CEO Preferences and Acquisitions

Journal of Finance

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The role of managers in M&A

- The theory literature regularly assumes that managers' preferences and self-interest affect M&A decisions
  - Target: Private benefits of control
  - Acquirer: Empire building
  - Both: Monetary payoffs (e.g., golden parachutes)

- However, direct evidence on the role of managers' preferences in M&A is rare
  - Cross-sectional differences in preferences are difficult to observe

What do we do?

- We use "**being at or beyond retirement age**" as a plausible indicator for <u>target</u> CEO preferences
  - Idea: Being acquired likely to be less costly for retirement-age CEOs

⇨ Results:

- We find strong evidence that target CEOs' retirement preferences affect the incidence and the pricing of takeovers
  - Firms with retirement-age CEOs are much more likely to receive takeover bids and to be acquired
    - The takeover frequency spikes for CEOs aged 64-66
  - Retirement-age CEOs receive similar (or even higher) premiums for their firms as younger CEOs
  - The spike in takeovers around age 65 is much smaller for better-governed firms
  - The spike shifts to a lower age during the 1997-99 merger wave

CEO career concerns and retirement preferences

- Target CEOs' preferences and career concerns likely at odds with target shareholders' objectives
  - Target CEOs usually lose their jobs. Rarely find a comparable position later.
    - Many target CEOs forced into early retirement
      - Walkling and Long (1984), Martin and McConnell (1991), Agrawal and Walkling (1994), Hartzell, Ofek, and Yermack (2004)

⇨ Suggests that mergers can impose large costs on target CEOs

- CEO compensation contracts recognize these costs and try to compensate through golden parachutes
  - Little empirical evidence whether this is successful

CEO career concerns and retirement preferences

- Intuitively, a CEO’s personal cost from being acquired should decline as the CEO approaches her expected retirement age
  - But: CEO age may be correlated with other CEO and firm characteristics

- **The age-65 effect:** labor economics shows that a disproportionate fraction of workers retires at age 65
  - Many more than can be explained by Social Security, Medicare, or other incentives
    - Attributed to customs and social norms
  - Employees’ preferences for work vs. retirement seem to change abruptly (or at least rapidly) around age 65

The age-65 effect for CEOs

Porbability of CEO Departure

0.23
0.21
0.19
0.17
0.15
0.13
0.11
0.09
0.07
0.05

<51 51 52 53 54 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 >69

CEO Age

- Suggests that target CEOs' personal merger costs may change around age 65

⇨ If CEOs' are sufficiently powerful, this may affect merger patterns

The age-65 effect and acquisitions

- How exactly CEOs' retirement preferences affect merger patterns depends on why CEOs retire around age 65
- Depending on the cause, might see a gradual increase in M&A activity as age 65 approaches, or a sudden increase at retirement-age
  - Holding bidder behavior constant:
    - If CEOs' benefits from continued employment smoothly decline to zero at age 65 $\Rightarrow$ gradual increase in M&A activity
    - If CEOs' benefits from continued employment decline abruptly at age 65, or if (some) CEOs are forced to retire at age 65 $\Rightarrow$ sudden increase in M&A activity
  - Bidder behavior: if sufficiently patient, wait till target CEO turns 65 $\Rightarrow$ sudden increase in M&A activity

Additional predictions

- The merger wave of 1997-99
  - Increased benefits from merging (overvaluation; technological shock)
  - Implications for the age-65 effect?
    - Retirement motives relatively less important (+urgency) => weaker age-65 effect?
    - If younger CEOs block more “good deals” before the wave, might see a larger increase in deals during the wave => shift in the peak to a younger age?
- Corporate governance
  - If the age-65 effect is driven by agency problems, it should be weaker for better governed firms
    - Better governance => more acquisitions with young target CEOs, and a smaller increase in acquisitions at retirement age

Data

- Mergers and acquisition data from the SDC database
- CEO data for 1989 - 2007 from Compustat Research Insight CDs (formerly Compustat PC Plus)
  - Made available by Fee, Hadlock, and Pierce (2013)
  - Includes Compustat firms with at least $10 million in book assets, excludes financial firms, utilities and firms incorporated outside the U.S.
  - CEO age data and turnover years hand-verified
- Results in 4,640 firms and 56,183 firm-years
- Accounting data from Compustat
- Stock price and return information from CRSP

Empirical analysis

We examine the “effect” of having a retirement-age CEO on:

