WHAT'S DRIVING ACQUISITIONS? AN IN-DEPTH ANALYSIS OF CEO DRIVERS DETERMINING MODERN FIRM ACQUISITION STRATEGY

Jennifer E. Wuebker *

INTRODUCTION

Firms pursuing growth strategies often perceive mergers and acquisitions as the most efficient means to obtain additional resources and increase firm value.[1] But who decides which firm to acquire and when? And what factors motivate this decision? Preferably, the decision to acquire stems from shareholder value, with strategic decision making confidently rooted in financial justifications projecting a positive return. Opportunistic synergies for the aggregate entity moving forward should further attest to the deal's value, with the ultimate decision resting in the hands of a capable board. But researchers do not seem convinced. Overwhelming evidence indicates that acquisitions tend to harm acquiring firms more than they help.[2] This article argues certain drivers impact the decision to acquire and examines current drivers in acquisitions. Additionally, this article parses these drivers into two broad categories—value-enhancing drivers and private-interest drivers—and recommends that boards consider these drivers in developing acquisitive strategy. Specifically, drivers should guide board determination of the level of scrutiny to use when evaluating target firms and board implementation of process and payment changes capable of mitigating the potential negative impacts of acquisition drivers.

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* Law Clerk to the Honorable H. Christopher Mott, United States Bankruptcy Court, Western District of Texas, Austin, Texas. J.D., 2015, University of Richmond School of Law; M.B.A., 2015, University of Richmond Robins School of Business; B.A., 2011, University of Richmond.

1. Carol Yeh-Yun Lin & Yu-Chen Wei, *The Role of Business Ethics in Merger and Acquisition Success: An Empirical Study*, 69 J. BUS. ETHICS 95, 97 (2006) (stating that acquisitions present the most efficient way for firms pursuing growth strategies to obtain external human and financial resources as well as expand operational domain).

2. *See infra* Part II.

Part I provides an overview of the acquisition landscape, including a brief history of the prevalence and success of acquisitions as well as an analysis of acquisitions today. Part II outlines the acquisition process and highlights the importance and dynamics of decision making, both in principle and in practice. Part III explores two theories of acquisitive strategy driving CEO decision making: value enhancement and private interest. Part IV analyzes the implications of CEO personality and psychological drivers on acquisition strategy and decision making. This article argues that CEO traits are central decision drivers, but that no particular set of traits can predict or determine the viability of an acquisition. Further, current mechanisms aimed at protecting against CEO greed remain insufficient to prevent the consummation of bad deals. The board of directors must understand and systematically consider the impact of specific drivers, facing the acquisition decision with higher scrutiny for CEOs exhibiting multiple drivers or drivers with particular likelihood to impact the acquisition's return on investment.

I. ACQUISITIONS: THE LANDSCAPE

Successfully integrated acquisitions can significantly increase firm value for both the CEO and shareholders of the acquiring firm.[3] Yet "acquisitions have been found to have a neutral to negative effect on the shareholder wealth of acquiring firms."[4] A ho-

3. *See* Cynthia E. Devers et al., *Do They Walk the Talk? Gauging Acquiring CEO and Director Confidence in the Value Creation Potential of Announced Acquisitions*, 56 ACAD. MGMT. J. 1679, 1680 (2013).

4. Mathew L.A. Hayward & Donald C. Hambrick, *Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris*, 42 ADMIN. SCI. Q. 103, 103 (1997) (citing Elazar Berkovitch & M.P. Narayanan, *Motives for Takeovers: An Empirical Investigation*, 28 J. FIN. & QUANTITATIVE ANALYSIS 347, 347–62 (1993)). Berkovitch and Narayanan assessed a database of 330 tender offers made between 1963 and 1988. Elazar Berkovitch & M.P. Narcyanan, *Motives for Takeovers: An Empirical Investigation*, 28 J. FIN. & QUANTITATIVE ANALYSIS 347, 349 (1993). The sample was selected based on the following criteria:

> (1) the shares of both the acquirer and the target were traded on the New York Stock Exchange or the American Stock Exchange, (2) the price and/or number of shares outstanding is available for each of the six days before the event date, and (3) sufficient daily stock return data is available to estimate the market model.

Id. at 353. The data came from the database of Michael Bradley and the Office of the Economic Analysis of the SEC. *Id.* at 353 n.5. The authors hypothesized three motivations for acquisitions: synergy, agency, and hubris, and considered the overall net value of acquisitions. *Id.* at 347. The authors concluded that, on average, takeovers yield positive net values. *Id.* This positive value is directly correlated with the subset of target firm value, and listic understanding of decision drivers exhibited by CEOs in acquiring firms and board processes in acquisitions today requires an understanding of the evolution of acquisitions.

A. *History of Acquisitions*

Firms have been engaging in acquisitions for decades. The frequency of these deals, however, has rapidly increased since the early 1990s. Firms announced more acquisitions in 1995 than any prior year,[5] and in 2001, approximately 30% of the world's top organizations were considering a merger or acquisition.[6] In the first half of 2004, the total value of mergers and acquisitions ("M&A") reached $394.2 billion.[7] Similarly in 2004, firms completed approximately 30,000 acquisitions globally, equating to one such transaction every eighteen minutes, with over $1.9 trillion in total value.[8] "In 2005, worldwide M&A volume surged to more than $2.3 trillion, indicating a new wave of strategic deal making."[9]

B. *Current Acquisition Landscape*

Despite the downturn of the economy in 2008, firms worldwide announced as many as 64,981 M&A in 2009.[10] 2014 proved to be the "most active mergers and acquisitions market in years,"[11] reinforcing the importance of M&A today. In fact, a study conducted by Ulrike Malmendier and Geoffrey Tate in 2008 noted that "U.S. firms spent more than $3.4 trillion on over 12,000 mergers

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negatively correlated with the subset of acquiring firm value, indicating the target firm receives value while the acquiring firm actually suffers a net loss. *See id.* at 349.

5. Hayward & Hambrick, *supra* note 4, at 103.

6. Lin & Wei, *supra* note 1, at 97.

7. Aleksey A. Tikhomirov & William D. Spangler, *Neo-Charismatic Leadership and the Fate of Mergers and Acquisitions: An Institutional Model of CEO Leadership*, 17 J. LEADERSHIP & ORG. STUD. 44, 45 (2010).

