CEO COMPENSATION FOR BIDDERS IN UK M&As

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Preliminary
February 2005

Abstract
The paper investigates the impact of M&As on bidder CEO and other executive compensation employing a unique sample of 100 completed bids in the UK over the period 1998-2001. Our findings indicate that less independent and larger boards award CEOs significantly higher bonuses following M&A completion and that UK CEOs and executive directors are rewarded more for the effort they place in order to accomplish an outside of their industry (large) merger rather than a horizontal (small) merger. Overall our findings offer support for the managerial power rather than the agency theory perspective on managerial compensation.

JEL Classification: G34; J33

Keywords: Executive compensation; managerial power; agency theory.

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Iliopoulou acknowledges the financial support provided by the Greek State Scholarship Foundation (IKY) through a PhD scholarship.

1. Introduction

Recent years have witnessed an explosive growth in UK and US boardroom pay and especially in its long- and short-term incentive elements. This is viewed as an attempt both to attract and motivate managerial talent and to obtain a desirable alignment of incentives between principals and agents. In this context, mergers and acquisitions (M&As) are amongst the most visible and significant investment decisions executives can make due to their potential long-term effects. There is a huge literature on the impact of M&As. Within this, one can distinguish between two opposing views on the links between M&As and executive and, more specifically, CEO compensation.

On one hand, agency theory approaches view executive compensation as rewarding managerial skill in seeking out only those M&A deals that contribute to shareholder value creation. Put differently, it should discourage those value-destroying deals highlighted in Jensen's (1986) free cash flow theory of takeovers. On the other hand, managerial power approaches view M&As as driven by personal motives such as empire building. Extant research indicates a strong positive relationship between firm size and executive pay for both the UK and USA. Thus managers may incline toward size-expanding strategies through M&As and extracting the associated rents even if their long-term effects are value destroying.

Most of the existing literature on these issues relates to studies of samples of US M&A deals. The early literature points mainly to the detrimental effects of M&As for acquiring shareholders (Jensen and Ruback, 1983; Moeller et al., 2003; Loughran and Vijh, 1997; Kohers and Kohers, 2001). Hallock (1997) reports that the existence of interlocking board relations increases CEO pay. In addition, Core et al. (1999) report that the larger the influencing power of CEOs over the selection of board members, the higher the levels of pay they receive. In a pioneering recent paper,

Grinstein and Hribar (2004) argue that it is managerial power rather than value creation that drives the payment of M&A bonuses. Using a sample of 327 M&A deals in the USA 1993-1999, they find that more powerful CEOs receive significantly larger bonuses and engage in larger (relative to their firms) deals to which the market responds more negatively. They find no relation between bonus compensation and deal performance.

Although there are existing studies of UK executive compensation, none of them has analysed the issue of executive compensation in relation to M&A deals.[3] The first and main contribution of this study is that it fills this lacuna in the literature by addressing the latter issue in a UK context. This is accomplished by employing a unique sample of 100 completed M&A bids in the UK over the 1998-2001 period. A second contribution is that we provide evidence consistent with the managerial power perspective for our sample. In this respect our study supports the findings of Grinstein and Hribar (2004) for the USA. A final contribution is that we distinguish between CEOs and other executives as well as between UK and US bidders for UK targets. The objective here is to shed light on the levels of compensation received by US acquirers of UK targets relative to that awarded to UK bidder companies.

Our empirical results indicate significant increases in executive pay in the year following the completion of the M&A deal. More precisely we find that some elements of pay are doubled or even tripled. We provide evidence that the power of the CEO on the board can account for such increases. Our results indicate that board size is a dominant factor in setting executive pay for bidding companies and that the levels of board independence are important in the levels of compensation received by UK bidding CEOs.

[3] Girma, Thompson and Wright (2000) have addressed the issue of merger activity and executive pay in the UK context. However, they use data of the highest paid director (who is not necessarily the CEO) as supplied from Hemmington-Scott Corporate Registers.

The lion's share of salary and bonus pay is paid to CEOs when compared to the average executive of their firm. Also, the former experience significantly higher (positive) rate of change in the levels of salary plus bonus received in the period before and following the acquisition than their executive counterparts, whose average rate is negative. There are significant differences on the levels of bonus and salary received by UK and US executives both in the year before and following the acquisition announcement. CEOs who also serve as chairmen for their companies receive substantially higher levels of salary plus bonus (around £3.4m) whereas the average executive receives £0.86m more than those in their peer companies whose CEO and chairman roles are separated. Board size significantly increases bonus and salary pay received by all executives, indicating that larger boards are associated with higher levels of pay for both CEOs and other executive directors. Finally, we report that UK executives of bidding companies receive significantly higher (lower) levels of cash pay when involved in a large (diversifying) as opposed to a small (within their industry) acquisition.

The paper is organized as follows. In section 2 we provide information on sample formation and section 3 describes our variables. Section 4 offers analyses the empirical results while a final section concludes.

2. Data and methodology

2.1 Sample

UK listed companies have only recently begun to report relevant information on executive compensation following the recommendations of the Greenbury (1995) and Hampel (1998) reports. To our knowledge, there are no electronic databases on all elements of UK boardroom pay. As a result, our unique sample of executive

remuneration data is extracted directly from company financial statements.[4] Using Acquisition's Monthly, we identify a total of some 971 corporate acquisition announcements during the period February 1998 to February 2002. The following filtering process is applied to this total.

