Board independence information is obtained from the target's proxy statement. We define outside board members as directors who are not currently employed or have not been employed by the firm for the past 3 years. In Panels B, we obtain information on acquirers' board representation from Compact Disclosure. The board representation ratio is measured as the ratio of the number of directors appointed by acquirers to the total number of directors on the target's board one year after the block acquisition. We use as an instrumental variable a SAB101dummy variable that takes the value of one ifthe acquisitiontook place after fiscal year 2000 and zero otherwise. In the first-stage OLS regression, we regresstarget accounting conservatism (C_Score) on the SAB101dummy and other control variables used in the second-stage regression. The fitted value from the first-stage regression is used in the second-stage regression as an instrument for thetarget C_Score. Appendix A provides a detailed description of the construction of the variables. p-values are in parentheses. The symbols *, **, and *** denote significance at the 10%, 5% and 1% levels, respectively.

Panel A: Univariate test

	Frequency of control-motivated acquisition	G-index (Gompers, Ishii, and Metrick, 2003)	Board independence (proportion of outside directors on the board)

	N	Mean	N	Mean	N	Mean
Low C_Score subsample	48	0.125	18	9.125	175	0.669
High C_Score subsample	48	0.111	19	9.261	175	0.641
High-Low		-0.014		0.136		-0.028

Panel B:Two-stage least squares regression

Variable	Tobit regression estimates of the board representation ratio
Intercept	-2.261**
	(0.03)
Instrumented target C_Score: a	2.704**
	(0.02)
Size	0.150**
	(0.03)
Return volatility	-0.847
	(0.18)
Earnings volatility	-0.147
	(0.66)
Operating income	0.016
	(0.93)
Dividend yield	-0.804
	(0.83)
Leverage	-0.932**
	(0.05)
Tobin’s q	-0.017
	(0.61)
Prior year stock return	-0.044

	(0.49)
Hostile (dummy)	-1.337
	(0.99)
Ownership purchased	0.614***
	(<0.01)
Open market purchase (dummy)	-0.153
	(0.12)
Same industry (dummy)	-0.104
	(0.19)
Stock financing (dummy)	0.390
	(0.30)
Stock financing * a	-1.896
	(0.44)
Industry dummy	YES
Year dummy	YES
Adjusted-R^2/Pseudo-R^2	0.26
Sample size	423

Appendix A

Variable definition

This appendix provides a detailed description of the construction of all the variables used in the tables. Unless otherwise indicated, all variables are measured at the fiscal year-end that immediately precedesthe announcement date of block share acquisitions.

Variable name	Definition
Analyst forecastdispersion	Standard deviation of analyst forecasts deflated by the absolute value of the mean consensus analyst forecast at the end of the fiscal year prior to the block acquisition.
Bid-ask spread (%)	Mean percentage of monthly bid-ask spread deflated by the midpoint of bid and ask prices in the 12 months before the month of acquisition.

Board Rep Ratio	Ratio of the number of directors appointed by acquirers to the total number of directors on the target's board one year after the block acquisition.
CAR (-10, 10)	Cumulative abnormal return (-10, 10).
Change in EARN	Change in the target's earnings before extraordinary items (Compustat item 18) from one year before to one year after the block acquisition, divided by the target's total assets (Compustat item 6) in the year prior to acquisition, minus the median value of the industry (using the first two digits of the SIC code).
Control-motivated acquisition (dummy)	A dummy variable which equals one if the stated purpose of acquisition is to control the targets and zero otherwise.
C_Score	Conservatism measure based on Khan and Watts (2009) in the year prior to the announcement of block acquisition.
D	A dummy variable which equals one if prior fiscal year return is negative and zero otherwise.
Dividend yield	Dividend per share (Compustat item 26) deflated by fiscal year end price (Compustat item 199).
Earnings volatility	Standard deviation of past ten year ROAs (Compustat item 18/Compustat item 6) before the acquisition.
Hostile (dummy)	A dummy variable which equals one if the acquisition is hostile and zero otherwise.
Instrumented target C_Score	The fitted value from the first-stage regression in which target C_Scoreis regressed on the SAB101 dummy (instrumental variable) and other control variables used in theboard representation ratio regression.