8. Susan Cartwright & Richard Schoenberg, *Thirty Years of Mergers and Acquisitions Research: Recent Advances and Future Opportunities*, 17 BRIT. J. MGMT. S1, S1 (2006).

9. Tikhomirov & Spangler, *supra* note 7, at 45.

10. Martin Spraggon & Virginia Bodolica, *Post-Acquisition Structuring of CEO Pay Packages: Incentives and Punishments*, 9 STRATEGIC ORG. 187, 188 (2011) (stating that these transactions were valued at $3.62 trillion).

11. Dana Mattioli & Dana Cimilluca, *Deal Boom Feeds on Surging Stocks*, WALL ST. J. (Nov. 17, 2014, 7:33 PM), http://wsj.com/articles/deal-boom-feeds-on-surging-stocks-1416270817 (stating that "[a]t roughly $3.1 trillion, the current dollar volume of announced deals and offers globally is higher than in any full year since 2007 . . ."). For a graph of U.S. and global trends in mergers and acquisitions, see Appendix A.

during the last two decades."[12] These numbers continue to grow rapidly. The Wall Street Journal recently reported more than $3.4 trillion of M&A deal flow in 2014 alone.[13] "The deal market is on a tear," with current global takeover activity indicating a 32% increase over last year's total.[14]

Theoretically, this deal flow should result in substantial growth in the value of the acquiring firms. Yet, acquiring shareholders lost over $220 billion as a direct result of the announcement of M&A bids between 1980 and 2001,[15] and acquisitions today may prove to be less fruitful for these shareholders.[16] Despite numerous empirical studies and CEO attestations to the inherent value of acquisitions, the past thirty years tell a different story.[17] Acquisitions have a history of producing negative average returns for the acquiring firm.[18]

There is a consensus among empirical studies that acquisitions enhance value for shareholders in target firms only.[19] Conversely, many acquisitions are value-neutral at best, and often unfavorable, for acquiring firms.[20] Richard Roll first formalized this notion

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12. Ulrike Malmendier & Geoffrey Tate, *Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction*, 89 J. FIN. ECON. 20, 21 (2008).

13. Dana Mattioli & Dana Cimilluca, *To Last, M&A Boom Needs to Broaden*, WALL ST. J. (JAN. 1, 2015), http://www.wsj.com/articles/to-last-m-a-boom-needs-to-broaden-1420130620 (according to Dealogic, "[t]hat is the most since the height of the last deal boom in 2007, when there was a record $4.3 trillion of transactions").

14. Mattioli & Cimilluca, *supra* note 11.

15. Malmendier & Tate, *supra* note 12, at 21 (citing Sara B. Moeller et al., *Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave*, 60 J. FIN. 757, 757–58 (2005) (finding that, at the announcement of acquisitions, acquiring-firm shareholders lost an average of $0.12 for every dollar spent for a total loss of $240 billion between 1998 and 2001)).

16. *See generally* G. Alexandridis et al., *Gains from Mergers and Acquisitions Around the World: New Evidence*, 39 FIN. MGMT. 1671 (2010).

17. *See* Cartwright & Schoenberg, *supra* note 8, at S4.

18. *See id.*

19. Rayna Brown & Neal Sarma, *CEO Overconfidence, CEO Dominance and Corporate Acquisitions*, 59 J. ECON. & BUS. 358, 360 (2007) (suggesting that a number of "explanations for this disappointing outcome for acquirers" exist).

20. *Id.* (citing Gregor Andrade et al., *New Evidence and Perspectives on Mergers*, 15 J. ECON. PERSP. 103, 110 (2001) (finding a positive abnormal return of 16% to targets (remarkably consistent over time) and a negative, but insignificant abnormal return to acquirers); Terry Walter & Raymond da Silva Rosa, *Australian Mergers and Acquisitions Since the 1980s: What Do We Know and What Remains to Be Done?*, 29 AUSTL. J. MGMT. (Special Issue) i, iv, ix (2004) (indicating that "the evidence is unequivocal . . . target firm shareholders benefit considerably" whereas significant decreases in acquirer share prices coupled with long-term losses make reconciling acquisitions with the value-enhancing hypotheses difficult)); *see also* Alexandridis et al., *supra* note 16.

and its nexus to the winner's curse[21] in 1986 by linking a CEO's propensity for overbidding to the negative returns for shareholders.[22] "The implications of overconfidence for mergers and acquisitions, however, are more subtle than mere overbidding."[23] More drivers play into the value balance.

Furthermore, market response to acquisition announcements reflects the bane of the winner's curse; the acquirer's stock is almost always marked down.[24] This creates an initial negative impact on firm value and precipitates long-term devaluation. The "adverse market reaction is reinforced by findings that acquisitions lead to declines in the acquiror's longer-term profitability and shareholder returns" in the future,[25] suggesting that acquisitions not only create complexities and hobble nimble firms, but also cause lasting financial damage.

II. ACQUISITION STRATEGY: WHO DECIDES?

A. *Acquisition Process*

Acquisitions constitute one of the more central strategic decisions made by executives.[26] The process begins "with the emergence of the acquisition idea and the evaluation and selection of the target."[27] Performance pressures and specialized industry knowledge often make CEOs a common source for inception of the acquisition idea,[28] placing initial control of the process in the

21. *See* Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 200 (1986). The "winner's curse" focuses on the psychological effects of bidding environments and the proclivity for overbidding. *Id.* Because each bidder seeks to win, he or she bids high, often higher than the true value. *Id.* This behavior is reinforced by the reward: winning. *Id.* The winner of the auction, however, is in fact the loser because he or she has overpaid, decreasing his or her overall value. *Id.* The curse assumes bidders focus more on winning and less on rational decision making. *Id.*

22. Malmendier & Tate, *supra* note 12, at 21 (citing Roll, *supra* note 21, at 198) (finding that in the process of overbidding, CEOs effectively transfer most of the value generated by the acquisition from the acquiring firm to the target firm).

23. *Id.*

24. Hayward & Hambrick, *supra* note 4, at 103 ("[I]nvestors mark down the stock of acquirors following takeover announcements."); *see also* Brown & Sarma, *supra* note 19, at 360 ("[A] significant negative abnormal return accrues to bidding firms upon the announcement of a diversifying acquisition.") (citing Randall Morck et al., *Do Managerial Objectives Drive Bad Acquisitions?*, 45 J. FIN. 31, 31–48 (1990)).