We consider only UK and US listed companies' acquisition transactions that have a completion date within the period under examination (47% of bids) and whose share price and other relevant accounting data are available from Datastream Advance. To avoid conflating the effects of multiple transactions in our analysis, we require that each included acquirer made no further takeovers in the year of the acquisition. Annual Report and proxy statement data availability for a three-year window (one year preceding and two years following the acquisition announcement) further reduces our sample size. As a result, we end up with a sample of some 100 companies that can be subdivided into 73 UK and 27 US bidding firms for targets based in the UK.

2.2 Post-M&A company performance

We use an event study methodology to examine the effects of the acquisition on shareholder wealth. We apply the market model, which is commonly used in the M&A literature. This allows for a comparison of our results with prior, predominately US, findings. Given our sample firms' characteristics, we use the FTSE-All Share (for UK bidders) and the S&P 500 (for US bidders) index returns as the benchmark for calculating company abnormal returns around and following the acquisition announcement.

[4] Our sample data are collected manually and this differs from that of the US study by Grinstein and Hribar (2004). As a result, estimation methods had to be adjusted given the limitations in UK data availability.

The literature on abnormal returns for bidding companies over the announcement period has produced mixed results. On one hand, some researchers report positive performance (Jensen and Ruback, 1983; Franks and Harris, 1989; Markides and Ittner, 1994; Doukas, 1995, Cakici, 1996). By contrast, others find either zero or even negative abnormal performance (Firth, 1979; Roll, 1986; Limmack, 1991; Servaes and Zenner, 1990, 1994; Sudia, 1992; Datta and Puia, 1995; Danbolt, 1995). In general, the sign of a bidder's performance following an acquisition transaction is associated with how the market reacts to the managerial decision. Thus negative returns indicate that the market evaluates CEO decisions to acquire as value destroying.

There is a variety of different explanations on what drives such market reaction and the subsequent abnormal performance. Travlos, (1987) finds that the method of pay for the acquisition is an important driver of returns (stock settlements are often associated with overvalued bidders). On those grounds, Harford (1999) shows that cash settlements generate positive signals towards the reduction of the agency costs of free-cash-flow, leading to positive returns irrespective of the quality of the investment itself. Other researchers (Fuller et al., 2002; Morck et al., 1990; Maquieira et al., 1997) report an association between the type of target and abnormal returns (returns to bidding companies involved in diversifying mergers are lower). Also, it is possible that large firms involved in acquisition deals might signal to the market that they have exhausted their internal growth opportunities. As a result, a negative return may be observed following the transaction irrespective of whether there is value creation through the merger (Rosen, 2004). Finally, the market reaction to a merger announcement may be a reflection of the value added on the entire merger strategy of the acquiring firm and not just one merger itself. We rule out such an

effect by requiring that the bidder has made no more acquisition offers in the year of the bid.

To examine the short-run post merger company performance, we calculate the Cumulative Abnormal Returns (CAR) of our sample firms. Under the Market Model, we calculate:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad and \quad E\left(R_{it} \middle| R_{mt}\right) = \hat{\alpha}_i + \hat{\beta}_i R_{mt}$$

The AR of a company is computed as the difference between its actual return less the return on a benchmark typically given by an appropriate market index:

$$AR_{it} = R_{it} - E\left(R_{it} \middle| R_{mt}\right) \qquad (1)$$

where R_{it} and R_{mt} are the log returns of share *i* on day *t* and on the market index *m,* respectively. Given that all the parameters are estimated in the test period, no adjustment is necessary. The CAR is the sum of all arithmetic abnormal returns (AR) in the chosen event window:

$$CAR_i = \sum_{t=1}^{T} AR_{it} \qquad (2)$$

We select a variety of event windows from 2 days (-1; 0) up to 10 days (-5; +5) days surrounding the day of the M&A announcement.

3. Variables

Executive pay levels are determined by a number of factors. We identify three separate sets of indicators that might explain them. These are those associated with firm performance, executive skill and effort exerted in successful completion of the bid, and with CEO power. The former two are standard while the latter would indicate the extent to which the firm insider-control mechanisms are in place to protect

shareholder wealth or to enhance CEO compensation. Although it may be difficult for remuneration committees to measure the time, effort and skill exerted by CEOs towards their completion in order to compensate them appropriately, it is expected that "compensation should rely on indirect measures of effort, such as performance measures".[5]

3.1 Executive pay

Executives in both the UK and US are paid three separate forms of compensation. They receive a cash component embracing their base salary and benefits called managerial emoluments, an annual cash bonus[6] and long-term awards. The latter consist of share options and long-term incentive plans (Ltips) while in the US it consists of option, Ltip payouts and restricted stock awards.[7] We define total cash pay (*TCP*) as the sum of bonus, salary and benefits received by executives. Similarly, total incentive pay (*TIP*) equals to the value of share option awards plus the future value of Ltip grants, and total pay (*TP*) is the sum of total cash and total incentive pay.

Choudhary and Orszag (2003) examine 130 UK large companies for the year 2002 and report that the level of CEO salary is decided on the basis of firm size and on competing companies' proposed salaries. Grinstein and Hribar (2004) find that CEO compensation for completing M&A deals in the US takes the form of cash bonus and that increases in such payments are related to managerial power rather than to performance.

[5] Grinstein and Hribar (2004), p.13.
[6] In a US study, Holthausen et al. (1995) use non-public survey data from a consulting firm and document that many bonus plans are fixed-target plans in which executives do not receive any payoff until they reach a lower bound of the performance measure. This seems to be the case in the UK as well.
[7] Share options awarded to executives are treated as call options. We price share option awards with the conventional Black-Scholes (1973) pricing formula adjusted for continuously paid dividends on grant date. Long-term incentive plan shares are valued using the stock price on the day of grant discounted at 20% to account for the performance restrictions assigned to them.

