Abstract
Recent empirical studies on stock misvaluation as a possible determinant of mergers are inconclusive concerning the central hypothesis that over(under)valuation is negatively (positively) associated with merger announcement returns in stock mergers, but not in cash mergers. We provide empirical support for this hypothesis. In contrast to prior research, we employ a two-stage model to account for endogenous mergers and suggest an alternative specification of misvaluation based on an asset-pricing model (bidder momentum). In the first stage, we specify panel logit models to predict U.S. mergers from 1981 to 2003 and find that bidder momentum triggers stock mergers, but not cash mergers. In a second stage, we regress cumulated abnormal returns on merger probabilities to control for the endogeneity of mergers. This reveals a lower market response for stock mergers compared to cash mergers, which we identify as market correction of misvalued acquirers.