25. Hayward & Hambrick, *supra* note 4, at 103 (citations omitted).

26. *See id.* at 120.

27. Tikhomirov & Spangler, *supra* note 7, at 45.

28. *Id.* at 46 (stating that the acquisition process "has a notorious aura of secrecy, par-

CEO's hands. The board of directors may appoint a committee charged with supervising the acquisition process, including due diligence, negotiating price, managing announcement of the deal, and orchestrating integration.[29] The ultimate decision-making process, however, remains murky.

B. *Decision Making in Principle*

Inappropriate decision making or integration, as well as poor negotiation and pricing of the target firm, "can lead to inferior acquisition outcomes."[30] As a result, careful, measured decision making remains key. Although no set of particular guidelines apply to acquisition strategy, such decisions are often evaluated based on three principles: (i) the degree to which the board and management engaged in strategic planning; (ii) whether the board and management fulfilled their fiduciary duty[31] to the firm's shareholders; and (iii) how well the board and management integrate the target and recognize potential synergies. This framework elicits a particular decision-making process. The board should evaluate a proposed target acquisition for its fit within the overall corporate strategy. If the target fits appropriately, the board and management may pursue the target and engage in due diligence.

C. *Decision Making in Practice*

"If shareholders could perfectly monitor and control the investment decisions of managers, acquisitions that reduce shareholder wealth because they deliver managerial benefits would not

ticularly when the acquisition strategy is early in the making," creating deeper connections between CEO knowledge and decision making within the acquisition committee and entrenching information asymmetry).

29. *Id.* at 45.

30. Cartwright & Schoenberg, *supra* note 8, at S3.

31. Management and the board are bound by the duty of care. *See generally* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)) ("[A] director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty. [Where] there are no allegations of fraud, bad faith, or self-dealing, or proof thereof . . . it is presumed that the directors reached their business judgment in good faith. . . . 'While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.'").

be allowed,"[32] or at least the advent of such decisions would likely decrease substantially. Managers of large, public firms, however, typically receive only loose scrutiny.[33] The CEO proves instrumental in the acquisition decision[34] because boards give managers considerable leeway in the formation of acquisition strategy.[35] Boards often fail to utilize forms of punishment, such as removal or reduction of pay,[36] as retribution for poor acquisition performance. This perpetuates the often reckless acquisitive strategy of CEOs.[37] This parting from principle occurs for many reasons.

First, there remains a vast information gap between the CEO on one hand and the board and shareholders on the other, even at the inception of a proposed acquisition. Most aware of investment or acquisition opportunities, CEOs often control the deal inception.[38] Having seized this control, they often do not relinquish it at any point in the process.[39] This information asymmetry is furthered by specialized industry knowledge and may prove difficult for shareholders to rectify or overcome.[40] Boards seem to give wide deference to CEOs who appear most closely related to target opportunities, relying on the perceived expertise of the CEO to determine the viability of an acquisition.

Second, few acquisition plans could survive without first receiving vigorous support and approval from the CEO. "It is virtually inconceivable that terms of a major acquisition could proceed to the board without the CEO's personal sponsorship."[41] In fact, the role of CEO disposition may be even greater with respect to acquisition decision making than any other strategic planning or decision-making process.[42] By championing a deal, the CEO may taint the board's perception. Whether weak, compliant, or in-

32. Randall Morck et al., *Do Managerial Objectives Drive Bad Acquisitions?*, 45 J. FIN. 31, 32 (1990).

33. *Id.*

34. Nina T. Dorata & Steven T. Petra, *CEO Duality and Compensation in the Market for Corporate Control*, 34 MANAGERIAL FIN. 342, 343 (2008).

35. Morck et al., *supra* note 32.

36. *See* Andrei Shleifer & Robert W. Vishny, *Value Maximization and the Acquisition Process*, 2 J. ECON. PERSP. 7, 8 (1988).

37. *See* Morck et al., *supra* note 32.

38. *See infra* Part III.

39. *See* Yung-I Lou et al., *Determinants of Chief Executive Officer Compensation*, 7 INT'L J. BUS. & FIN. RES. 29, 32 (2013).

40. *Id.*

41. Hayward & Hambrick, *supra* note 4, at 107.

42. *Id.* at 120.

volved, the CEO's endorsement will likely sway the board to accept that the deal is a good one,[43] often without properly reviewing the firm's due diligence.[44] This can facilitate ineffective or fruitless acquisitions with mediocre to non-existent shareholder returns for the acquiring firm.

III. CEO DEAL DRIVERS

The CEO serves as the highest-ranking executive within a firm and ultimately bears responsibility for the success or failure of the firm.[45] As a result, the CEO likely enjoys wide deference in determining acquisition strategy. The CEO considers factors suggesting that an acquisition will increase the value of the CEO's firm. Part A outlines such factors, but proceeds to caution that these factors may prove illusory.

But "[i]ndividual, group, and social factors, not efficient strategic calculation, drive key decisions" in a firm,[46] and the relationship between the board and management can have vast implications in implementing acquisition strategy. Human factors "clearly manifest themselves" in large-firm acquisition strategies,[47] and therefore merit careful consideration in order to understand why firms continue to acquire. Part B identifies and discusses factors that motivate CEO support of acquisitions but are divorced from benefits that might accrue to the firm.

A. *Value-Enhancement Drivers*

One line of reasoning considers acquisitions based on their purported value enhancement. These acquisition drivers share a common notion: the motivation of acquisitive CEOs by the long-term potential of acquisitions and pursuit of acquisitions believed

43. *See* Ranjay Gulati & James D. Westphal, *Cooperative or Controlling? The Effects of CEO-Board Relations and the Content of Interlocks on the Formation of Joint Ventures*, 44 ADMIN. SCI. Q. 473, 473, 480 (suggesting that "CEO-board relationships characterized by independent board control reduce the likelihood of alliance formation by prompting distrust between corporate leaders, while CEO-board cooperation in strategic decision making appears to promote alliance formation by enhancing trust" and that trust in the CEO may influence board decision making).

44. *Id.* at 501.

