

CEO Attributes, Board Composition, and Acquirer Value Creation: A Canadian Study

Walid Ben Amar

University of Ottawa

Ameur Boujenoui*

University of Ottawa

Claude Francoeur

HEC-Montréal

Abstract

We examined CEO attributes, board composition, and ownership structure for their relationship to the share performance of the acquiring company around the acquisition announcement. Based on 273 acquisitions by Canadian firms from 1998 through 2002, we have shown that the levels of CEO and director ownership as well as the level of board independence were positively associated with the short-term financial performance of the acquirer. Board size was negatively related to value creation. Finally, cash-based deals and cross-border transactions were also positively related to increases in shareholder wealth for the acquirer. Copyright © 2011 ASAC. Published by John Wiley & Sons, Ltd.

JEL Classifications: G32, G34

Keywords: corporate governance, mergers and acquisitions, value creation, agency theory

Résumé

Cette étude examine la relation entre, d'une part, les attributs des PDG, la composition du conseil d'administration et la structure du capital et, d'autre part, la performance des actions de la société acheteuse au moment de l'annonce de l'acquisition. En se basant sur 273 acquisitions réalisées par les firmes canadiennes de 1998 à 2002, l'étude montre que les niveaux de participation des PDG et des directeurs ainsi que le niveau d'indépendance du conseil d'administration sont positivement reliés à la performance financière à court terme de la société acquéreuse. La taille du conseil d'administration quant à elle est négativement reliée à la création de la valeur. Enfin, les transactions payées en espèces et transfrontalières sont aussi positivement reliées à l'accroissement de la richesse des actionnaires de l'acquéreur. Copyright © 2011 ASAC. Published by John Wiley & Sons, Ltd.

Mots-clés : gouvernance d'entreprise, fusions et acquisitions, création de la valeur, théorie de l'agence

Merger and acquisitions (M&A) have always been of great interest both to managers and researchers in strategic management, economics, and finance, among others. Seen as one of the most important forms of investment, M&A tends to intensify conflicts of interest between managers and shareholders of publicly traded companies (Morck, Shleifer & Vishny, 1990; Shleifer & Vishny, 1997).

From a managerial perspective, one of the aims of M&A is the creation of value for shareholders, but empirical

studies show that value is not always created. Rather, in some cases, other personal motivations were the primary drivers of these strategic decisions. For example, free cash flow theory (Jensen, 1986) suggests that managers often enjoy personal gain through “empire-building” associated with M&A. Businesses with monetary assets but few opportunities for profitable investments are more likely to make acquisitions that ultimately destroy value, when the better choice would have been to simply distribute the surplus wealth back to shareholders using dividends.

Reviews of the empirical research on value creation through M&A have shown that typically, shareholders of the acquired business are the winners whereas break even and/or loss outcomes are usually seen on the side of the acquirer (Bruner, 2002; Tuch & O'Sullivan, 2007). While the majority of such research was conducted in the US, some Canadian studies have found it is the target companies who tend to gain (Eckbo, 1986

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*Please address correspondence to: Ameur Boujenoui, Telfer School of Management, 55 Laurier E. Ottawa ON K1N 6N5 Canada. Email: boujenoui@telfer.uottawa.ca

Yuce & Ng, 2005), though some Canadian-based acquirers have succeeded in creating value (Ben-Amar & André, 2006; Eckbo & Thornburn, 2000; Yuce & Ng, 2005).

Researchers have often tried to explain abnormal returns variation around the M&A announcement date using the specifics of transactions (e.g., the payment method or the type of merger) (Moeller, Schlingemann, & Stulz, 2004; Morck et al., 1990; Yuce & Ng, 2005). Relative to other Canadian-based studies, we take a different approach by examining the role of the governance structure of acquirer as it relates to value creation derived from M&A.

M&A is a strategic decision in which the key actors are the CEO and the board. The CEO typically plays a decisive role in formulating and implementing the acquisition strategy, including the identification of targets. For its part, the board must approve the acquisition and the financial terms surrounding it.

We analyzed 273 M&A transactions undertaken by publicly traded Canadian companies from 1998 to 2002. Agency theory (cf. Jensen & Meckling, 1976) and upper echelon theory (Hambrick & Mason, 1984) were used to guide a multidimensional framework (cf. Agrawal & Knoeber 1996; Jensen & Zajac, 2004) linking CEO attributes and board composition to value creation on the part of the acquirer. We contribute to the literature firstly by addressing the call of Agrawal and Knoeber (1996) to use a multidimensional approach to assess the interrelationships among governance mechanisms as they relate to firm performance. Moreover, our study is the first to examine the relationship between CEO attributes, board composition, and the performance of acquirers in Canada.

The Canadian environment is an interesting one to study because since 1995 it has had a voluntary principles-based approach to corporate governance (Anand, Milne, & Purda, 2006; Broshko & Li, 2006), which does not require listed companies to strictly comply with all guidelines. It merely requires disclosure of governance practices in the annual report and in the proxy solicitation circulars, including any departures from the guidelines. Thus, Canadian governance practices are more variable than those in rules-based contexts, such as the US, where practices tend to be more uniform (Broshko & Li, 2006; National Instrument NI 58–101, 2005; National Policy NP 58–201, 2005).

