

MANAGERIAL INCENTIVES, OVERCONFIDENCE, RISK-TAKING, AND ACQUIRER SHAREHOLDER VALUE CREATION IN MERGERS AND ACQUISITIONS

Sudi Sudarsanam¹
Professor of Finance & Corporate Control
School of Management
Cranfield University
Cranfield MK43 0AL
United Kingdom
p.s.sudarsanam@cranfield.ac.uk

Jian Huang
Ph.D. student in Finance
School of Management
Cranfield University
Cranfield MK43 0AL
United Kingdom
jian.huang.phd.03@cranfield.ac.uk

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¹ Corresponding author

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Abstract

This paper provides empirical evidence of strong relations among managerial incentives, risk-taking, and acquirer post-acquisition performance. Our analyses suggest that two primary measures of managerial incentives, the sensitivity of CEO wealth to stock price (Delta) and the sensitivity of CEO wealth to stock return volatility (Vega), affect managerial risk-taking propensity and acquirer acquisition performance differently. Generally, increase in Vega is associated with enhancement in acquirer shareholder value while increase Delta is related to reduction in shareholder value. Since Vega is solely related to stock option compensation while Delta originates mainly from restricted stock grant, these empirical results are consistent with the theoretical discussion of Lambert and Larcker (2004) that restricted stock grant is generally not the optimal contract form, and that stock option compensation possesses both efficiency and incentive advantage. In the analysis of acquisition-related risk change, our regression analyses support the hypotheses that increase in risk change is associated with increase in Vega while decrease in risk change is related to increase in Delta. However, even though increase in Vega is associated with increased risk due to acquisition and is directly related to acquirer post-acquisition performance, this impact does not vary with different levels of risk change. Similarly, the impact of Delta seems invariant to the level of risk change. Our analysis of managerial behavioral bias, overconfidence, is consistent with the hypothesis that managerial overconfidence provides an alternative solution to the underinvestment problem caused by managerial risk aversion. In addition to ordinary least squares regression, we employ simultaneous equations modelling to account for the endogeneity among managerial incentives, risk, and performance. To our best knowledge, our study is among the first to use the simultaneous equations model in investigating the impact of managerial incentives on shareholder value in the context of mergers and acquisitions.