45. Emilia Peni, *CEO and Chairperson Characteristics and Firm Performance*, 18 J. MGMT. & GOVERNANCE 185, 189 (2014).

46. Hayward & Hambrick, *supra* note 4, at 105 (citations omitted).

47. *Id.* at 119.

to offer value-enhancing opportunities.[48] Assuming the inherent rationality of CEOs, value-enhancement drivers will only lead a CEO to acquire a target firm when he or she confidently perceives the acquisition holds strong potential for sustainable growth and when he or she possesses the ability to achieve such potential.[49] This type of driver is summarily manifested in four, distinct motivations: private synergies, access to superior information, market-share growth, and CEO hubris.

1. Private Synergies

Private synergies reflect a CEO's notion that something specific and unique about the target firm will mesh particularly well with something inherent in the acquiring firm, creating added value through the acquisition. CEOs will make acquisitions when they obtain specific information indicating the presence of a particular synergistic opportunity capable of creating enhanced value by exploiting complementary resources or capabilities.[50] The decision to acquire a target firm rests on whether that firm presents such synergistic opportunities that will render the aggregate firm more valuable than the sum of the individual firms.[51]

2. Access to Superior Information

Another potential driver for CEO acquisition strategy derives from access to superior information. Under this line of thought, the CEO believes that he or she possesses "asymmetric or superior information" that permits the CEO to recognize potential more aptly than others.[52] The CEO believes he or she can capitalize—through the acquisition—on opportunities competitors have not yet realized.[53] This drives the CEO to move forward without

48. Devers et al., *supra* note 3, at 1682.

49. *See id.*

50. *Id.* at 1681.

51. *Id.*; *see also* Jeffrey. S. Harrison et al., *Mergers and Acquisitions: A Value Creating or Value Destroying Strategy*, *in* THE BLACKWELL HANDBOOK OF STRATEGIC MANAGEMENT 384, 384–408 (R. Edward Freeman et al. eds., 2001); Hayward & Hambrick, *supra* note 4, at 105 (finding that "commonalities or complementaries between the acquiror and target enable the combined value of the firms to exceed their value as two independent entities" and suggesting that synergistic opportunities exist); James M. Mahoney & Joseph T. Mahoney, *An Empirical Investigation of the Effect of Corporate Charter Antitakeover Amendments on Stockholder Wealth*, 14 STRATEGIC MGMT. J. 17, 21 (1993).

52. Devers et al., *supra* note 3, at 1681.

53. *Id.* at 1681–82 (citations omitted).

properly considering the risk or reward apparent in an acquisition and, perhaps prematurely, without proper vetting of potential targets. Further, this perceived private information may preclude the CEO from rationally considering the input of the board, mistakenly assuming that the board lacks cognizance of the same information. Although the CEO could, and likely should, share the information with the board, the CEO may not feel the board will understand his or her unique take on the deal or may wish to preserve the secrecy to further entrench his or her authority. Opacity of information permits the CEO to start in charge and stay in charge.

3. Market-Share Growth

Growth remains one of the most salient corporate goals. Perhaps the quickest way for large firms, in particular, to achieve such growth lies in capturing market share through acquisition.[54] The CEO can simultaneously gain market share and decrease competition through acquiring similar and competing firms.[55] In turn, increased scale permits the firm to explore cost-reduction strategies.[56] The CEO creates shareholder value through increased leverage and decreased production costs, likely increasing profits.[57] Thus, it is no surprise that substantial growth may allure CEOs into supporting more aggressive or risky acquisitions.

Economic theory supports this idea by positing that superior firms seek out inferior firms for the value potential; inefficient managers will be forced out by acquirers attempting to extract untapped potential.[58] Although the process of large firms engulfing smaller firms often plays a role in the life cycle of corporations, acquiring firms do not always possess the superior management they envision. In fact, these firms often struggle to integrate their targets.[59] The post-acquisition entity proves too

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54. *See, e.g.*, Satish Shankar et al., *How to Win in Emerging Markets*, 49 MIT SLOAN MGMT. REV. 19, 20–21 (2008) (reviewing the decision for Philip Morris to acquire Sampoerna and finding the firm experienced "an enormous success" with a jump in market share of 1.5% to nearly 28%—enabling Philip Morris to become the market leader).

55. Devers et al., *supra* note 3, at 1682.

56. *Id.*

57. *Id.*

58. Hayward & Hambrick, *supra* note 4, at 104.

59. *See, e.g.*, Don Clark & Tess Stynes, *Riverbed Agrees to be Bought Out by Thoma Bravo for $3.6 Billion*, WALL ST. J. (Dec. 15, 2014), http://www.wsj.com/articles/riverbed-

complex to recognize the perceived potential. As a result, the firm becomes more fragmented, inefficient, and difficult to manage. Regardless, the allure of larger market share likely plays a sizable role in acquisitions driven by perceived value.

4. CEO Hubris Distorting Value-Enhancing Drivers

While each of the value drivers can contribute to a profitable acquisition, each can prove illusory in a particular case, and the probability that these drivers will constitute only illusions increases with evidence of CEO hubris. Hubris is "exaggerated pride or self-confidence,"[60] often including overconfidence. This overconfidence is intrinsic to the individual[61] and can derive from strong recent firm performance, media hype, or the measure of a CEO's compensation relative to other directors or managers.[62] "Psychologists suggest that individuals are especially overconfident about outcomes they believe are under their control."[63] Overconfident CEOs often fall into the trap of predicting greater synergies between the target and acquiring firms than are achievable.[64] "[O]verconfident CEOs are likely to undertake more acquisition[s],"[65] and prove more likely to engage in "value-destroying" projects that dispassionate analysis would reject.[66]

Further, CEOs often make acquisitions because they overvalue their own managerial skills and believe their managerial strengths can resurrect a diminishing or fledgling target firm.[67] This hubris encourages CEOs to acquire target firms based on the

agrees-to-be-bought-out-by-thoma-bravo-for-3-3-billion-1418652793 (reporting that Riverbed suffered financial hardship after a series of acquisitions culminating in apparent "trouble integrating Opnet"—ultimately resulting in the firm's purchase by private equity firm Thoma Bravo).