Literature Review and Hypotheses

Cannella and Monroe (1997) have noted that most of the research concerning the relationship between senior management attributes and business strategy has been driven either by upper-echelons theory (Hambrick & Mason, 1984) or agency theory (Jensen & Meckling, 1976). Upper-echelons theory suggests that there is a close relationship between the attributes of managers and their strategic choices. Agency theory on the other hand, is less concerned with the demographic characteristics of management teams and more focused on the positions they hold on the board.

Jensen and Zajac (2004) combined elements of the two theories to examine diversification and acquisition strategies. We have done the same by examining the impact of CEO and board characteristics as well as the ownership structure on the creation of wealth for shareholders of the acquirer when the transaction is announced.

CEO Attributes

Following previous studies in business strategy (Desai, Kroll, & Wright, 2003; Jensen & Zajac, 2004), we examined the impact of the CEO's stock ownership, CEO duality (i.e., when the CEO is also the board chairperson), as well as the age and organizational tenure of the CEO as these relate to M&A wealth creation.

CEO stock ownership. The alignment of interest hypothesis as a core tenant of agency theory (Jensen & Meckling, 1976) predicts a positive relationship between managerial stock ownership levels and firm performance. However, Stulz (1988) argued that above a certain level of control, managers may become entrenched and begin to act in accordance with personal interests to the detriment of other shareholders. Prior empirical research on the relationship between managerial ownership and the value of firms has yielded mixed results. In the context of M&A per se, some have found a positive relationship between the managerial ownership level and abnormal returns at the announcement date of the transaction (Kroll, Walters, & Wright, 2008; Lewellen, Loderer, & Rosenfeld, 1985; Shinn 1999; Walters, Kroll, & Wright, 2007). Others have found a nonmonotonic relationship between manager shareholdings and the financial performance of the M&A (Hubbard & Palia, 1995; Wright, Kroll, Lado, & Van Ness, 2002). Based on the alignment of interest hypothesis, we predicted a positive link between CEO ownership and acquirer value creation.

Hypothesis 1a: The CEO ownership level is positively associated with acquirer value creation.

CEO duality. According to agency theory (Jensen & Meckling, 1976), negative outcomes for the company are to be expected when the same person concurrently holds the CEO and chairperson of the board positions because there is a lack of separation between management decisions and control decisions. For example, Agrawal and Knoeber (1996) showed that board effectiveness and firm performance are negatively impacted when the same person holds both positions. On the other hand, from the perspective of organization theory, if the power of both positions is consolidated, this should strengthen the leadership position of upper management and result in enhanced performance (Boyd, 1995) due to, among other things, the enhanced capability for quick decision making, which is often called for during M&A deliberations (Baliga, Moyer, & Rao 1996; Finkelstein & D'Aveni, 1994). Based on the agency

theory arguments, our second hypothesis predicts a negative association between CEO duality and acquirer value creation.

Hypothesis 1b: CEO duality (i.e., CEO is also board chairperson) is negatively associated with acquirer value creation.

CEO age. The age of the CEO tends to be associated with strategic decision making (Hambrick & Fukutomi, 1991; Wiersema & Bantel, 1992). For example, when the CEO is close to retirement, agency costs potentially rise due to the career horizon problem (McClelland & Barker, 2007). Hambrick and Fukutomi (1991) argued that managers near the end of their careers tend to be more concerned with the immediate consequences of their decisions, which can make them unduly risk adverse to the long-term detriment of the firm (McClelland & Barker, 2007). Barker and Mueller (2002) found that the age of managers was negatively associated with the scale of research and development investment. Also, in the context of M&A, Faleye and Huson (2002) reported a negative relationship between the age of the CEO and abnormal returns obtained by shareholders on announcement dates.

Hypothesis 1c: CEO age is negatively associated with acquirer value creation.

CEO tenure. Governance research (Faleye & Huson, 2002; Walters et al., 2007) holds that CEO tenure and power within the board are positively related due to the CEO influence on the appointment of top managers. Of course, tenure could also be associated with CEO entrenchment and an undue emphasis on personal interests to the detriment of other shareholders, especially during M&A deliberations (Walters et al., 2007). Nonetheless, given effective governance mechanisms, Walters et al. (2007) argued that incompetent managers are discharged by the board early in their tenure. From this perspective, extended CEO organizational tenure is likely a sign of superior performance and a reflection of experience crucial to successfully identifying and evaluating M&A targets (Faleye & Huson, 2002).

Empirical studies concerning the impact of CEO tenure have yielded inconsistent results. Thomas (1988) found a positive relationship between CEO tenure and firm performance, but others concluded that long serving CEOs tend to be out of sync with the business environment resulting in poor firm performance (Finkelstein & Hambrick, 1990; Miller, 1991). Walters et al. (2007) reported an inverted u-shaped relationship between CEO tenure and the wealth of shareholders of acquirers. Given that organizational tenure is associated with CEO entrenchment, we expect a negative association between CEO tenure and acquirer value creation.

Hypothesis 1d: CEO organizational tenure is negatively associated with acquirer value creation.

Board Attributes

Concerning the board attributes thought to be important from either a governance or strategy perspective, we examined the impact of board member shareholdings, the level of board independence, and the size of the board for their association with M&A value creation.

Director ownership. Agency theory holds that the ownership of shares by board members aligns their interests with those of outside shareholders (Jensen, 1993; Walters et al., 2007), encouraging better vigilance of strategic decision making, including M&A (Walters et al., 2007; Kroll et al., 2008). Consistent with this view, Oswald and Jahera (1991) found that the level of share ownership by the board as well as top management related positively to firm performance. Moreover, with regard to M&A per se, Walters et al. (2007) and Kroll et al. (2008) both reported a positive relationship between ownership by outside board members and excess returns obtained by shareholders.