Morck et al. (1990) suggest that firms with better prior performance make better acquisitions. Barber and Lyon (1996) find that return on assets (ROA) is the most powerful measure for detecting abnormal performance when it actually is present. We employ a number of variables to capture for performance. Return on assets (*ROA*) is earnings over the book value of total assets; *ROA growth* is ROA in the year of acquisition over that of the previous year; Total shareholder return (*TSR*) is the annual growth in value of shareholdings assuming that dividends are reinvested; and *Margin* is earnings divided by sales.

3.2. Executive skill and effort

Standard theory predicts that CEOs will be rewarded for the skill and effort exerted in M&As. We expect that CEOs acquiring targets from the same industry will be rewarded with higher levels of bonus and no subsequent decreases in salary after the completion of the bid. We control for this effect with a dummy variable *Industry* that takes the value of 1 if the firm is acquiring a target from a different industry and 0 otherwise. In addition, we control for deal complexity with the log of the number of days between the deal announcement and the day of completion (*Completion*) and with the *Deal Value* variable representing the acquisition value (in £millions).

3.3. CEO Power

Bebchuck and Fried (2003) link managerial power to remuneration levels. They establish that CEOs who have more power vis-à-vis their boards will be able to extract higher levels of rents in the form of managerial compensation. Shivdasani and Yermack (1999) offer evidence on the ability of CEOs to affect the selection of directors. Furthermore, Bebchuck and Fried (2003) show that CEOs could discourage board members who oppose or disagree with them from participating on the board.

Following Zhao and Lehn (2003), we investigate whether internal control mechanisms can discipline CEOs who take on value-reducing acquisition decisions. In order to address the issue of leadership structure and its possible effects on executive pay and shareholder wealth, we employ 3 dummy variables. The *Nominations* and *Remuneration* variables, take the value 1 when the CEO is participating on his company's nominations and remuneration committees respectively, and 0 otherwise. Similarly, the *Chair* variable takes the value of 1 when the CEO is also the chairman of the company and 0 otherwise.

Further, the number of members in the Board (*Board Size*) and the ratio of executive to non-executive directors on the board (*Ex-NE*) could play an important role in eliminating CEO power and leading to improved performance through board independence. Faccio and Lasfer (2000) show that the board of directors is more independent as the number of outside directors' increases. Yermack (1996), Agrawal and Knoeber (1996) and Klein (1998) suggest that firms with a high percentage of independent directors may perform worse. Welsbach (1988) reports that the proportion of independent directors on large firm boards increases slightly when a company has performed poorly, and Bhagot and Black (2001) find a reasonably strong correlation between poor performance and subsequent increases in board independence.

Yermack (1996) and Jensen (1993) show that larger numbers of board members are often associated with less effective board and higher managerial power. We expect that insider-dominated boards are less independent. This leads to higher levels of CEO power over the setting of their pay and bonuses following M&A deals.

4. Empirical findings

4.1 Descriptive statistics

Figure 1 indicates that the number of M&A deals increased from 1998 to reach a peak in 1999 and declined thereafter overall for the UK market (Panel A) as well as for our sample (Panel B).

[Figure 1 around here]

UK and US bidders differ in a number of respects. Tables 1 and 2 present the summary statistics and tests (*t*-statistics) of the differences in means for financial, deal and governance characteristics and executive pay characteristics respectively (both CEO and average (other) executive).

[Tables 1 and 2 around here]

Table 1A indicates that there are significant differences in the financial characteristics of the two sets of bidders. US acquirers are significantly larger in the year prior to and following the acquisition. On average, they are four times larger in size than their UK counterparts (£16m as opposed to £4.21m and £13.6m to £3.25m). US companies have on average significantly higher market-to-book ratios with figures of 7.62 as opposed to 1.84 pre-acquisition and 7.80 to 2.76 in the post-acquisition period, respectively.

US acquirers complete more expensive bids than their UK counterparts. The median (mean) value of acquisitions by US bidders equals £139m (£804m) whereas that for UK bidders is only £73.8m (£254m). Our sample firms show a preference towards financing their deals with a combination of cash and shares. US acquirers show a clear preference towards cash transactions (52%) and payments with a combination of cash and debt (44%). On the other hand, there is greater dispersion in the UK bidders methods of payment, with 38.6% of UK bids being paid with a combination of cash and shares and 24.5% with a combination of cash and debt

(22.8% shares only), leaving pure cash settlements as the last source of capital (14%) in use. Method of pay models across the literature predict that shareholders of bidding companies are worse off in stock transactions compared to cash transactions. We report that, on average, there are significant differences in the levels of use of stock-settled acquisitions (7.4% of US and 55% of UK transactions). In a UK study covering the period 1988-1996, Draper and Paudyal (1991) report that cash acquirers do not experience any significant abnormal returns but stock acquisitions experience significant negative returns.

Our median UK bidder employs 9 directors on its board with some 55% of insiders whereas US boards employ 14 directors with 43% of insiders. While 74% of US CEOs are chairmen, this rarely happens in the UK (1 in 4 cases only). Nevertheless, 34% of UK CEOs are members of the nominations committee as opposed to 41% of our US sub-sample. Existing research has established the existence of a relationship between CEO pay and board structure. Bebchuck et al. (2002) and Bebchuck and Fried (2003) associate board structure and the decrease in board independence through the appointment of CEOs as chairmen or as members of nominations committees with the ability to influence board decisions including those regarding their pay.