Leverage	Sum of the book value of long-term debt (Compustat item 9) and short-term debt (Compustat item 34) divided by total assets (Compustat item 6).
Open market purchase(dummy)	A dummy variable which equals one if acquirers purchase shares through open market purchases and zero otherwise.
Operating income	Operating income before depreciation (Compustat item 13) deflated by total assets (Compustat item 6).
Ownership purchased	Percentage of ownership block acquirers purchased.
Prior year stock return	Past 12-month industry-adjusted buy-and-hold returns before the announcement of block acquisition. Industry is defined using the first two-digit of SIC codes.
Positive stock return (dummy)	A dummy variable that equals one if prior year stock returnis positive and zero otherwise.
R	Buy-and-hold return in the previous fiscal year, specifically from fourth month after fiscal year end of fiscal year t-2 to twelve months after.
SAB 101(dummy)	A dummy variable which equals one ifthe acquisition occurs after the implementation date of the SEC's Staff Accounting Bulletin 101 and zero otherwise. The implementation date is no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999.
Same industry (dummy)	A dummy variable which equals one if the first two-digit SIC codes of the acquirer and the target are same and zero otherwise.
Size	Logarithm of the market value of equity (Compustat item 25 * Compustat item 199).
Stock financing (dummy)	A dummy variable which equals one if the deal is entirely financed by stock

	and zero otherwise.
Tobin's q	Ratio of market value of assets over its book value of assets (Compustat item 6), where the market value of assets is computed as the book value of total debt (Compustat item 181) plus the market value of common equity (Compustat item 25 × item 199).
Return volatility	Standard deviation of past 12-month stock returns before the announcement of block acquisition.
X	Earnings per share (Compustat item 18) deflated by price at the end of the prior fiscal year (Compustat item 25 * Compustat item 199).

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[1] See Watts (2003a, 2003b) and Kothari,Ramanna, and Skinner, (2010) for an excellent review of this literature.

[2] One potential counter argument on this hypothesis is that blockholding provides insider-access that enables blockholders to use alternative information channels for their monitoring activity. To alleviate this concern, in our study, we examine acquirers' governance activity that occurs during one-year period after the block acquisition. Within such a short period, it is unlikely that blockholdersare able to establish insider-access to information, making the counter argument less appealing.

[3] See Holderness (2003) for a review of empirical literature on the monitoring role of blockholders.

[4] We argue that accounting conservatism reduces information asymmetry and lowers the blockholders' monitoring costs. This argument predicts that blockholders are more likely to monitor conservative targets. However, it is also possible that accounting conservatism reduces information asymmetry and a more transparent information environment of firms with high conservatism increases the efficiency of existing corporate governance, implying that the benefits from blockholders' additional monitoring should be low. This alternative argument predicts that blockholders are less likely to monitor conservative targets. The results in the paper suggest the dominant role played by our argument.

[5] It should be noted that our regression models control for three measures of the litigation explanation, i.e., return volatility, earnings volatility, and operating income. Francis, Philbrick, and Schipper (1994) and Jones and Weingram (1996) show that firms with volatile returns, firms with volatile earnings, and firms with poor earnings face higher litigation risks. We also control for the leverage ratio, an important proxy for the contracting explanation, in our regressions. To the extent that these measures capture the effects related to the contracting and litigation explanations, our model specification at least partially controls for some of the concern that accounting conservatism is endogenously determined.

[6] Using a different definition of partial block acquisitionsin which the investors acquire at least 5% but less than 50% of the target's shares does not change the results reported in the paper.

[7] Pseudo *R*-squared is 0.08 if we only include the ownership purchased as the independent variable.

[8] We obtain similar results when we use CAR (-10, +1) as the dependent variable.

[9] A potential alternative explanation for the positive coefficient on target *C_Score* is that targets with more conservative accounting are underpriced to a greater extent prior to the acquisitions and thus the changes in stock prices of these targets around the acquisition announcement dates simply reflect the correction of prior mispricing.

This alternative explanation is, however, inconsistent with the empirical observation that conservative firms tend to have high valuation multiples (e.g., high market-to-book ratio).

[10]Using Fama-French (1997) 48 industry-adjusted returns does not change the inferences.

[11]HuiMatsunaga, and Morse (2009) use R&D expenditures, leverage, and dividends as instruments in addressing the endogeneity problem of accounting conservatism. Using their instrumental variables, we find that our untabulated results are qualitatively similar to those reported in Panel B of Table 3.

[12]We find qualitatively similar results if we identify turnover events over the three yearsfollowing the acquisition.

[13] Using 60 as the retirement age does not change the results.