Hypothesis 2a: Directors' ownership is positively associated with acquirer value creation.

Board independence. According to agency theory, a board consisting mostly of outside members is a key controlling mechanism. Fama and Jensen (1983) hold that competition in the labour market for independent board members encourages them to build and maintain a professional expert image wherein the interests of the shareholders they represent are furthered. Independent outside members of the board are therefore thought to exercise a greater degree of influence over strategic decisions than insiders who are more subject to the CEO influence (Fama & Jensen, 1983). Nonetheless, empirical research concerning this issue has been mixed. Rosenstein and Wyatt (1990) found abnormal positive gains in stock performance around the recruitment date of outside board members. On the other hand, Erickson, Park, Reising, and Shin (2005) reported a negative relationship between the level of independence of board members and firm value, while Hermalin and Weisbach (1991) found no relationship.

Regarding M&A per se, Walters et al. (2007) and Kroll et al. (2008) reported a positive relationship between the proportion of independent members of a board and the share performance of acquirers; whereas in the banking sector per se, Subrahmanyam, Rangan, and Rosenstein (1997) reported a negative relationship. Byrd and Hickman (1992) found a curvilinear relationship such that for up to 40% of independent board members, the relationship was monotone with a slight upward trend, while increases beyond this level (i.e., 40% to 60% outside membership) were associated with a significant positive increase in share performance. Interestingly, outside board membership in excess of 60% related negatively to the share performance of acquirers. In all, based on agency theory, a

positive link between board independence and acquiring firm's financial performance was anticipated.

Hypothesis 2b: The proportion of independent outside members of the board is positively associated with acquirer value creation.

Board size. Jensen (1993) suggested that increasing the size of a board is likely to increase its effectiveness up to a point, but that unduly large boards reduce the capacity to quickly adapt to change. Hackman and Morris (1975) and Gladstein (1984) showed that increases in group size were associated with coordination difficulties and lower levels of member involvement. Accordingly, large boards may be at greater risk of being unable to make timely decisions. Consistent with this view, Judge and Zeithaml (1992) found board size related negatively to its involvement in the strategic decisions of the firm. Further, both Yermack (1996) and Eisenberg, Sundgren, and Wells (1998) reported a negative relationship between board size and firm value.

Hypothesis 2c: Board size is negatively associated with acquirer value creation.

Ownership Structure

External blockholders. External blockholders potentially exercise a relatively high degree of influence on M&A decisions (Wright, Ferris, Sarin, & Awasthi, 1996). For example, they can act as a counterweight to managers and controlling shareholders, furthering the influence of minority shareholders in general. The existence of large external shareholders relates positively to the value of a firm (MacIntosh & Schwartz, 1995) and to the returns obtained by the shareholders of acquirers (Wright et al., 2002).

Hypothesis 3: The presence of external blockholders is positively associated with acquirer value creation.

Control Variables

For reasons described in the method section, we controlled for eight additional variables: (a) whether or not the transaction was paid for using cash; (b) the debt level of the acquiring firm; (c) whether or not the target firm was publicly traded; (d) whether or not the transaction involved companies based in the same country; (e) the cultural distance separating the countries of the transacting firms; (f) the relative size of the acquiring firm; (g) whether the parties were members of the same industry group; and finally, (h) whether the transaction occurred during a period of relative upward or relative downward momentum in the stock market. Since any of these variables are likely to be of primary interest to some M&A researchers, we detail the logic for controlling them in the method section, even though they were not the focus of our study.

Method

Sample

Our sample consisted of 273 completed transactions by 201 firms covered in the Securities Data Corporation (SDC) Platinum, Worldwide M&A database. The acquirer had to be a Canadian firm and listed on the Toronto Stock Exchange (TSX) and the transaction had to have been concluded between January 1, 1998 and December 31, 2002. We used SEDAR (www.sedar.com) to gather data on governance practices from proxy solicitation circulars. Since the information became available from 1997 onward, our sample was limited to transactions announced from January 1st 1998 and covered a five-year period. The pretransaction ownership percentage held by the acquiring firm had to be less than 50%, whereas posttransaction the comparable figure was required to be at least 50%. Thus, only transactions that resulted in a change of control were included in our sample. Also, consistent with prior M&A research (Datta & Puia, 1995), only transactions significant in monetary terms—those involving sums in excess of 10 million US dollars—were examined since to the extent that M&A creates value for shareholders, it is more visible in large deals (Asquith, Bruner, & Mullins, 1983). Finally, to be included in the sample, the firms had to be covered in both the Canadian Financial Markets Research Centre, CFMRC-TSX Database, which details daily stock exchange returns, as well as the Compustat and Stock-Guide, which lists financial and accounting data.

Dependent Variable

Consistent with prior M&A research, we employed an event study methodology (Brown & Warner, 1985) to assess the variation in acquirer shareholder wealth around the announcement dates. The market model was used to generate the expected returns using the following parameters: a_i and b_i were calculated using a regression of the return of firm i 's security on that of the market. The estimation period covered the two hundred day period between 240 and 40 days before the transaction announcement date. Firms that did not have at least 100 historical stock returns during the estimation period were excluded from the sample. Consistent with prior research (Andrade, Mitchell, & Stafford, 2001; Bruner, 2002; McWilliams & Siegel, 1997), abnormal returns were cumulated over a three-day period around the announcement date (the day before, the day of, and the day after).

