

Does Jensen's Free Cash Flow Hypothesis explain European LBOs today?

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Abstract: Jensen's "Eclipse of the public corporation" (1989) predicts that LBO transactions solve the agency problems of publicly listed companies with high levels of undistributed free cash flows (FCFs) and low growth opportunities. So far, empirical evidence in this context is mixed. This study is the first that provides evidence on the application of Jensen's FCF hypothesis (1986) to Leveraged Buyouts (LBOs) in the European market. My univariate and multivariate findings indicate that Continental European companies with high Cash Flows before distribution and few investment opportunities whose P/E ratio is significantly lower than that of their industry peer group are more likely to be an LBO target. I do not find any evidence that European LBO targets suffer from agency problems prior to the transaction.

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