Table 2 presents the summary statistics for CEO (Panel A) and other average executive (Panel B) pay for our overall, UK and US samples. The average salary and bonus post-acquisition (pre-acquisition) amount to £0.623m (£0.571m) and £1,648m (£0.612m), respectively. That received by UK CEOs is £0.327m (£0.256m) and £0.155m (£0.146m) and for their US counterparts £1.422m (£1.423m) and £5.68m (£1.87m) respectively. The mean ratio of cash to total pay received by US (UK) CEOs following the acquisition is 87% (62%). Finally, there are significant differences in

the change of salary plus bonus in the year following the acquisition (*Δsalary+bonus*), with US CEOs experiencing an average (median) increase of 303% (63%) and UK just 43% (15%).

Panel B of Table 2 shows that there are significant differences in pay levels for the average executive (other than the CEO) of the UK and US bidding companies. Such differences may be driven by the significant variation in average size between the US and UK bidding companies during the pre- and post-acquisition period. Notably, whereas US executives receive higher levels of pay compared to their UK counterparts, they earn slightly lower *Δsalary+bonus* following the completion of the bid. The test (*t*-statistic) of the differences in the means for CEO and the average executive *Δsalary+bonus* (2.14) highlights the significant differences in pay across the firm's hierarchy.

4.2 Cross-section analysis

Following the Grinstein and Hribar (2004) methodology, we estimate the possible determinants of the cash elements of CEO (Panel A) and total executive (Panel B) remuneration following M&A completion. In particular, we estimate the following cross-section regression by OLS:

$$\begin{aligned} Y_i = {} & \beta_0 + \beta_1 Size_i + \beta_2 Deal\ Value_i + \beta_3 CAR(-1;0)_i + \beta_4 Completion_i \\ & + \beta_5 Industry_i + \beta_6 Chairman_i + \beta_7 No\ min\ ation_i + \beta_8\ Board\ Size_i \\ & + \beta_9 Ex - NE_i + \beta_{10} TSR_i + \beta_{11} ROA_i + \varepsilon_i \end{aligned}$$

where Y_i is the measure of managerial cash compensation (bonus, salary and salary + bonus), Size, TSR ad ROA are control variables and the other independent variables capture elements of either managerial effort and skill (Deal Value, CAR(-1,0), Completion, and Industry) or managerial power (Chairman, Nomination, Board Size,

and Ex-NE). All measures of effort, performance and managerial power are as defined in Section 3 above.[8]

The results for the full sample (N=100) are presented in Table 3 while those for the UK and US samples are given in Tables 4 and 5, respectively.

[Table 3 around here]

The first, second and third columns present estimates of the determinants of the total bonus, salary and salary plus bonus respectively received following completion of the deal.

The table shows that there is a positive relationship between company size and executive bonus pay (Panel B) and a negative and significant relation between the 2-day market-adjusted return following the acquisition announcement and CEO salary (Panel A). The CAR (-1;0) reflects the market's perception on the quality of the acquisition decision, and as a result, this evidence contradicts the traditional view that increases in managerial pay should follow performance (or valuable acquisition decisions). This evidence points towards the managerial power view under which managerial pay increases with respect to firm size and irrespectively of the value of the acquisition decision.

The table indicates that the cash elements of CEO remuneration are unaffected by either managerial effort or by skill since none of the relevant coefficients is significant at conventional levels. By contrast, managerial power variables emerge as significant drivers of CEO cash remuneration. More particularly, the coefficients on CEO chairmanship and Board Size are correctly signed and statistically significant at the 1% level for all three regression specifications (Panel A). In other words, CEOs with greater board influence earn higher levels of performance-related cash pay and

[8] We also tried using elements of equity-based-compensation as the dependent variable but the results of such regressions were uninformative.

larger boards award higher levels of cash pay to their CEOs. More precisely, CEOs that also serve as chairmen (or for every additional member on the board) receive an additional £3.06m (£410k) of bonus and £357k (£94.9k) of salary than their non-chairmen counterparts. In addition**,** Panel B indicates that executive directors who participate in large boards and whose CEO is powerful earn higher levels of cash pay. For them, the combined CEO-chairman role (or every additional member on the board) increases bonus and salary by £830.6k and £286.1k (£90.18 and £40.39k) respectively.

Finally, we report that the ratio of executive to non-executive directors has a significantly positive effect on CEO salary pay which, although not very strong evidence, also supports the managerial power view that CEOs of less independent boards receive higher levels of cash pay. On the contrary, the Panel B results indicate a negative relation between the salary received by the average executive and the ratio of executive to independent directors. That indicates that (holding NE directors constant), while the CEO receives £233.5k more in salary for every additional executive director, the average executive experiences a significant decrease of £254.3k.

This evidence is in line with the Bebchuck and Fried (2003) prediction and the Grinstein and Hribar (2004) US findings that high CEO power leads to higher levels of rent extraction through M&A deals. Note that our results are more striking than those of the latter study, which also found a significant role for managerial effort and skill variables. Our results are also consistent with those of Calgano (2004) who investigates a sample of the 510 largest UK firms during 1997-1998 and shows that when the firm's stock price performance is low and the wealth of a CEO with large exposure to share price decreases, the CEO is paid a relatively higher level of cash

compensation. As a result, "entrenchment not only eliminated the disciplining role of poorly performing management but also introduced a pernicious remuneration incentive scheme".[9]

The results for the three regression specifications for the UK (N=73) and the US (N=27) samples are given in Tables 4 and 5, respectively:

[Tables 4 and 5 around here]

For our UK sample, the deal size (as measured by the *Deal Value* variable) is a positive and significant indicator of bonus and salary pay at the 1% (Panel A) and 5% (Panel B) significance levels.[10] This evidence is in line with Grinstein and Hribar (2004) who find that deal size is a positive and significant indicator of bonus pay received by US CEOs. Since deal size is a measure of deal complexity, Panels A and B of Table 4 confirm that more complex acquisition deals lead to higher levels of bonus (CEO) and salary (other executive) pay. More precisely, for every £1m spent on the deal the CEO receives an additional £0.135k (£0.224k) bonus (salary+bonus) and the average executive's salary increases by £0.043k (£0.085k).