Independent Variables

Unless noted otherwise, information regarding the variables described below was obtained from proxy solicitation circulars on the SEDAR (www.sedar.com) website.

CEO ownership level (CEOOWN). The level of stock ownership held by the CEO was used to assess the degree of alignment of their financial interests with those of external shareholders. Canadian securities laws require the disclosure of all shareholders who hold 10% or more of shares outstanding as well as the number of shares held by board members. We calculated the level of ownership of CEOs as of the end of the year preceding the acquisition.

CEO duality (CEODUALITY). This dichotomous variable was coded as 1 when the CEO and chairperson of the board were held concurrently by the same person in the year preceding the acquisition announcement and 0 when the positions were separated.

Age of the CEO (CEOAGE). This variable measured in years was gathered from the Financial Post Directory of Directors and proxy solicitation circulars.

Age-related retirement effect (AGEDUMMY). This variable gathered from the Directory of Directors and proxy solicitation circulars is dichotomous and was coded as 1 if the CEO was at least 60 years old and 0 if not.

CEO organizational tenure (CEOTENURE). This variable measures the number of years of experience of the CEO within the acquiring firm and was obtained from the Financial Post directory of directors and proxy circulars.

Director ownership level (DIRECTOWN). The percentage of stock ownership of board members, excluding the CEO, was obtained for the year preceding the acquisition.

Proportion of independent members (INDEP). This variable was measured using the ratio of the number of independent board members relative to the total. According to TSX (1994) guidelines, an independent director is someone who is not a member of management or an employee of the firm or its subsidiaries. Further, the person cannot have a business relationship with the firm or any links to the controlling shareholder.

Size of the board (BOARDSIZE). This variable is the total number of board members.

External block-holders (EXTERNBLK). Large shareholders who do not take part in managing a firm are generally institutional investors (pension and mutual funds), but they can also be individuals and families. This variable was measured using the ratio of the number of shares held relative to the total shares in circulation.

Control Variables

We controlled for a series of variables identified in the M&A literature as being likely to affect the level of abnormal returns obtained by the shareholders of the acquirer. These variables represent characteristics of either the firms involved or of the transaction itself. We did not control for whether the deal was hostile or friendly because using SDC Worldwide M&A Database criteria, almost all of the transactions in our sample were initiated on a “friendly”

basis, which is typical of M&A in Canada (Daniels & MacIntosh, 1991).

Payment method (CASH). Prior research (Travlos, 1987; Walters et al., 2007) has documented a positive association between cash financing and the short-term financial performance of an acquiring firm. Thus, we used a dichotomous variable coded as 1 when the merger was funded by cash and 0 when it was not.

Level of debt (LEVERAGE). A high level of debt can lessen agency conflicts between managers and shareholders (Jensen, 1986). Specifically, high debt levels lessen the availability of free cash-flows that managers might otherwise use in ways profitable to them, but not to shareholders in general. Although Maloney, McCormick, and Mitchell (1993) and Masulis, Wang, and Xie (2007) documented a positive relationship between debt levels and the short-term performance of acquirers in the US, Moeller et al. (2004) and Cosh, Guest, and Hughes (2006) did not. In any case, to control for the effect of the capital structure, we included the debt level of the acquirer as a control variable using the ratio of acquirer’s long-term debt to their total assets at the end of the financial year preceding the transaction announcement.

Public or private status of the acquired firm (LISTED). The acquisition of private companies generates higher abnormal returns than those from the acquisition of public companies in the US (Chang 1998; Fuller, Netter, & Stegemoller, 2002) and Canada (Yuce & Ng, 2005). This is because public companies are likely to be accurately valued by financial markets meaning that successful acquirers must typically pay a premium, which reduces their gains at least in the short term. A dichotomous variable was coded 1 if the target firm was listed and 0 if it was not.

Geographical proximity between the acquirer and the target (CROSSBORDER). Eun, Kolodny, and Scheraga (1996) noted that cross-border acquisitions can generate value for shareholders of both firms, especially when managers of the acquiring firm are able to take advantage of imperfections in foreign markets. Eun et al. found that the shareholders of foreign acquirers who carried out acquisitions in the US obtained significant abnormal returns of approximately 2%, while Faccio, McConnell, and Stolin, (2006) found that cross-border acquisitions in Europe generated higher abnormal returns than domestic transactions. However, Eckbo and Thornburn (2000) found that Canadian acquirers of Canadian firms had better financial performance than US acquirers of Canadian firms. In any case, a dichotomous variable was coded as 1 if the firm acquired was non-Canadian and 0 otherwise.

Cultural distance between the acquirer and the target (CDISTANCE). Scholars in the international business arena have argued that the cultural distance between the country of the acquirer and that of the target is likely to affect value creation at the time of the announcement due

to increased integration fears including the transfer of skills between firms. Datta and Puia (1995) found that the cultural distance between acquirers and targets was negatively related to the performance of cross-border acquisitions. On the other hand, Morosini, Shane, and Singh (1998) and Chakrabarti, Jayaraman, and Mukherjee (2009) found that there was a positive relationship between cultural distance and acquisition outcomes.