60. Hayward & Hambrick, *supra* note 4, at 106 (quoting *Hubris*, WEBSTER'S NEW COLLEGIATE DICTIONARY (9th ed. 1983)).

61. Brown & Sarma, *supra* note 19, at 363.

62. *Id.* at 361 (utilizing a measure of the difference between compensation of the CEO and compensation of top management as an indicator of CEO over-confidence).

63. Malmendier & Tate, *supra* note 12, at 22 (citing James G. March & Zur Shapira, *Managerial Perspectives on Risk and Risk Taking*, 33 MGMT. SCI. 1404, 1404–18 (1987)).

64. Brown & Sarma, *supra* note 19, at 361.

65. Shantanu Dutta et al., *CEO Power, M&A Decisions, and Market Reactions*, 21 J. MULTINATIONAL FIN. MGMT. 257, 258 (2011).

66. Malmendier & Tate, *supra* note 12, at 22.

67. Devers et al., *supra* note 3, at 1682; *see also* Hayward & Hambrick, *supra* note 4, at 104 ("[A]cquiring managers overestimate their ability to extract value from acquisitions.").

purported ability of the CEO to successfully integrate the firms and increase value through synergies.[68] CEOs often fall victim to gross overestimation of future value.[69] CEO hubris likely increases the probability that the CEO's confidence in profit from synergies is unwarranted, thereby increasing the likelihood that the CEO overvalues the information regarding the target firm and overestimates his or her ability to capitalize on that information.

These dangers derive from innocent miscalculation driven by arrogance or willful blindness or potential drawbacks. The next set of drivers, however, are more pernicious.

B. *Private-Interest Drivers*

CEOs may be driven to acquire target firms by self-interest. Scholars have begun to recognize that CEOs can derive substantial compensation and personal benefits from acquisitions regardless of the return to shareholders or the measure of success or failure of the acquisition.[70] Although it remains possible for executives to balance the interests of shareholders jointly with their own, the likelihood that "executives may make decisions that satisfy their own interests at the expense of the shareholders" still weighs heavily.[71] As a result, the board should not disregard personal drivers influencing CEO decision making. These personal drivers often surface through greater compensation for the CEO, a desire to engage in empire building, and job security.

1. Greater Compensation

Enhanced CEO compensation likely plays a pivotal role in determining acquisition strategy. We know CEO compensation increases following acquisitions,[72] and compensation often surfaces

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68. Devers et al., *supra* note 3, at 1682.

69. Brown & Sarma, *supra* note 19, at 362 (finding that a CEO often believes the company's equity is undervalued in the current market, causing the CEO to overvalue the potential return on the proposed union of the firms).

70. Devers et al., *supra* note 3, at 1683; Hayward & Hambrick, *supra* note 4, at 105; *see also* DONALD DEPAMPHILLIS, MERGERS, ACQUISITIONS, AND OTHER RESTRUCTURING ACTIVITIES 31 (4th ed. 2007); Cartwright & Schoenberg, *supra* note 8, at S4 (indicating that in 2000, studies showed 26% of U.S. cross-border acquisitions stemmed from manager instigated deals focused on personal gain rather than shareholder value).

71. S. Trevis Certo et al., *Board of Directors' Self Interest: Expanding for Pay in Corporate Acquisitions?*, 77 J. BUS. ETHICS 219, 221 (2008).

72. *Id.* at 223.

as a prime motivation for driving acquisitions.[73] Professors Shantanu Dutta, Kenneth MacAulay, and Samir Saadi examined incentive compensation in relation to M&A deals in over 1000 completed Canadian M&A mergers and acquisitions.[74] These authors found that M&A bonuses "are positively related to managerial power: managers who have more board power are likely to get substantially higher bonuses, to engage in larger deals, and to have substantially smaller announcement returns."[75] Perhaps CEOs continue to pursue acquisitions despite a history of net loss, in part, due to the allure of such bonuses.

Further, corporate acquisitions are often a crucial factor in determining annual CEO compensation.[76] Annual compensation typically correlates with firm size, creating additional incentive to increase firm size by any means.[77] Because acquisitions induce rapid firm growth, acquisitive CEOs achieve similarly rapidly growing compensation packages;[78] CEOs may prove inclined to make acquisitions to increase total firm size.[79] Recent studies have indicated this increase in compensation post-acquisition oc-

73. Dorata & Petra, *supra* note 34, at 342.

74. Dutta et al., *supra* note 65, at 265 tbl.1. "This study considered all Canadian M&A deals [occurring] between 1997 [and] 2005 and involv[ing] TSX-listed bidding compan[ies]." *Id.* at 264. Importantly, this timeframe spans two large regulatory changes in Canada impacting Canadian companies, the Dey Report in 1994 and the Toronto Stock Exchange governance guidelines in 1995, as well as the time-period during which the United States implemented Sarbanes-Oxley. *Id*. The authors required that all deals within the study meet two criteria: (i) the deals were completed and (ii) the acquiring firm was not a member of the financial industry. *Id*. The study did not eliminate acquiring firms with multiple acquisitions during the period, nor did it discriminate based on the size of the deal. *Id*.

75. *Id.* at 258 (quoting Yaniv Grinstein & Paul Horibar, *CEO Compensation and Incentives: Evidence from M&A Bonuses*, 73 J. FIN. ECON. 119, 121 (2004)).

76. Dutta et al., *supra* note 65, at 258 (noting that a CEO can maximize compensation in two ways: (1) increasing the size of the firm or (2) by stealing or expropriation); Detelin Elenkov et al., *Acquisition Returns, Increase in Firm Size, and Chief Executive Officer Compensation: The Moderating Role of Monitoring*, 45 ACAD. MGMT. J., 599, 599 (2002).

77. Kevin F. Hallock, *The Relationship Between Company Size and CEO Pay*, WORK SPAN (Feb. 2011), https://www.ilr.cornell.edu/sites/ilr.cornell.edu/files/workspan/02-11-Research-for-the-real-world_0.pdf (showing that for a 1% increase in company size, CEO pay goes up by about one-third of 1%——meaning that for each 10% increase in company size, annual CEO compensation increases by 3%.); *see also* Certo et al., *supra* note 71, at 220 (finding that director compensation packages increase following M&As); Dorata & Petra, *supra* note 34, at 344 ("[F]irm size is a significant influence on CEO rewards of acquiring firms."); Dutta et al., *supra* note 65, at 264 ("Extant literature shows that firm size directly influences CEO compensation levels.").