Note however that this interpretation is not straightforward. Whereas UK CEOs are compensated for the complexity and higher levels of effort and skill associated with large deals, these could also be the outcome of over investment and the subsequent failure of boards to monitor CEO decisions effectively as a result of managerial power. CEOs may receive the wrong signals from the existence of such a link between deal size and acquisition-related cash rewards and this could lead to managerial power exertion towards empire-building behavior for rent extraction.

To investigate further the relationship between CEO effort and pay components, we employ an Industry dummy variable. We expect that CEOs who

[9] Calgano (2004), p.18.
[10] The significance of the salary+bonus variable indicates that there is no substitution between the two elements of pay (i.e. salary and bonus).

engage in deals outside their own industry are rewarded differently due to less synergetic and integration problems and the subsequent lower demand for effort. The significantly negative results across Table 4 indicate that UK executives acquiring from a different industry receive lower levels of bonus (and salary). The bonus and salary of CEOs (the average executive) acquiring from outside their industry is £118.7k and £144.5k (£89.8k and £101.4k) lower than that of their counterparts acquiring within their industry. These results are in line with those of Grinstein and Hribar (2004).

Traditional views on board size stipulate that keeping boards small can improve their performance (Jensen, 1993; Yermack, 1996). The Board size coefficient in Table 4 is significantly positive at the 5% level for CEO bonus. While this diverges from that of Grinstein and Hribar (2004), it reports surprise at finding a negative coefficient on this variable. This result implies that larger boards pay higher bonuses.

Finally, the table indicates that insider-dominated boards lead to lower levels of salary pay. More precisely, for an additional executive to non-executive director employed on the board, the CEO suffers a higher reduction to salary (£112.5k) as opposed to that realized by the average executive (£60.65k).[11] Zhao and Lehn (2003) show that CEO tenure is more sensitive to firm performance when outsiders (i.e. non-executive directors) form the majority of the board and that consequently, in line with Faccio and Lasfer (2000), the board of directors is more independent as the number of outside directors increases.

Finally we analyse the results for our US sample given in Table 5. The latter table shows that CEO chairmanship significantly increases CEO salary and bonus cash pay

[11] Note however that we cannot exactly replicate the Grinstein and Hribar (2004) *Insider* (corresponding to our *Ex-NE ratio*) variable since they are able to identify grey insiders.

although this result is significant at the 5 per cent level only for this sample.[12] Furthermore, we find that the ratio of executive to non-executive directors is negatively related to salary pay (Panels A and B) at the 10% level.

Overall, our results in Tables 3, 4 and 5 outline the different wealth effects on CEO and average executive directors as a result of company performance, CEO skill and power exertion between UK and US bidders. We report that size is a driver of executive bonus and that there is a negative relationship between the market valuation of the deal and CEO salary. Whereas CEO chairmanship and board size significantly increases cash pay for both groups, CEOs enjoy around three times higher increases than their executive directors. Similar differences exist for the increases on UK cash pay driven by the deal value. By contrast, the subsequent decreases in UK CEO pay due to diversified acquisitions are higher than those for other executives. Taken as a whole, our results demonstrate that measures of CEO power rather than performance and executive effort and skill can explain the cross-sectional variation in the bonus and salary pay received following the completion of a M&A deal.

5. Concluding remarks

There is considerable debate surrounding CEO and other executive incentives for M&A deals and the association between such incentives and post-deal gains. This paper employs a sample of 100 UK and US bidders for 1998-2001 to investigate the determinants of CEO and executive director pay following M&A deals. While cash compensation subsequent to M&A completion for the full sample is unaffected by measures of managerial skill and performance, we find that UK CEOs and executive director pay increases with deal size. This latter evidence suggests that there is a

[12] The weak results on the US CEO pay could be due to the small size of this sample.

positive association between deal size complexity and CEO pay. Moreover, UK CEOs and executive directors receive higher levels of cash (salary and bonus) pay when involved in acquisitions within their industry.

At the same time the finding on deal size raises concerns about possible rent extraction by CEOs who get involved in large acquisition deals to enjoy the associated increases in their cash pay. These are also in line with the finding of consistently significant coefficients on managerial power variable(s) across the full and sub-samples that imply that less board independence leads to higher levels of bonus. These support the evidence favoring the managerial power approach found in the US study of Grinstein and Hribar (2004). They are also consistent with the Bebchuck and Fried (2003) and Bebchuck (2002) views that CEO power is a significant driver of compensation. Overall, our findings suggest that CEOs may get involved in M&A bids due to self-dealing perks instead of shareholder value creation. They raise concerns about the ability of existing corporate governance mechanisms to align CEO behavior to measures of performance.

