

Unexpected Changes to Financial Risk During Takeovers

Researchers at the Swiss Finance Institute have developed an approach to probe hidden sources of risk during corporate takeovers. Their findings, published in a forthcoming edition of the prestigious Journal of Finance, were the focus of the very first research paper issued by the Swiss Finance Institute and will help investment managers and other financial decision makers to predict the impact of mergers on stock returns.

During a takeover, investors face uncertainties about the financial consequences of the change to corporate control. Professor Erwan Morellec of the Swiss Finance Institute leads an ongoing study aimed at better understanding the changes in financial uncertainties and stock returns in the time period surrounding mergers and acquisitions.

The new publication, co-authored with Professor Dirk Hackbarth of Washington University in St-Louis, reveals systematic changes in a key financial risk measure during takeover events. Known within the financial community as beta, this risk measure is in standard use by financial experts for making decisions about the investment potential of individual firms.

The systematic changes in the value of beta had not been described previously. Indeed, Morellec's achievement lies in having developed a novel approach to predict beta during takeovers. The approach enables Morellec to predict abrupt, and otherwise unexpected, changes in the value of beta, and hence in expected stock returns.

The finding is far from academic. "Conventional economic wisdom says that closing a deal should always reduce financial risk, but our work predicts that it can also increase it", explained Morellec. This unexpected increase could lead to costly investment mistakes. Morellec's approach potentially enables investors to predict whether a given takeover will be subject to these effects.

Morellec holds a Swiss Finance Institute Professorship at the University of Lausanne. With financial backing from the banking and financial services industry, the Swiss Finance Institute will appoint a further 30 professors at research-based universities throughout Switzerland.

Swiss Finance Institute

The Swiss Finance Institute is a private foundation created in 2005 by the banking and the finance community of Switzerland together with several Swiss universities. The institute aims to advance research activity in finance and to support doctoral research and executive education in the banking and finance industry as well as organising interfacing activities between research and the industry.

The Swiss Finance Institute is proud to announce that the first paper made available in the Swiss Finance Institute Research Paper Series, entitled "Stock Returns in Mergers and Acquisitions", co-authored by Profs. Dirk HACKBARTH of Washington University and Erwan MORELLEC of the Swiss Finance Institute at the University of Lausanne, has been accepted for publication in the prestigious Journal of Finance.

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