

Value of Mergers

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Abstract : This study investigates sources of value in mergers and acquisitions. While much emphasis is put on operating synergies from acquisitions the evidence provided in this study shows that the difference between the WACCs of the combined firm and the merging firms may have a significant role on the value effect of mergers. These findings suggest that changes in the capital structure of the combined firm, compared to capital structures of the acquirer and the target, play a key role in determining the value of an acquisition. Moreover, findings of this study suggest that reducing the cost of capital of the combined firm, compared to the merging firms, is value creating even in the absence of operating synergies. Furthermore, this study shows that the component of value associated with the difference between the WACCs of the combined firm and the acquirer is mainly determined by leverage of the acquiring firm and the method of payment. While cash payment is value creating, high leverage of the acquirer prior to an acquisition can destroy value by raising the cost of capital of the firm. This is especially important to managers when they are planning an acquisition.

Keywords : acquisitions, mergers, synergy, value, WACC

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