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Table 1
Descriptive Statistics of Acquiring Firms

The Table presents summary statistics for Total, UK and US CEO samples the year prior and following the acquisition deal and t-statistics from tests of the differences in Means between the UK and US CEO samples. *Size* is the book value of total assets; *ROA* is Earnings per share times number of shares divided by the book value of total assets; *MTBV* is the market-to-book ratio; *Deal Value* is GBP value of the acquisition deal (in millions); *Completion* is the log of the number of days between the deal announcement and the day of completion; *CAR (-1;0)* and *CAR (-5;+5)* are the cumulative abnormal returns in the respective event windows; *Industry* is a dummy variable taking the value 1 if the company is acquiring from outside its industry and 0 otherwise; *Method of Pay* is a dummy variable taking the value 1 if the deal settlement involves stock and 0 otherwise; *Board Size* is the number of members in the Board of Directors; *Ex-NE* is the ratio of Insiders in the Board; *Chairman* is a dummy variable taking the value 1 if the CEO holds the Chairman position in the company; *Nominations* is a dummy variable taking the value 1 if the CEO is a member of the Nominations committee.

	TOTAL SAMPLE			**UK SAMPLE**			**US SAMPLE**			**t-statistic**
	Mean	Std. Dev.	Median	Mean	Std. Dev.	Median	Mean	Std. Dev.	Median	
Panel A. Financial Characteristics of Bidders										
Size £m (Post-acq)	7.32	22.7	0.50	4.21	16.1	0.32	16.0	34.2	4.75	2.28*
Size £m (Pre-acq)	5.97	19.0	0.32	3.25	13.0	0.19	13.6	29.1	4.44	2.39*
ROA	13%	81%	0.1%	15%	93%	2.2%	6.7%	34%	0.1%	50%
MTBV (Post-acq)	3.43	8.02	2.19	1.84	7.91	1.74	7.62	6.79	4.96	3.35*
MTBV (Pre-acq)	4.15	6.10	2.64	2.76	5.45	1.82	7.80	6.29	6.66	3.92*
Panel B. Deal Characteristics										
Deal Value (£m)	409	1064	87.5	254	728	73.8	804	1588	139	2.33*
Completion (days)	43.7	30.8	35.5	42.5	33.7	34	46.8	21.5	44	0.62
CAR (-1;0)	-0.01	0.05	-0.01	-0.01	0.04	-0.004	-0.02	0.05	-0.02	1.10
CAR (-5;+5)	-0.01	0.10	-0.003	-0.002	0.10	0.005	-0.03	0.10	-0.03	1.26
Industry	77%	42%	-	78%	42%	-	74%	45%	-	0.42
Method of Pay	42%	50%	No	55%	50%	Yes	7.4%	27%	No	4.66*
Panel C. Governance Characteristics										
Board Size	11	4	10	10	3	9	14	3	14	5.85*
Ex-NE	1.1	0.53	1.0	1.2	0.6	1.2	0.7	0.3	0.7	3.94*
Chairman	37%	0.49	No	24%	43%	No	74%	45%	Yes	5.22*
Nominations	36%	0.48	No	34%	48%	No	41%	50%	No	0.59

An asterisk indicates a significant difference between means at the 5% level.

Table 2
Descriptive Statistics of Pay

The Table presents summary statistics for Total, UK and US CEO samples the year prior and following the acquisition deal and t-statistics from tests of the differences in Means between the UK and US CEO samples. *TCP/TP* is the ratio of Total Cash to Total Pay; *Δsalbon* is the ratio of the difference between the salary plus bonus after completion and prior to the bid divided by salary plus bonus in the year prior to the bid.

	TOTAL SAMPLE			**UK SAMPLE**			**US SAMPLE**			**t-statistic**
	Mean	Std. Dev.	Median	Mean	Std. Dev.	Median	Mean	Std. Dev.	Median	
Panel A. CEO										
Bonus £000 (Post-acq.)	1648	4736	138	155	218	75	5684	7881	2844	6.04*
Bonus £000 (Pre-acq.)	612	2043	51.4	146	308	50	1870	3658	270	4.02*
Salary £000 (Post-acq.)	623	740	333	327	368	220	1422	895	1360	8.71*
Salary £000 (Pre-acq.)	571	749	290	256	173	207	1423	1013	1270	9.55*
TCP/TP % (Post-acq)	69%	34%	87%	62%	984%	74%	87%	117%	95%	3.44*
TCP/TP % (Pre-acq.)	59%	42%	81%	59%	116%	81%	59%	377%	71%	0.88
Δsalary+bonus %	112%	369%	20%	43%	162%	15%	303%	634%	63%	3.23*
Panel B. Average Executive										
Bonus £000 (Post-acq.)	657	1486	110	124	164	61	2100	2320	995	7.30*
Bonus £000 (Pre-acq.)	590	1272	67	148	387	38	1787	1928	1077	6.95*
Salary £000 (Post-acq.)	470	506	255	230	134	218	1119	571	1147	12.5*
Salary £000 (Pre-acq.)	446	507	236	213	157	174	1077	585	1002	11.6*
TCP/TP % (Post-acq)	27%	34%	7%	23%	35%	3%	40%	29%	43%	2.33*
TCP/TP % (Pre-acq.)	38%	41%	14%	37%	44%	9%	39%	31%	31%	0.19
Δsalary+bonus %	30%	68%	15%	32%	70%	19%	24%	64%	-10%	0.53
Panel C. CEO vs. Executive										
Δsalary+bonus %										2.14*

An asterisk indicates a significant difference between means at the 5% level.