As with Chakrabarti et al. (2009), we controlled for cultural distance between countries using the cultural distance scores provided by Hofstede (1980). Cultural distances were calculated using an index composed of four dimensions: (a) individualism; (b) control of uncertainty; (c) power distance, and (d) masculinity. Cultural distance between the two countries was calculated using the following formula:

$$\text{Cultural distance (CDISTANCE)} = \frac{\sqrt{\sum_{j=1}^4 (\text{Score}_{\text{Acq},j} - \text{Score}_{\text{Cib},j})^2}}{4}$$

In which:

Acq,j score: score of the country of the acquirer (Canada) for the dimension j

Cib,j score: score of the country of the target for the dimension j

The data required to calculate cultural distances were obtained from the Institute of Training in Intercultural Management's (ITIM's) website at www.geert-hofstede.com/hofstede_descriptions.php.

Relative size of the acquired firm (RELATIVE SIZE). Asquith et al. (1983) argued that if acquisitions create value for shareholders of acquirers, such gains should be larger when the size of the acquired firm is large relative to the acquirer. Both Asquith et al. and Moeller et al. (2004) found that the abnormal yields obtained by shareholders of acquirers associated positively with the logarithm of the ratio of the market value of shareholders equity of the acquired firm and the market value of the shareholders equity of the acquirer. We used this ratio as a control variable.

Overlap between the operations of the acquirer and the target firm (INTRAINDUSTRY). Acquisitions involving firms in the same industry are expected to ultimately have better financial performance relative to diversified acquisitions undertaken to create conglomerates, though empirical studies of the issue have yielded divergent results (Datta, Pinches, & Narayanan, 1992; Tuch & O'Sullivan, 2007). In any case, we used the SDC database to create a dichotomous variable coded as 1 when the firms had the same three-digit SIC code and 0 when they did not.

Transaction announcement period (PERIOD). We controlled for the impact of stock market cycles on excess returns by creating a dichotomous variable coded as 1 if the announcement was between January 1, 1998 and February 29, 2000 (an upward cycle) and 0 if

it occurred between March 2000 and December 2002 (a downward cycle).

Analysis

Using STATA statistical analysis software, multiple regression analysis was used to test the study's hypotheses.

Results

Descriptive Statistics

Means and standard deviations for all study variables are presented in Table 1. The average cumulative abnormal returns (CARs) observed around the announcement dates are not statistically different from zero, which suggests that on average, M&A during the period did not create significant value for the shareholders of the Canadian acquirers. This result is in line with previous studies in the US where negative or zero returns are typically observed (Bruner, 2002; Walters et al., 2007). The absence of abnormal returns is consistent with the idea that the Canadian market for corporate control is highly competitive in that on average the reaction of the stock market, at least initially, implies that on average the acquirers paid a fair value for the expected cash flows. Nonetheless, there was also substantial variance associated with abnormal returns (see Table 1) such that the initial reaction to these deals varies considerably from firm to firm. As reflected by our hypotheses, we expected some of this variation to be accounted for by the independent variables.

As shown in Table 1, the average level of CEO ownership was 7%, while the posts of CEO and Chairman were held by the same person in 45% of the companies—almost identical to the 42% reported by Forester, Gross, Shapiro, Toner, and Yaro (2004) in their analysis of TSX-listed firms between 1999 and 2001. The average age and organizational tenure of the CEOs was 51 and 10 years respectively.

With regard to board composition variables, the average board had 10 members. Similar to Forester et al. (2004), approximately 70% of the members were independent. Surprisingly, their level of stock holdings was equal to that of the CEO (7%).

As for characteristics of the transactions, the majority of the acquirers (55%) used cash as their financing method. Less than half (42%) of the acquisition targets were listed, while 50% of the transactions were cross-border in nature.

Table 2 shows the correlations among the study variables. Although 273 transactions were represented in the study, data from companies that conducted more than one acquisition were averaged to reflect a single observation such that the Table is based on 201 independent observations. The largest correlation among the independent variables involved cross-border transactions and the cultural distance between the acquirer and the target ($r = .68$), which

Table 1
Descriptive Statistics

Variable	Average	Median	Standard deviation	Q1	Q3
<i>Acquirer performance</i>					
CAR	.01	.01	.06	-.02	.04
<i>CEO attributes</i>					
CEOOWN	.07	.01	.14	.00	.08
CEODUALITY	.45	0	.50	0	1.00
CEOAGE	51.05	52.00	7.90	45.50	57.00
CEOTENURE	10.27	8.00	7.90	5.00	14.00
<i>Board composition</i>					
DIRECTOWN	.07	.01	.13	.00	.07
INDEP	.70	.71	.17	.59	.84
BOARDSIZE	9.77	9.00	3.74	7.00	12.00
<i>Ownership structure</i>					
EXTERNBLK	.09	0	.15	0	.13
<i>Control variables</i>					
CASH	.55	1.00	.50	0	1.00
LEVERAGE	.19	.17	.16	.05	.29
LISTED	.42	0	.49	0	1.00
CROSSBORDER	.50	0	.50	0	1.00
CDISTANCE	3.04	3.31	4.45	0	3.76
RELATIVE SIZE	.21	0.13	.21	.05	.31
INTRAINDUSTRY	.48	0	.50	0	1.00
PERIOD	.52	1.00	.50	0	1.00