78. *See* Devers et al., *supra* note 3, at 1683.

79. *See* Dutta et al., *supra* note 65, at 258 (noting that maximizing firm size maximizes compensation).

curs *irrespective of whether the acquisition created recognizable value for the firm*,[80] suggesting CEOs endeavor to acquire target firms to enhance their own managerial compensation rather than increase overall shareholder value.[81]

2. Empire Building

Perhaps in tandem with increased compensation lies the fear that CEOs engage in acquisitive corporate strategy for the sake of empire building.[82] Not only do larger firm sizes foster firm—and CEO—recognition and prestige, but increased firm size enhances CEO discretion and bargaining power within the industry and within the firm.[83] "[A] CEO can radically transform the size and profile of the firm, perhaps instantly enabling it to enter the *Fortune* 500 list," or break into a new or challenging industry previously barred.[84] Understandably, CEOs may struggle to recognize and differentiate between the social value in growing the size and prestige of the firm versus the financial value of achieving a high return on investment.[85]

Firm growth can increase a CEO's personal autonomy. Not only are acquisitions themselves complex deals, often requiring extensive periods of integration, but the resulting larger firms exhibit increased internal complexity, creating opacity and restricting outside monitoring and regulation.[86] This permits the firm to operate with fewer regulatory constraints so that it can throw its weight around in the industry. It may also further vitiate the board and its ability to properly oversee corporate strategy and play a substantial role in the decision-making process. As

80. Devers et al., *supra* note 3, at 1683 (citing Yaniv Grinstein & Paul Hribar, *CEO Compensation and Incentives: Evidence from M&A Bonuses*, 73 J. FIN. & ECON. 119, 119–43 (2004)).

81. Elenkov et al., *supra* note 76, at 600.

82. Malmendier & Tate, *supra* note 12, at 22 ("Empire-building, like overconfidence, predicts heightened acquisitiveness to the detriment of shareholders, especially given abundant internal resources."); *see generally* Jarrad Harford, *Corporate Cash Reserves and Acquisitions*, 54 J. FIN. 1969 (1999).

83. Devers et al., *supra* note 3, at 1683 (citing Donald C. Hambrick et al., *Executive Job Demands: New Insights for Explaining Strategic Decisions and Leader Behaviors*, 30 ACAD. MGMT. REV. 472, 472–91 (2005)).

84. Hayward & Hambrick, *supra* note 4, at 120.

85. *See id.* at 110.

86. Devers et al., *supra* note 3, at 1683 (citing Matt Bloom & George T. Milkovich, *Relationships Among Risk, Incentive Pay, and Organizational Performance*, 41 ACAD. MGMT. REV. 283, 283–97 (1998)).

a firm becomes more complex, the board may rely more heavily on the CEO's expertise and insight, diluting the effect of the board as a countermeasure against CEO greed.

3. Job Security

Not only does growth of the firm create attractive promotion opportunities for junior managers and industry-wide opportunities for CEOs, but growth has become an expectation of CEO performance.[87] As a result, despite the inherent risk associated with acquisitions, CEOs appear relatively unphased and are not apprehensive about undertaking large deals.[88] This may stem partially from the need to achieve growth in order to meet external and internal growth expectations, thereby improving the CEO's prospects for remaining at the top.

Collectively, these personal drivers pose a potential threat to the success of any acquisition and may prove aggravating factors in tandem with certain value-enhancing drivers. As a result, the board of directors should carefully consider the presence or absence of each driver and how these drivers might interplay to affect the firm's acquisition strategy and process.

IV. ANALYSIS AND ARGUMENT

A. *CEO Drivers Impact Acquisition Strategy*

Given the range of decision making under the purview of a CEO, it is fair to say that CEOs impact acquisition strategy. This article argues one step further—that CEO drivers explain and influence acquisition strategies in large firms. The drivers detailed above weigh on CEO decision making, fostering CEO dominance and over-bidding on target firms, which in turn help to explain why acquisitions are consummated despite low or negative returns for shareholders.

87. *See* Morck et al., *supra* note 32, at 33.
88. Dutta et al., *supra* note 65, at 258.

1. CEO Dominance

CEO dominance signifies "the ability of the CEO to impose his or her overconfident views on the decisions of the firm."[89] An inherently objective measure, dominance focuses on whether an individual can actually exert his or her influence over another individual or group of individuals.[90] As a result, dominance only has meaning in a social or organizational context, such as in the context of a CEO's relationship with the firm's board.[91] "Only a powerful CEO can impose his [or] her decision on a firm" and its board,[92] suggesting weaker boards or firms with weaker corporate governance will have more powerful and dominant CEOs.[93]

Dominance carries huge implications in acquisition decision making. Dominant CEOs can manipulate and maneuver the decision-making process, the acquisition committee, and the full board. Dominant CEOs likely focus more on drivers such as compensation, empire building, and diversification of personal assets. Dominant CEOs may also leverage drivers such as private synergies and CEO hubris, believing they can pressure the board to either accept an M&A decision or afford greater deference by adopting a lower level of review.

2. Overbidding

Perhaps the largest harm to the shareholders caused by misguided CEOs remains overbidding. CEOs often make offers significantly above the market value of a target firm.[94] This decreases overall firm value and causes the firm to expend additional capital without achieving any additional gain. According to Richard Roll, managers of bidding firms "infected by hubris" overpay for target firms because they "overestimate their own ability to run them."[95] To the extent acquisitions serve personal objectives, such as compensation or empire building, managers of bidding

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89. Brown & Sarma, *supra* note 19, at 359.

90. *Id.* at 363.

91. *See id.* at 363–64.

92. Dutta et al., *supra* note 65, at 258.

93. *Id.* at 260.

94. *See* Brown & Sarma, *supra* note 19, at 361 (overbidding based on overconfidence); Dorata & Petra, *supra* note 34, at 342 (overbidding based on personal benefit).

95. Morck et al., *supra* note 32, at 31 (citing Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 197 (1986)).

firms are willing to pay more than the target firm is worth to further these objectives.[96]

B. *Additional Drivers May Effect CEO Decision Making*

In addition to the drivers discussed above, additional drivers may impact CEO decision making. These factors stem from origins other than value enhancement or personal gain. These drivers, though not of central focus here, warrant review to alert boards of directors of potential mitigating or aggravating factors that may merit consideration in the holistic review process.