Table 3
Post-Acquisition Cash Rewards, Performance and CEO Power

The sample includes the full sample of 100 completed M&A deals of UK and US bidders for the period 1998-2001. The dependent variables are bonus, salary and bonus plus salary received by the CEO (Panel A) and the average executive director (Panel B) the year following the acquisition. The independent variables are listed on the left-hand side of the Table. *Size* is the book value of total assets prior to the acquisition; *Deal Value* is the GBP value of the acquisition deal (in millions); *CAR (-1;0)* is the two-day market-adjusted return for the day prior to the deal announcement and the day of the merger announcement; *Completion* is the log of the number of days between the deal announcement and the day of completion; *Industry* is a dummy variable taking the value 1 if the company is acquiring from outside its industry and 0 otherwise; *Chairman* is a dummy variable taking the value 1 if the CEO holds the Chairman position in the company; *Nominations* is a dummy variable taking the value 1 if the CEO is a member of the Nominations committee; *Ex-NE* is the ratio of Insiders in the Board; *Board Size* is the number of members in the Board of Directors; *TSR* is Total Shareholder Return; *ROA* is Earnings per share (EPS) times number of shares divided by the Book value of Total Assets.

	Panel A						**Panel B**					
	Bonus		**Salary**		**Salary + Bonus**		**Bonus**		**Salary**		**Salary + Bonus**	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
C	-4163	-1.54	-934.7	-2.94	-5098	-1.79	-700.9	-0.76	59.17	0.23	-590.0	-0.68
Size	4E-05	1.56	4E-06	1.08	5E-05	1.59	2E-05	2.20**	4E-06	1.45	1E-05	1.43
Deal Value (£m)	-0.641	-0.92	0.093	1.14	-0.547	-0.74	-0.041	-0.19	0.042	0.72	-0.014	-0.07
CAR (-1;0)	-14528	-1.30	-3361	-2.55***	-17889	-1.51	372.4	0.11	543.9	0.61	635.9	0.21
Completion	-240.6	-0.39	41.39	0.57	-199.3	-0.31	81.73	0.45	39.65	0.78	68.09	0.39
Industry	1060	0.88	-108.9	-0.76	951.2	0.74	160.9	0.44	-101.9	-0.99	157.1	0.45
Chairman	3066	2.87***	357.6	2.84***	3423	3.03***	830.6	2.57***	286.1	3.17***	858.9	2.82***
Nomination	-105.9	-0.10	57.83	0.48	-48.11	-0.04	32.38	0.10	97.22	1.11	171.2	0.58
Board size	410.1	2.76***	94.93	5.41***	505.0	3.21***	90.18	1.78*	40.39	2.86***	102.6	2.15*
Ex-NE ratio	291.2	0.28	233.5	1.93*	524.7	0.48	-415.9	-1.31	-254.3	-2.87***	-488.4	-1.63
TSR	-0.011	-0.33	-0.006	-1.59	-0.018	-0.49	0.001	0.10	-2E-03	-0.01	0.001	0.14
ROA	250.9	0.42	330.8	4.71***	581.6	0.92	63.46	0.35	63.75	1.27	142.4	0.84
Adj. R-sq	16.2%		50.6%		21.5%		19.5%		42.7%		23.6%	

Asterisks indicate significance at the 5 (*), 10 (**) and 1 (***) percent levels respectively.

Table 4

Post-Acquisition Cash Rewards, Performance and CEO Power

The sample includes 73 completed M&A deals of UK bidders for the period 1998-2001. The dependent variables are bonus, salary and bonus plus salary received by the CEO (Panel A) and the average executive director (Panel B) the year following the acquisition. The independent variables are listed on the left-hand side of the Table. *Size* is the book value of total assets prior to the acquisition; *Deal Value* is the GBP value of the acquisition deal (in millions); *CAR (-1;0)* is the two-day market-adjusted return for the day prior to the deal announcement and the day of the merger announcement; *Completion* is the log of the number of days between the deal announcement and the day of completion; *Industry* is a dummy variable taking the value 1 if the company is acquiring from outside its industry and 0 otherwise; *Chairman* is a dummy variable taking the value 1 if the CEO holds the Chairman position in the company; *Nominations* is a dummy variable taking the value 1 if the CEO is a member of the Nominations committee; *Ex-NE* is the ratio of Insiders in the Board; *Board Size* is the number of members in the Board of Directors; *TSR* is Total Shareholder Return; *ROA* is Earnings per share (EPS) times number of shares divided by the Book value of Total Assets.

	Panel A						**Panel B**					
	Bonus		**Salary**		**Salary + Bonus**		**Bonus**		**Salary**		**Salary + Bonus**	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
C	-51.53	-0.43	319.2	1.68	267.7	1.08	-101.9	-0.92	296.3	3.60	194.4	1.15
Size	-8E-07	-0.47	-7E-06	-0.26	-1E-06	-0.43	-1E-06	-0.80	-8E-07	-0.73	-2E-06	-0.88
Deal Value (£m)	0.135	3.94***	0.089	1.64	0.224	3.17***	0.042	1.34	0.043	1.88***	0.085	1.79*
CAR (-1;0)	-690.3	-1.46	953.7	1.27	263.4	0.27	-540.3	-1.24	73.61	0.23	-466.7	-0.69
Completion	35.80	1.31	4.128	0.10	39.93	0.71	32.63	1.32	2.007	0.11	34.64	0.92
Industry	-118.7	-2.26**	-144.5	-1.73*	-263.2	-2.43***	-89.80	-1.84*	-101.4	-2.81***	-191.2	-2.57***
Chairman	-24.95	-0.51	-25.31	-0.32	-50.26	-0.49	12.76	0.28	5.037	0.15	17.79	0.26
Nomination	-47.95	-1.03	-27.94	-0.38	-75.88	-0.79	-3.073	-0.08	47.79	0.59	44.72	0.72
Board size	15.57	1.85*	18.78	1.40	34.35	1.97*	10.99	1.43	3.338	0.58	14.33	1.22
Ex-NE ratio	-22.98	-0.58	-112.5	-1.78*	-135.5	-1.65	27.78	-0.07	-60.65	-2.22**	-32.87	-0.58
TSR	0.005	2.53***	0.002	0.75	0.007	1.81*	0.044	2.43***	0.002	1.49	0.006	2.31***
ROA	-27.25	-1.24	264.7	7.55***	237.4	5.22***	-25.91	-1.27	43.07	2.83***	17.17	0.54
Adj. R-sq	48.5%		54.2%		55.1%		20.2%		32.2%		25.0%	

Asterisks indicate significance at the 5 (*), 10 (**) and 1 (***) percent levels respectively.