Note: N = 273 mergers by 201 TSX-listed firms. CAR = Cumulative abnormal returns around the announcement date of the transaction; CEOOWN = level of CEO stock ownership; CEODUALITY = 1 if the CEO and Chairman of the board are the same person, 0 if not; CEOAGE = age of the CEO in years; AGEDUMMY = 1 if the age of the CEO is 60 years or more, 0 if not; CEOTENURE = organizational tenure of the CEO in years; DIRECTOWN = level of stock ownership by board members other than the CEO; INDEP = ratio of the number of independent board members to the size of the board; BOARDSIZE = the total number of board members; EXTERNBLK = voting rights held by external holders of blocks of shares; CASH = 1 if the transaction was funded by cash, 0 if not; LEVERAGE Ratio = the acquirer's long-term debt to its total assets at the end of the year preceding the transaction announcement; LISTED = 1 if the target firm is publicly traded, 0 if not; CROSS-BORDER = 1 if the acquired firm is non-Canadian, 0 if it is Canadian; CDISTANCE = the cultural distance between the country of the acquirer and the target based on Hofstede's cultural dimensions; RELATIVE SIZE = the logarithm of the ratio of the value of the transaction by the stock market capitalization of the acquiring firm; INTRAINDUSTRY = 1 if the firms involved have the same three-digit SIC code, 0 if not; PERIOD = 1 if the transaction was announced between January 1998 and February 2000, 0 if not. Abnormal returns at the announcement date were cumulated over a three-day window (announcement date, the day before, and the day after) using market model parameters calculated over the period (240, -40).

is not surprising given that cross-border transactions involve foreign targets having the potential to be culturally distant from Canada. These two variables were not included in the

same regression model to avoid multicollinearity threats to our multivariate analysis. The remaining correlations are not high enough to warrant exclusion from the regression analysis, though some are of conceptual interest. For example, CEO stock ownership level and CEO duality were positively related ($r = .38$), indicating that higher levels of stock ownership were associated with instances when the CEO and chairperson were the same person. Also, there was a negative relationship between the proportion of independent board members and the stock ownership of directors ($r = -.34$).

Multiple Regression Analysis

Table 3 shows multiple regression results involving the relationship of CEO attributes, board composition, and ownership structure to the abnormal returns obtained by shareholders of the acquirer. The low variance inflation factors associated with each of the models show the lack of multicollinearity problems (cf. Hair, Anderson, Tatham, Black, 1995). Model 1 contains the controlled variables only. Models 2 and 3 add the independent variables and, due to collinearity issues noted earlier, differ only in terms of whether the cross border variable or the cultural distance index was used.

For each model, we present unstandardized and standardized coefficients. As noted earlier, our sample involves 273 acquisitions by 201 firms. We control for within-cluster correlations by using Huber/White/sandwich robust estimators of variance (Williams, 2000). It should also be noted that the results of the models presented below do not change substantially when a control variable reflecting the effect of multiple versus single acquirers is included. Standardized coefficients are also presented in order to assess the relative contribution of the independent variables to the value creation for acquirers. Given that Stata software does not allow the use of within-cluster correction while computing standardized coefficients (beta), we used heteroskedasticity adjusted (White, 1980) standard errors to compute t-statistics for these coefficients. Our analysis is based on those standardized coefficients.

Model 1, containing the control variables only, predicted 6.3% (adjusted) of the variance in cumulative abnormal returns, whereas the comparable figures for models 2 and 3, which also included the governance variables, were 9.5% and 7.4% respectively. Thus, in the context of our predictors, the cross border variable accounted for more variance (Model 2) than did the cultural distance index (Model 3).

With regard to CEO attributes, the only statistically meaningful variable was the level of CEO stock ownership, which associated positively with value creation for acquirers in models 2 and 3. These results are consistent with the convergence of interests' hypothesis (Jensen & Meckling, 1976; Lewellen et al., 1985; Shinn, 1999) that the interests of

Table 2
Correlations among Study Variables

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1-CAR	1.00																
2-CEOOWN	.11	1.00															
3-CEODUALITY	.03	.38	1.00														
4-AGEDUMMY	.08	.15	.11	1.00													
5-CEOTENURE	-.01	.16	.10	.23	1.00												
6-DIROWN	.07	-.12	-.20*	-.05	-.12	1.00											
7-INDEP	-.01	-.11	.04	.08	.16	-.34	1.00										
8-BOARDSIZE	-.13	-.20	-.10	.19	.26	-.11	.27	1.00									
9-EXTERNBLK	.12	-.13	.13	-.15	-.08	-.15	-.06	-.03	1.00								
10-CASH	.14	.01	-.06	.05	-.01	-.10	-.04	.13	-.05	1.00							
11-LEVERAGE	-.03	-.05	-.17	.02	-.02	-.01	.12	.18	.03	.14	1.00						
12-LISTED	-.16	.00	.12	.15	.01	.02	-.03	.02	-.06	-.19	-.02	1.00					
13-CROSSBRD	.22	.02	.05	-.01	-.09	.03	-.10	-.01	-.07	.17	-.15	-.24	1.00				
14-CDISTANCE	.11	-.05	.01	.08	-.06	-.02	-.13	.01	-.05	.24	-.08	-.14	.68	1.00			
15-RELSIZE	.08	.14	.08	-.07	-.27	-.02	-.15	-.42	.07	-.16	.05	.16	.13	-.00	1.00		
16-INTRAIIND	.01	.04	-.01	-.03	-.21	.05	.04	-.20	-.02	-.03	-.06	.07	-.00	-.03	.15	1.00	
17-PERIOD	-.03	-.10	-.02	-.01	-.01	-.04	.16	.19	.00	.07	.16	-.04	-.06	-.03	-.07	.03	1.00

Note: N = 201. Though 273 acquisitions were in the database, multiple acquisitions by the same company were averaged to reflect a single observation. Correlations $\geq .14$ are significant, $p < .05$.