Age and tenure. The age of the CEO may play a large role in his or her acquisition strategy. Older CEOs may be more prone to selecting strategies with hurdle rates or projected payoffs closely aligned with, and markedly prior to, the CEO's planned retirement.[97] This gravely affects a firm's growth rate and direction. Further, CEOs with more tenure may hold entrenched positions within the firm and within the industry, enabling the CEO to pursue personal interests.[98] Experienced executives may have more specific knowledge relating to both the firm and the industry, permitting these executives to navigate acquisition decision making more dexterously and, perhaps, exacerbating the information asymmetry with the board.[99]

Ascribed social status. Ascribed social status is assigned to individuals without reference to innate differences or abilities.[100] This driver is bestowed on individuals irrespective of individual traits and often based on some irreversible fact, such as family lineage or gender.[101] CEOs with more ascribed status may prove more elitist and connected, affording greater opportunities but less need to "prove themselves." This may cause CEOs with such status to evaluate M&A deals more evenly with little attention to job security or compensation. Conversely, ascribed social status may trigger increased hubris or overconfidence, exaggerating overbidding and contributing to the likelihood of a bad deal.

96. *Id.*
97. Peni, *supra* note 45, at 188.
98. *Id.*
99. *See id.* at 199.
100. Michael Dowling et al., *CEO Social Status and Acquisitiveness*, 5 QUALITATIVE RES. FIN. MKTS. 161, 162 (2013).
101. *Id.* at 163, 166.

Gender. Some authors postulate that women's more cooperative leadership style may not only prove more productive than men's competitive nature, but suggests that women are more apt to recognize perceived synergies between target and acquiring firms, thus elevating the probability of successful integration.[102] In general, firms led by female CEOs may outperform matched firms with male executives.[103] These characteristics may stand alone in deal-making strategy or could serve as mitigating factors against certain deal drivers.

Achieved social status. Achieved social status derives from individual accomplishments. Psychological research suggests higher status can induce overconfidence directly associated with higher average acquisitiveness.[104] This calls into mind the above analysis regarding overconfidence and suggests that acquisitions may be viewed as an opportunity more for the CEO to grow in status than the firm to grow in size or stature. Additionally, achieved status may contribute to specific drivers, such as CEO hubris, and further complicate the board's understanding of just what is behind the acquisition.

C. *Boards of Directors Do Not Sufficiently Counteract Private CEO Drivers*

Some research hypothesizes that vigilant monitoring through active institutional ownership, heightened board scrutiny, or proportionally large numbers of independent directors can control private CEO rewards tied to firm acquisitions. For example, one study indicates that "[a] higher proportion of independent directors on the board mitigates the effect of CEO overconfidence and CEO dominance and reduces the probability of the firm deciding

102. *See* Peni, *supra* note 45, at 198.

103. *Id.* at 186. The sample's empirical analysis consisted exclusively of S&P 500 firms. *Id.* at 190. The authors omitted observations with insufficient data and proceeded with a final sample consisting of 305 firms and 1525 firm-year observations. *Id.* The sample period extended from 2006 to 2010. *Id*. All data on CEO and Chairperson characteristics was hand collected from the AuditAnalytics database. *Id*. In the case of data availability issues, the executive data was acquired from the firms' annual reports and press releases. *Id*. The authors obtained financial statement data from Thomson Reuters Worldscope. *Id*. The authors analyzed the relationship between CEO or Chairperson characteristics and firm performance with cross-sectional panel regressions. *Id.* at 194.

104. Dowling et al., *supra* note 100, at 164. *See generally* Malmendier & Tate, *supra* note 12 (examining CEO overconfidence in merger decisions).

to make an acquisition."[105] Conversely, CEOs can more effectively induce abusive acquisitions and corporate strategy when monitoring proves lax.[106] The fact that acquisitions continue to destroy value so frequently demonstrates that board control and monitoring, to date, has not worked.

D. *Equity Ownership Is Insufficient to Curb Private CEO Drivers*

Scholars have long emphasized the importance of aligning the interests of the CEO with those of the firm and its shareholders.[107] In fact, "[m]anagement ownership of shares may be the most effective deterrent to investments that dissipate market value . . . ."[108] But some forms of equity compensation—particularly options—provide upside potential without symmetrical downside penalties, exacerbating those drivers that encourage CEOs to make M&A deals that are risky to those who hold common stock outright. The board should consider the effect equity compensation may have on CEO decision making and weigh such compensation when considering the impact of deal drivers that may be present.

E. *Integrating Personality Analysis in CEO Decision Making*

It is "incorrect to say that existing monitoring and control devices keep managers from pursuing personal non-value-maximizing objectives."[109] Acquisition decisions should be viewed in the context of the total payoff structure and relative board power.[110] The board can utilize the drivers discussed in this paper to track potential CEO motivators in acquisition decision making and determine the effect, if any, such drivers should have on board consideration of individual transactions and acquisition development processes.

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105. Brown & Sarma, *supra* note 19, at 376.

106. Elenkov et al., *supra* note 76, at 601, 606.

107. Devers et al., *supra* note 3, at 1682.

108. Morck et al., *supra* note 32, at 32 (providing the caveat that large firms recognize this protection less as managers own fewer stocks relative to the size of the firm; the value is somewhat superfluous).

109. *Id.*

110. Dutta et al., *supra* note 65, at 258.

1. Process Changes: Shaping the Role of the Board

a. Earlier Board Involvement

Significant acquisitions necessarily involve the board at the acquiring company.[111] Too often, however, board involvement occurs once the deal has effectively been made. In these instances, a rubber stamp from the board remains the sole barrier between the CEO and effectuation of the deal. This places the board in a position where they must either derail the entire transaction or simply acquiesce to the CEO's recommendation. To avoid this trap, the board of directors should consider early involvement in acquisition deals by instituting a new step in the acquisition process: approval of leads for acquisition targets.