Table 5

Post-Acquisition Cash Rewards, Performance and CEO Power

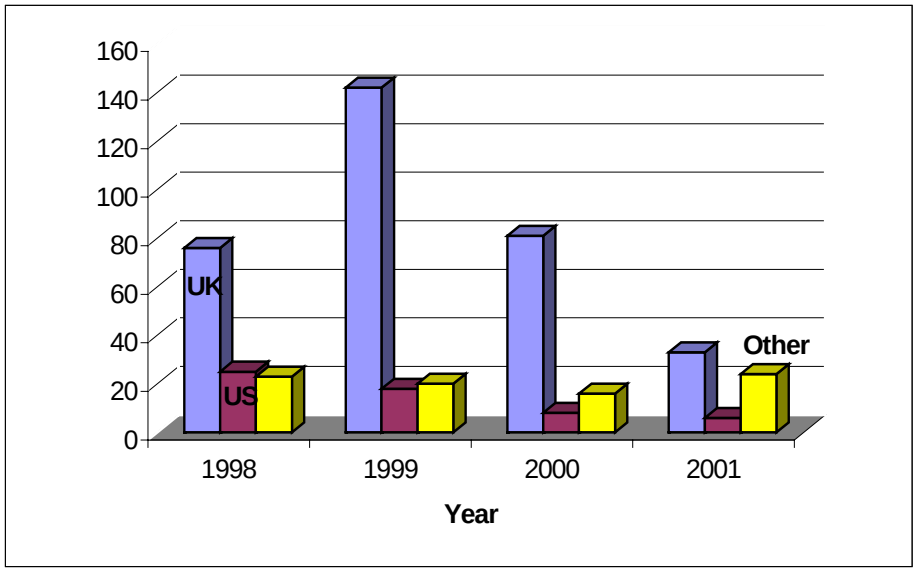
The sample includes 27 completed M&A deals of US bidders for the period 1998-2001. The dependent variables are bonus, salary and bonus plus salary received by the CEO (Panel A) and the average executive director (Panel B) the year following the acquisition. The independent variables are listed on the left-hand side of the Table. *Size* is the book value of total assets prior to the acquisition; *Deal Value* is the GBP value of the acquisition deal (in millions); *CAR (-1;0)* is the two-day market-adjusted return for the day prior to the deal announcement and the day of the merger announcement; *Completion* is the log of the number of days between the deal announcement and the day of completion; *Industry* is a dummy variable taking the value 1 if the company is acquiring from outside its industry and 0 otherwise; *Chairman* is a dummy variable taking the value 1 if the CEO holds the Chairman position in the company; *Nominations* is a dummy variable taking the value 1 if the CEO is a member of the Nominations committee; *Ex-NE* is the ratio of Insiders in the Board; *Board Size* is the number of members in the Board of Directors; *TSR* is Total Shareholder Return; *ROA* is Earnings per share (EPS) times number of shares divided by the Book value of Total Assets.

	Panel A						**Panel B**					
	Bonus		**Salary**		**Salary + Bonus**		**Bonus**		**Salary**		**Salary + Bonus**	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
C	2065.4	0.07	2867	1.47	4933	0.17	2940	0.34	2374	1.64	5315	0.55
Size	1E-04	1.37	8E-06	1.26	1E-04	1.42	3E-05	1.22	6E-06	1.22	4E-05	1.27
Deal Value (£m)	-0.043	-0.01	0.210	0.97	0.167	0.05	0.108	0.11	0.123	0.76	0.231	0.22
CAR (-1;0)	30401	0.72	3152	1.05	33552	0.77	3878	0.28	2557	1.09	6436	0.42
Completion	-1112	-0.40	116.1	0.59	-995.6	-0.35	-211.1	-0.23	95.40	0.64	-115.7	-0.12
Industry	3047	0.52	-375.7	-0.91	2672	0.44	864.5	0.47	-124.6	-0.40	739.9	0.36
Chairman	9555	1.61	664.7	1.59	10220	1.68*	1411	0.77	291.3	0.94	1702	0.83
Nomination	-6366	-1.34	128.9	0.38	-6237	-1.27	-160.9	-0.11	212.3	0.86	51.38	0.03
Board size	243.1	0.19	-75.41	-0.82	167.7	0.13	-45.52	-0.11	-63.80	-0.95	-109.3	-0.24
Ex-NE ratio	-4752	-0.37	-1632	-1.79*	-6384	-0.48	-1895	-0.47	-1384	-2.04*	-3280	-0.73
TSR	-2E-04	0.00	-0.008	-0.84	-0.008	-0.06	-0.001	-0.02	-0.002	-0.23	-0.002	-0.05
ROA	1114	0.18	1780	4.17*	2894	0.47	2291	1.26	821.2	2.66***	3112	1.53
Adj. R-sq	34.5%		54.6%		37.5%		-32.3%		38.6%		-18.2%	

Asterisks indicate significance at the 5 (*), 10 (**) and 1 (***) percent levels respectively.

Figure 1
Number of Completed Acquisitions per year of bid

Panel A. All Acquisitions



Panel B. Sample Acquisitions