 Download This Paper (Delivery.cfm/SSRN\_ID350422\_code030208100.pdf?abstractid=350422&mirid=1)

Open PDF in Browser (Delivery.cfm/SSRN\_ID350422\_code030208100.pdf?abstractid=350422&mirid=1&type=2)

 Add Paper to My Library

Share:    

## The Free Cash Flow Theory of Takeovers: A Financial Perspective on Mergers and Acquisitions and the Economy

*"The Merger Boom", Proceedings of a Conference sponsored by Federal Reserve Bank of Boston, pp. 102-143, October 1987*

57 Pages

Posted: 8 Feb 2003

Michael C. Jensen (Deceased) (https://papers.ssrn.com/sol3/cf\_dev/AbsByAuth.cfm?per\_id=9)

Harvard University - Business School (HBS); SSRN; National Bureau of Economic Research (NBER); European Corporate Governance Institute (ECGI); Harvard University - Accounting & Control Unit

### Abstract

Through dozens of studies, economists have accumulated considerable evidence and knowledge on the effects of the takeover market. Most of the earlier work is well summarized elsewhere (Jensen and Ruback (1983); Jensen (1984); Jarrell, Brickley and Netter (1988)). Here, I focus on current aspects of the controversy. In brief, the previous work tells us the following:

- ✂ Takeovers benefit shareholders of target companies. Premiums in hostile offers historically exceed 30 percent on average, and in recent times have averaged about 50 percent.
- ✂ Acquiring-firm shareholders on average earn about 4 percent in hostile takeovers and roughly zero in mergers, although these returns seem to have declined from past levels.
- ✂ Takeovers do not waste credit or resources. Instead, they generate substantial gains: historically, 8 percent of the total value of both companies.
- ✂ Actions by managers that eliminate or prevent offers or mergers are most suspect as harmful to shareholders.
- ✂ Golden parachutes for top-level managers do not, on average, harm shareholders.
- ✂ The activities of takeover specialists (such as Icahn, Posner, Steinberg, and Pickens) benefit shareholders on average.
- ✂ Merger and acquisition activity has not increased industrial concentration. Over 1200 divestitures valued at \$59.9 billion occurred in 1986, also a record level (Grimm, 1986).
- ✂ Takeover gains do not come from the creation of monopoly power.


Although measurement problems make it difficult to estimate the returns to bidders as precisely as the returns to targets, it appears the bargaining power of target managers, coupled with competition among potential acquirers, grants a large share of the acquisition benefits to selling shareholders. In addition, federal and state regulation of tender offers appears to have strengthened the hand of target firms; premiums received by target-firm shareholders increased substantially after introduction of such regulation.

**Keywords:** Dividend policy, Corporate Payout Policy, Optimal Capital Structure, Optimal Debt, Reinvestment Policy, Overinvestment

**JEL Classification:** D23, D24, D82, G31, G34, L21, L22

[Suggested Citation](#) >

[Show Contact Information](#) >

 Download This Paper (Delivery.cfm/SSRN\_ID350422\_code030208100.pdf?abstractid=350422&mirid=1)

Open PDF in Browser (Delivery.cfm/SSRN\_ID350422\_code030208100.pdf?abstractid=350422&mirid=1&type=2)

## 0 References

Fetch References

**0 Citations** that are necessary to make our site work. We may also use additional cookies to analyze, improve, and personalize our content and your digital experience. For more information, see our [Cookie Policy](#)

[Policy \(https://www.elsevier.com/legal/cookiepolicy\)](https://www.elsevier.com/legal/cookiepolicy)

Fetch Citations

[Cookie Settings](#)

[Accept all cookies](#)

## Paper statistics

DOWNLOADS 11,607

ABSTRACT VIEWS 52,763

RANK 841

7 Citations

140 References

PlumX Metrics



[https://plu.mx/ssrn/a/?ssrn\\_id=350422](https://plu.mx/ssrn/a/?ssrn_id=350422)

### Related eJournals

Harvard Business School: Negotiation, Organizations & Markets Unit Working Paper Series ([https://papers.ssrn.com/sol3/JELJOUR\\_Results.cfm?form\\_name=journalBrowse&journal\\_id=205096](https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=205096))

Follow



Diversification Strategy & Policy eJournal ([https://papers.ssrn.com/sol3/JELJOUR\\_Results.cfm?form\\_name=journalBrowse&journal\\_id=1358726](https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=1358726))

Follow



## Recommended Papers

The Market for Corporate Control: The Scientific Evidence ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=244158&rec=1&srcabs=350422&pos=1](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=244158&rec=1&srcabs=350422&pos=1))

By Richard S. Ruback ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=58677](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=58677)) and Michael C. Jensen (deceased) ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=9](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=9))

New Evidence and Perspectives on Mergers ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=269313&rec=1&srcabs=350422&pos=2](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=269313&rec=1&srcabs=350422&pos=2))

By Gregor Andrade ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=38420](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=38420)), Mark L. Mitchell ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=22879](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=22879)), ...

Do Managerial Objectives Drive Bad Acquisitions? ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=979724&rec=1&srcabs=350422&pos=3](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=979724&rec=1&srcabs=350422&pos=3))

By Randall Morck ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=71368](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=71368)), Andrei Shleifer ([https://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=17066](https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=17066)), ...

View more >

Feedback

Submit a Paper > (<https://hq.ssrn.com/submission.cfm>)

SSRN Quick Links

SSRN Rankings

About SSRN

