Wining by Losing—Evidence on Overbidding in Mergers

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This project evaluates whether acquiring companies profit from acquisitions or, instead, acquiring CEOs overbid and destroy shareholder value on average. Answering this question empirically is difficult since the hypothetical counterfactual is hard to determine. While negative stock reactions to the announcement of mergers are consistent with value-destroying mergers, they are also consistent with overvaluation of the acquiror at the time of the announcement. Similarly, studies of long-term returns to acquirors are affected by slow adjustments in valuation.

In this project, we propose a new empirical methodology to address this identification issue: we exploit merger contests and compare the post-merger returns of winners and losers. First, we construct a novel data set of all mergers with overlapping bids of at least two potential acquirors between 1983 and 2004. We then compare adjusted abnormal returns of all candidates both before and after a merger fight. The key identifying assumption is that the returns and other corporate outcomes of losing bidders are a valid counterfactual for the winner, after employing the standard controls and matching criteria. We find that stock returns of bidders are not significantly different before the merger fight, but diverge significantly after one bidder has completed the merger. Winners significantly underperform losers over a five-year horizon. These results are robust to various sample selection criteria and controls including firm and case fixed effects. Our findings suggest that CEOs significantly overbid, at least in the context of merger fights.