Do Managers Face a Paradox in Selecting Corporate Strategy? Evidence from Mergers and Acquisitions

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Using mergers and acquisitions as a testing ground we examine whether managers face conflicting incentives in selecting the uniqueness of their corporate strategy. We argue that firms that pursue strategies which assemble commonly-bundled assets may pay more for these assets, perhaps as a reflection of the greater degree of competition among rivals for them. On the other hand, firms that pursue common business strategies may receive more favorable stock market response to these asset acquisitions, as market participants may possess greater information about the value to assign to these asset acquisitions. We find that acquirers, who at the time of an announced acquisition are more similar to their rivals, receive a significantly higher positive announcement return. A decrease from the top to the bottom decile of the measure of uniqueness of the corporate strategy of the post-merger company is associated with an increase in abnormal announcement returns (within -1 to +1 days around the announcement) of 1.01%. At the same time acquirers in the bottom decile of our uniqueness measure pay on average 13.6% more for their targets than acquirers in the top decile; they also have subsequent one-year-post-merger-closing profitability which is about 1.25% lower than their peer group with more unique corporate strategy. These findings are stronger for a measure of uniqueness that compares the post-merger company to the primary industry rivals that are covered by analysts. Overall we interpret our results to suggest a managerial paradox in selecting strategy between unique strategies that permit a discounted acquisition of assets and high long run performance, but poor market response, and more common strategies that enjoy strong short run market performance, but elevated acquisition prices and poor long run performance.