Does a firm’s takeover vulnerability cause its stock price to deviate from random walks?

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Abstract

This paper examines whether the takeover vulnerability of a firm increases the scope of speculative noise trading for its stock. Specifically, the hypothesis under test is that takeover vulnerability overly motivates investors to acquire and trade on private information, so that they react even to non-information as if it were information, thereby causing the stock price changes to be serially correlated. Using variance ratio, we find that the hypothesized pattern is indeed borne out by data but it is conditional on the quality of information environment. That is, a stock’s deviation from random walks is larger when its takeover vulnerability is greater and its information environment is poorer. In a sufficiently good information environment, on the other hand, there is no evidence that takeover vulnerability causes speculative noise trading. All those patterns are observed in individual stock returns, and at the portfolio level, we find no relationship between takeover vulnerability and the deviation from random walks.

\textbf{Keywords}: Takeover vulnerability; Noise trading; Information environment; Random Walk; Variance ratio

\textbf{JEL classification}: G10; G14; G30; G34

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