1) Acquisition frequencies

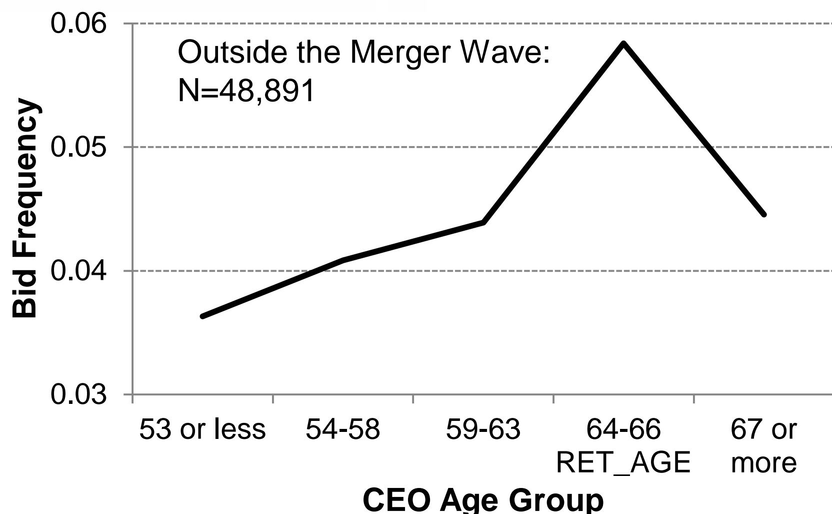
2) Deal pricing (i.e., takeover premiums)

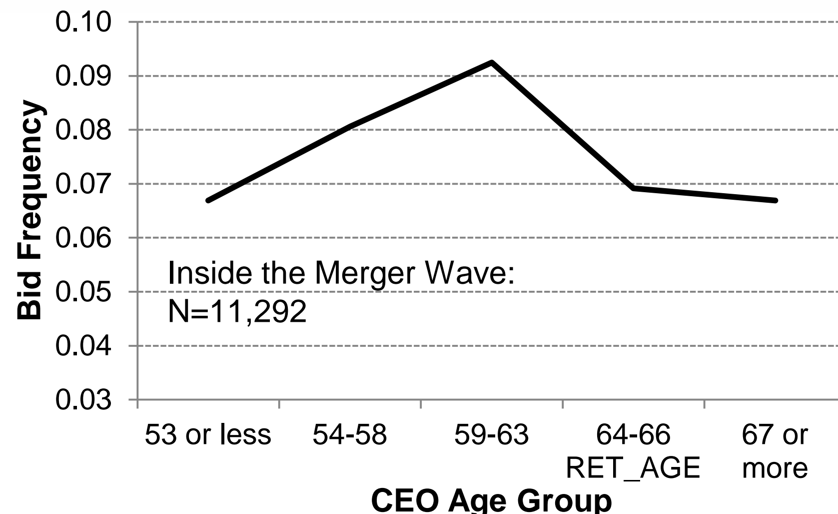
The effect of CEO age on acquisition frequencies

Logit model: Dep. variable = 1 if a firm receives a successful bid in a given year
Other controls include CEO tenure, founder dummy, target size, B/M, past ROA, past return

	Full sample		Outside Wave	Merger Wave	Full sample		Outside Wave	Merger Wave
AGE ≥ 67	-0.01	-0.01	0.07	-0.19				
	(-0.05)	(-0.06)	(0.47)	(-1.37)				
RET_AGE (64-66)	**0.34**	**0.24**	**0.35**	**-0.16**	**0.28**	**0.18**	**0.28**	**-0.18**
	(4.08)	**(2.66)**	**(4.07)**	**(-1.39)**	**(3.21)**	**(1.85)**	**(2.95)**	**(-0.87)**
AGE 59-63	0.10	0.10	0.07	0.16				
	(1.36)	(1.35)	(0.83)	(1.11)				
AGE ≤ 53	-0.14	-0.14	-0.12	-0.19				
	(-3.11)	(-3.12)	(-2.20)	(-2.25)				
RET_AGE*Wave	-0.45				-0.46			
	(-2.49)				(-2.51)			
CEO Age					0.05	0.05	0.03	0.11
					(1.60)	(1.60)	(0.68)	(3.15)
CEO Age Squared					0.00	0.00	0.00	0.00
					(-1.26)	(-1.26)	(-0.40)	(-2.74)
Wave	1.43	1.41			1.42	1.40		
	(31.17)	(27.94)			(30.30)	(27.24)		

Implied bid probabilities as a function of CEO age





- The effect of the merger wave
  - For younger CEOs: Takeover volumes increased about two-fold (e.g., 4.1% to 8.1% for age 54-58)
  - For retirement-age CEOs: a much smaller increase (5.8% to 6.9%)
  - As a result the peak in acquisition frequency shifts to the 59-63 group
  - Possible explanations:
    - Before the wave younger CEOs block more “good” deals => unblocked by the wave
    - The wave increased synergies more for firms led by young CEOs (e.g., technology firms)

