

71 Views | 107 CrossRef citations to date | 0 Altmetric

Research Articles

Overpaying in Corporate Takeovers: The Winner's Curse

Nikhil P. Varaiya & Kenneth R. Ferris

Pages 64-70 | Published online: 31 Dec 2018

🗨️ Cite this article 🔗 <https://doi.org/10.2469/faj.v43.n3.64>

🌿 CFA Institute members: [sign in to access the Financial Analysts Journal.](#)

Sample our
Economics, Finance,
Business & Industry Journals
>> **Sign in here** to start your access
to the latest two volumes for 14 days

🗨️ Citations

are

We Care About Your Privacy

We and our 872 partners store and access personal data, like browsing data or unique identifiers, on your device. Selecting "I Accept" enables tracking technologies to support the purposes shown under "we and our partners process data to provide," whereas selecting "Reject All" or withdrawing your consent will disable them. If trackers are disabled, some content and ads you see may not be as relevant to you. You can resurface this menu to change your choices or withdraw consent at any time by clicking the ["privacy preferences"] link on the bottom of the webpage [or the floating icon on the bottom-left of the webpage, if applicable]. Your choices will have effect within our Website. For more details, refer to our Privacy Policy. [Here](#)

We and our partners process data to provide:

.....

I Accept

Reject All

Show Purpose



Overpaying in Corporate Takeovers: The Winner's Curse

Economic rationale suggests that the bidder in a corporate takeover situation expects the acquisition to generate positive returns. The "winner's curse" hypothesis suggests, however, that in the event of competition for a takeover candidate, the successful bidder will tend to be the one that most overestimates the target's value. In that case, subsequent returns may not be significantly positive and may, in fact, be negative.

An examination of 96 acquisitions completed between 1974 and 1983 reveals that the winning bid premium did, on average, overstate the market's estimate of the expected takeover gain. Furthermore, the cumulative average excess return to the winning bidder, measured over the period from 20 days before to 100 days after the acquisition announcement, was significantly negative. For the 58 per cent of the acquisitions in which the bid premium overstated expected takeover gain, average excess return to the winning bidder was -14 per cent; in the cases in which the bid premium did not overstate expected gain, average excess return was a positive 13.4 per cent.

To counteract the winner's curse, bidders should bid less (proportionate to their value estimates) as the degree of uncertainty about the size of takeover gains and the degree of competition for control of the target increase.

THE PRICING OR PREMIUM-setting decision is clearly critical to the success of any takeover, not only because of its impact on the acquirer's ability to obtain the targeted number of shares, but also because of its affect on subsequent rate of return. The takeover bid must be set high enough to induce the target shareholders to relinquish their control rights, but not so high as to make the acquisition economically undesirable.

Most corporate bidders have access to all publicly available information regarding the target company, but only imperfect information about the target company's future cash flow

contribution and about the prospects of a competing bid or target management resistance. Using all available data, the corporate bidder forms an estimate of the value of the takeover candidate. If this estimate of value exceeds the target company's current market value, then a takeover offer can be expected; otherwise, no offer should take place.

In the absence of perfect information regarding the target company's future, the possibility of valuation (estimation) error becomes quite high. And as the level of uncertainty regarding the target's prospects increases, the likelihood of valuation error increases. In general, by invoking the law of averages, we would expect the corporate bidder's estimate of the target company's value to be sometimes overstated, sometimes understated, but on average approximately equal to the true value of the firm.

Not only can valuation error be a problem for the individual corporate bidder, but if multiple potential bidders exist, there may also be wide divergences in the estimates of value of the

Nikhil Varaiya is Assistant Professor of Finance and Kenneth Ferris is Associate Professor of Accounting at the Edwin L. Cox School of Business of Southern Methodist University.

The authors thank Ed Capen for his helpful comments and the Center for the Study of Financial Institutions and Markets at Southern Methodist University for research support.



Log i



Log i

Log

Resto

Res


Purchase options *

Save for later

PDF download + Online access

- 48 hours access to article PDF & online version
- Article PDF can be downloaded
- Article PDF can be printed


USD 53.00

 Add to cart

Issue Purchase

- 30 days online access to complete issue
- Article PDFs can be downloaded
- Article PDFs can be printed

USD 201.00

 Add to cart

* Local tax will be added as applicable

Related



Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

Keep up to date

Register to receive personalised research and resources by email

 Sign me up

- 
- 
- 
- 
- 

Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research

Help and information

- Help and contact
- Newsroom
- All journals
- Books

Copyright

Accessib

Registered
5 Howick Pl

or & Francis Group
orma business

