Summary of Paper: Overbidding in Mergers and Acquisitions: An Accounting Perspective

What is this Study About?

In 2001, the new Statement of Financial Accounting Standards No. 142 (SFAS 142) shifted from requiring companies to gradually deduct goodwill—a component of a subsidiary's acquisition cost (goodwill amortization)—to not requiring these deductions (non-amortization). The researchers wanted to see if this accounting change resulted in companies offering higher prices than they should (overbidding) during mergers and acquisitions (M&A). To examine the impact of this accounting change, they used a novel method to measure overbidding.

What are the major findings of the study?

After the accounting rules changed in 2001, there was a noticeable increase in overbidding—companies started to pay more than before the change to acquire other companies. This trend of paying too much in the post-SFAS 142 period was true for deals that were affected by the new accounting rules (purchase transactions). Consistent with this finding, in the pre-SFAS 142 period, overbidding is higher for pooling vis-a-vis purchase transactions. The study concludes that the way companies are required to report their finances (due to accounting rules) can significantly influence their decision-making in M&A, leading to potentially costly overbidding.

Why is the study important?

The study sheds light on the unintended consequences of accounting standards on corporate financial practices, particularly in the context of M&A. By linking changes in accounting rules to shifts in managerial bidding behavior that ultimately affects shareholder wealth, the research highlights the broader economic implications of accounting policies. The findings are relevant for researchers, corporate boards, and standards setters, offering insights into how accounting practices can shape managerial decisions and influence the strategic outcomes of corporate actions.

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