Governance and the age-65 effect

Each governance measure orthogonalized w.r.t. CEO and firm characteristics

GOVQ = governance index (formed from the individual measures) -> {0,1,2}

	Coef.	T-stat.		Coef.	T-stat.
RET_AGE	**0.31**	**2.65**		**1.23**	**3.76**
RET_AGE*GOVQ	**-0.18**	**-3.17**			
GOVQ	**0.07**	**3.69**			
RET_AGE*Block Own				**-0.26**	**-1.83**
RET_AGE*CEO Own				**-0.09**	**-0.74**
RET_AGE*Director Own				**0.04**	**0.16**
RET_AGE*Separation				**-0.35**	**-2.02**
RET_AGE*Independence				**-0.00**	**-0.02**
RET_AGE*Small Board				**-0.26**	**-2.12**
Block Own				0.15	4.16
CEO Own				-0.01	-0.34
Director Own				-0.04	-0.78
Separation				0.09	2.20
Independence				0.12	3.68
Small Board				0.11	3.15

The “effect” on target shareholder gains

- Several reasons to expect acquisition premiums to be lower for targets with retirement-age CEOs:
  1) The additional deals done around 65 might be relatively low-synergy deals that retirement-age CEOs do but younger CEOs (with higher personal costs) reject
  2) Investors might (correctly) view bids for firms with retirement-age CEOs as more likely, causing target valuations to increase already before the bid
  3) Retirement-age CEOs might bargain less hard and capture a smaller fraction of the synergies for their shareholders

- But: Bad governance might cause premiums to be especially high for deals at retirement age
  - Firms with bad governance are overrepresented among firms acquired around age 65
  - Firms with bad governance might benefit the most from being acquired
    - The value-added from changing management is high

The "effect" of CEO age on target shareholder gains

Dep. Variable = Takeover premium (-20, final offer)
Sample: 2,801 completed takeovers from 1989-2007
Controls include deal, bidder, target, and CEO characteristics

	Takeover premium		
AGE ≥ 67	-6.97	-7.66	-9.76
	(-2.32)	(-1.91)	(-1.64)
RET_AGE (64-66)	**5.52**	**4.91**	**5.26**
	(1.77)	**(1.49)**	**(1.06)**
AGE 59-63	2.51		
	(1.14)		
AGE 54-58	1.78		
	(1.33)		
AGE ≤ 53		-0.42	-0.16
		(-0.48)	(-0.15)
CEO age		0.00	0.00
		(0.38)	(0.11)
CEO age squared	-6.97	-7.66	-9.76
	(-2.32)	(-1.91)	(-1.64)

- Similar premiums for retirement-age and younger CEOs
  - Consistent with governance results: CEOs that sell at 65 are more likely in badly governed firms that benefit from being acquired
- CEOs older than 66 receive much lower premiums
  - Unexpected
  - A selection effect linked to retirements?
    - Firms run by CEOs older than 66 are different

What does it all mean?

- Results suggest that CEO preferences affect M&A behavior
  - Consistent with the hypothesis that young CEOs are on average too reluctant to sell their firms, and that retirement-age CEOs behave closer to the first-best

- Important: what we observe is the combined effect of CEO preferences <u>and</u> boards' endogenous reactions to them

1) Endogenous decision to have a retirement-age CEO
   - CEOs are bundles of attributes, difficult to optimally match on all dimensions at all times
2) Endogenous adjustment of compensation contracts (golden parachutes) to changing CEO preferences
   - Larger golden parachutes for younger CEOs?
     - Works against the pattern we document

Alternative explanations

1) Old interim CEOs
   - No: All results go through when we exclude CEOs in their first two tenure years

2) More disciplinary takeovers with old CEOs
   - No: Firms of retirement-age CEOs perform similarly before the takeover bids
     - No evidence that the age-65 effect is stronger for bad performers

3) Succession problems in firms with old CEOs
   - Possible. However, sharp increase in M&A activity at age 65 still requires a discrete change in the old CEOs' desire to leave
     - No evidence that the age-65 effect is stronger in industries or firms in which we expect succession problems to be more severe

Conclusions

- There is a sharp increase in takeover frequencies when target CEOs reach retirement age
  - The additional deals are done at similar premiums as other deals
  - The increase is driven by firms with “bad” corporate governance
- Suggests that CEOs’ preferences have a significant impact on takeover decisions and shareholder value
- **Big picture: CEOs’ self-interest affects firm behavior**
  - Boards apparently not strong enough to prevent CEOs from imposing their preferences on firm behavior
  - Makes it likely that other CEO preferences, such as empire building or the desire for a quiet life, also affect firm behavior