Abstract

One of the most conspicuous features of mergers is that they come in waves, and that these waves are correlated with increases in share prices and price/earnings ratios. We test four hypotheses that have been advanced to explain merger waves: the industry shocks, *q*-, overvaluation and managerial discretion hypotheses. The first two are neoclassical in that they assume that managers maximize profits, mergers create wealth, and the capital market is efficient. The last two, behavioral hypotheses relax these assumptions in different ways. We test the four hypotheses by estimating models of the amounts of assets acquired by firms, models that identify the characteristics of targets, and estimates of the returns to acquirers' shareholders. Although some support is found for each of the four hypotheses, most of the evidence favors the two behavioral hypotheses.