CAR = Cumulative abnormal returns around the announcement date of the transaction; CEOOWN = level of CEO stock ownership; CEODUALITY = 1 if the CEO and Chairman of the board are the same person, 0 if not; CEOAGE = age of the CEO in years; AGEDUMMY = 1 if the age of the CEO is 60 years or more, 0 if not; CEOTENURE = organizational tenure of the CEO in years; DIRECTOWN = level of stock ownership by board members other than the CEO; INDEP = ratio of the number of independent board members to the size of the board; BOARDSIZE = the total number of board members; EXTERNBLK = voting rights held by external holders of blocks of shares; CASH = 1 if the transaction was funded by cash, 0 if not; LEVERAGE Ratio = the acquirer's long-term debt to its total assets at the end of the year preceding the transaction announcement; LISTED = 1 if the target firm is publicly traded, 0 if not; CROSSBORDER = 1 if the acquired firm is non-Canadian, 0 if it is Canadian; CDISTANCE = the cultural distance between the country of the acquirer and the target based on Hofstede's cultural dimensions; RELATIVE SIZE = the logarithm of the ratio of the value of the transaction by the stock market capitalization of the acquiring firm; INTRAIINDUSTRY = 1 if the firms involved have the same three-digit SIC code, 0 if not; PERIOD = 1 if the transaction was announced between January 1998 and February 2000, 0 if not. Abnormal returns at the announcement date were cumulated over a three-day window (announcement date, the day before, and the day after) using market model parameters calculated over the period (240, -40).

CEOs are better aligned with other shareholders as their level of stock ownership increases. Though none of the remaining CEO-based attributes were significant, H1a received support, leaving H1b (duality), H1c (age), and H1d (tenure with the organization) unsupported.

Turning to board composition variables, consistent with H2a, the level of stock ownership by board members associated positively with abnormal returns obtained on announcement dates in models 2 and 3. This is consistent with both Walters et al. (2007) and Kroll et al. (2008) and suggests that increased ownership of shares by board members better aligns their interests with shareholders in general. Also, in support of H2b, and consistent with both Faleye and Huson (2002) and Walters et al. (2007), the proportion of independent board members was positively associated with increased shareholder value in model 2. This finding is consistent with the notion that the independent board members contribute to better M&A decisions.

Consistent with H2c and in line with other (Eisenberg et al., 1998; Yermack, 1996), board size was negatively

related to abnormal returns in models 2 and 3. Furthermore, this variable bears the highest standardized coefficient among governance variables, which means that it has the highest (negative) impact on acquirer value creation. This finding is consistent with Jensen (1993), who highlighted the potential for communication and co-ordination problems as board size increases.

H3 stipulating that the proportion of large outside shareholders would be positively associated with abnormal gains was supported only in model 2, which used unstandardized coefficients. Though the direction effect was similar in the other regressions, it did not attain statistical significance.

Finally, three control variables were statistically significant. Consistent with Travlos (1987), the use of cash as the means of financing the transaction by the acquirer was associated with increases in abnormal returns in all models. Further, the acquisition of listed targets was associated with lower returns in models 1 and 3, which is consistent with Chang (1998). Finally, in line with Faccio et al. (2006), models 1 and 2 revealed that cross-border transactions

Table 3
CEO Attributes, Board Composition, and the Value Creation for Acquirers

Variable	Expected sign	Model 1		Model 2		Model 3	
		Unstandardized coefficient (t stat)	Standardized coefficient (t stat)	Unstandardized coefficient (t stat)	Standardized coefficient (t stat)	Unstandardized coefficient (t stat)	Standardized coefficient (t stat)
Control Variables							
CASH	+	.02 (2.22)*	.14 (2.12)*	.02 (2.24)*	.14 (2.11)*	.02 (2.44)**	.16 (2.29)*
LEVERAGE	+	.00 (.06)	.00 (.06)	.01 (.47)	.03 (.46)	0.00 (.04)	.00 (.04)
LISTED	-	-.02 (-2.39)**	-.14 (-2.34)*	-.01 (-1.64)	-.10 (-1.62)	-.02 (-2.08)*	-.13 (-2.07)*
RELATIVE SIZE	+	.00 (1.60)	.09 (1.60)	.00 (.45)	.03 (.45)	.00 (.28)	.02 (.28)
INTRAINDUSTR	+	.00 (.02)	.00 (.02)	-.00 (-.52)	-.03 (-.52)	-.00 (-.55)	-.04 (-.57)
PERIOD	+/-	.01 (1.35)	.07 (1.29)	.01 (1.18)	.07 (1.15)	.01 (1.01)	.06 (1.00)
CROSSBORDER	+/-	.02 (2.29)*	.13 (2.27)*	.02 (2.55)**	.15 (2.50)**		
CDISTANCE	+/-					.00 (.28)	.02 (.30)
CEO attributes							
CEOOWN	+			.06 (2.25)*	.13 (2.27)*	.06 (2.31)*	.13 (2.33)*
CEODUALITY	-			.01 (.73)	.05 (.68)	.01 (.73)	.05 (.68)
AGEDUMMY	-			-.01 (-.52)	-.03 (-.48)	-.01 (-.60)	-.03 (-.56)
CEOTENURE	-			.00 (.66)	.04 (.63)	.00 (.37)	.02 (.36)
Board composition							
DIRECTOWN	+			.06 (2.45)**	.12 (2.26)*	.06 (2.35)**	.12 (2.18)*
INDEP	+			.05 (1.92)*	.13 (1.80)*	.05 (1.73)*	.12 (1.63)
BOARDSIZE	-			-.00 (-2.53)**	-.15 (-2.41)**	-.00 (-2.43)**	-.15 (-2.31)*
External ownership							
EXTERNBLK	+			.05 (1.67)*	.12 (1.63)	.05 (1.47)	.11 (1.45)
Constant		.00 (.01)		-.04 (-1.47)		-.02 (-.83)	
R ²		8.7%	8.7%	14.5%	14.5%	12.5%	12.5%
Adjusted R ²		6.3%	6.3%	9.5%	9.5%	7.4%	7.4%
F Stat		3.64**	3.73**	3.38**	3.08**	2.89**	2.82**
Max VIF		1.16	1.16	1.45	1.45	1.45	1.45
N		273	273	273	273	273	273

Note: Model 1 contains the control variables only. Models 2 and 3 incorporate the independent variables and differ only in terms of whether the cross-border transaction variable or the cultural distance index was included. N = 273 mergers and acquisitions carried out by 201 firms. Huber/White/sandwich robust estimators of variance (Williams, 2000) are used to compute t-statistics for unstandardized coefficients. Heteroskedasticity adjusted (White, 1980) standard errors are used to compute t-statistics for standardized coefficients.

**p < .01, *p < .05; T tests are one-tailed whenever directional predictions are involved.

^aVIF refers to variance inflation factors.

undertaken by Canadian acquirers were tied to increased levels of shareholder gains. Thus, although cross border transactions and the cultural distance variable were highly correlated, only the former was a significant predictor in the context of the other variables we examined.

Discussion

Summary

We examined CEO attributes, board composition, and the ownership structure of firms in relation to the short-term stock performance of Canadian-based acquirers. CEO and director ownership levels as well as board independence were positively associated with abnormal returns around the acquisition announcement date. On the other hand, board size related negatively to the short-term performance of the acquiring firm. Among the control variables, cash-based and cross-border transactions were positively associated to abnormal returns as were (in model 3 only) transactions involving unlisted targets.

Contributions to Scholarship

This study contributes to the governance structure and M&A literatures by using a multidimensional framework that combines elements of the upper-echelons and agency theories (Jensen & Zajac, 2004). This is the first Canadian-based study to emphasize governance structure over the characteristics of the transaction as they relate to value creation derived from M&A. Further, given the relative concentration of ownership in Canada, we also add to the empirical findings beyond those of the US and the United Kingdom, where widely held ownership structures are more typical.

Results show a positive association with M&A value creation of agency related factors—namely, stock ownership level of the CEO, and directors. Board composition variables were also relevant in that relatively small boards with a greater proportion of independent directors were associated with positive abnormal returns. In contrast, upper-echelons variables did not seem to play an important role in Canada. Thus, ownership concentration at Canadian firms appears to play the most important role in aligning the interests of the CEO and the board with other shareholders, at least in the context of M&A.

Applied Implications

The *Globe & Mail* annual review of corporate governance practices in Canada shows that an increasing number of companies listed on the TSX are implementing policies requiring executives and directors to own company shares (*Globe & Mail*, 2010). Our findings support the intended

beneficial impact of such policies, at least in the short term and in the context of M&A. Similarly, our results support the Canadian governance “best practices” guidelines recommendation that the board of directors should be composed of a majority of independent directors (NP 58–201). On the other hand, as noted earlier, the current governance regime in Canada, introduced in 1995, is largely voluntary (Broshko & Li, 2006). As such, this study should be of interest to shareholder activists and to members of Canadian regulatory bodies looking to pressure companies toward increased compliance.

Limitations and Future Research Directions

Although we had a fairly large sample of acquisitions, especially for the Canadian context, relatively small statistical fluctuations impacted our findings. For example, even though the effect size associated with the blockholder variable was virtually identical in models 2 and 3, statistical significance was obtained in model 2 only. Given a larger sample, the value of large external shareholders to abnormal returns may have been more clearly supported.

Although our analysis window (the day before, the day of, and the day after the official M&A announcement) has often been used in prior research (e.g., Bruner, 2002; McWilliams, & Siegel, 1997), it may not have reflected share gains arising from rumors preceding the official announcement.

Our analysis window also does not model the intermediate and long-term outcomes following an acquisition. Given the integration challenges associated with M&A, the expected synergies may or may not play out in the long run. Prior research (Loughran & Vijh, 1997; Mitchell & Stafford, 2000; Rau & Vermaelen, 1998) has shown that US acquirers tend to destroy value in the long run. André, Kooli, and L’her (2004) also found evidence of long-term underperformance among Canadian acquirers. These studies however, did not control for the impact of corporate governance quality on long-term returns. Obviously, future research should examine the relationship between corporate governance mechanisms and long-term M&A performance.

Finally, it is interesting to note that cross-border M&A tends to be profitable for the acquirer’s shareholders, but deals involving substantial cultural distance are not. This suggests that strategic managers in Canada looking to use M&A to expand globally should select foreign targets that involve minimal potential cultural integration issues.

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