Undoubtedly the CEO is best positioned to initiate leads, as the CEO's specialized industry knowledge often serendipitously lends itself to identifying acquisition targets.[112] Removing the CEO from this function serves no reasonable purpose. Establishing an additional step of review, however, bolsters not only the accountability of the CEO in determining viable target firms, but also permits the board to act in its purposeful "checks and balances" capacity. The board may perform a balancing test at the outset, determining whether acquisition of the target firm conforms to overall firm strategy and proves financially tenable before a possible deal gathers momentum.

Moreover, the board can measure the value of the deal more effectively when considering its purported return, in light of recognized CEO drivers as previously defined, absent the pressure of a seemingly fully consummated deal. The board retains the freedom to make an informed decision before the deal has effectively been made. The more private CEO drivers the board identifies and believes will impact a particular acquisition or acquisitions at the company generally, the greater the probability that early board involvement in the acquisition process will prevent a value-decreasing deal.

111. *See* DEL. CODE ANN. tit. 8, § 141(a) (2015) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

112. *See supra* Part III.A.

2. Higher Board Scrutiny

Additionally, the existence of one or multiple private drivers should trigger a higher level of scrutiny in reviewing proposed acquisitions. The board must learn to identify and recognize potential deal drivers from the perspective of the CEO. The existence of any particular drivers does not predispose the deal to failure, rather these drivers serve as key indicators, or red flags, requiring additional review of particular capital investments. For example, noting that an acquisition will increase firm size and thus perhaps double CEO compensation in the future does not alone render the deal harmful or inadvisable. Rather, the board must recognize this as an influencing factor on the CEO and evaluate the deal in light of its possible weight and impact on CEO decision making.

The board may utilize key tools to heighten scrutiny and mitigate the effects of aggravating drivers. Such tools may include hiring an independent financial adviser to consult with the board with respect to each proposed target firm. Additionally, the board may choose to set a higher hurdle rate based on the CEO's past acquisition performance. And, to heighten scrutiny in light of multiple private drivers, a board might require deal review by an acquisition committee populated solely by independent directors.

The level of scrutiny cannot, however, hinge on the presence of any one driver, nor should heightened scrutiny require evidence of all drivers. Instead, the board should utilize a totality of the circumstances approach, increasing scrutiny based on the number of drivers present and their potential interplay. The board also needs to weigh the potential implications of each driver and the likelihood of the effects occurring. For example, if the board determines the CEO may be swayed by the increase in firm size, yet knows the firm intends to sell a major division, leaving the firm relatively the same at year-end, the board can conclude that this particular driver is unlikely to impact decision making. The acquisition will cause the firm to grow temporarily, but overall firm size will stay comparable, making annual CEO compensation unlikely to change.

Determining the level of scrutiny may prove challenging. The board should track both the various drivers at play in each potential acquisition deal as well as the foreseeable effects of each driver. Many drivers may prove pertinent to the CEO in all acquisitions, while others may be deal specific. If the board ascertains the presence of a particular driver, however, and determines a resulting impact is more than likely to occur, the board should track the driver more closely. A clear documentation of these drivers can facilitate discussion amongst the board regarding the drivers at play and whether current processes are sufficient to allay any potential threat.

a. Payment Changes: Adjusting CEO Compensation Packages

i. Discounting Firm Size

In conjunction with process changes, payment changes may prove effective tools in mitigating the potential downside of acquisitions driven predominantly by CEOs' private interests. For example, firm size drives CEO compensation.[113] Oftentimes, this may persuade a CEO to take on acquisitions for the sake of firm growth, increasing his or her compensation in lock step. Unfortunately, although the firm does in fact grow in size, historically the return on investment proves less than desirable.[114] Desirable increases in compensation perpetuate the cycle of acquisitions for the sake of acquisitions—growth for the sake of compensation.

The board of directors should recognize the impact that firm size bears on CEO compensation and diminish the nexus between firm size and compensation by establishing an adjusted measure of firm size when determining annual CEO compensation. For example, suppose that a firm is valued at $1 billion prior to acquisition and $1.2 billion after acquisition, but the acquisition, according to firm metrics, proves wholly unsuccessful. Assuming the firm determines CEO compensation by firm size and comparative compensation at peer companies, the board would likely approve compensation based on firms valued at $1.2 billion. Instead, however, the board should discount the firm size to the original $1 billion given the inflated figure produced by the failed acquisition. Alternatively, the board might choose to give "credit" for the increase in firm size for the purpose of CEO compensation over time with more "credit" given (in terms of the increase in

113. *See supra* Part III.B.1.
114. *See supra* Part III.B.1.

size of peer companies used for compensation analysis) as the acquisition proves itself profitable over several years.

Perhaps the clearest method for determining the adjusted firm size would derive from the assigned hurdle rate for a particular acquisition. If the strategy proved fruitless and the acquisition fell short of the hurdle rate by a certain percentage, that particular acquisition would be discounted from the total firm size by the compensation committee.

ii. Instituting Acquisition Clawbacks

Lack of direct accountability may permit CEO private drivers to dominate the CEO's acquisition analysis. As an alternative to adjusting compensation by acquisition performance as an acquisition proves itself, the board might employ a clawback provision.[115] Using this technique, the CEO would be paid his or her bonuses and other compensation components giving full credit for an acquisition. The clawback would then provide the firm with an opportunity to reclaim compensation in the future if it determines that the compensation should not have been awarded because the deal did not enhance firm value.[116] Incorporating clawback provisions in executive compensation contracts may improve managerial decision making. "[E]xecutives appear to be more careful when making acquisition decisions" once a clawback provision is in place, as evidenced by improved M&A announcement returns and a decreased willingness to engage in poor acquisitions.[117] The

115. Clawback provisions became an important issue in executive compensation in the wake of the 2007–2008 credit crisis. Because the financial results of the lenders were extremely positive in the years leading up to the credit crisis, executives received large bonuses. When, just a short time later, the value of the lenders' portfolios was written down, the results no longer justified the compensation. Where there were no clawback provisions, executives had an incentive to frontload company earnings, and most managed to hold on to inflated compensation. *See* Joann S. Lublin & Charles Forelle, *Recovering Bonuses Remains Infrequent Despite Emphasis on Corporate Reform*, WALL ST. J. (Oct. 12, 2004), http://online.wsj.com/news/articles/SB109752837308242257.

116. Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Securities and Exchange Commission to direct national securities exchanges to prohibit listing any security of a company that does not adopt a clawback policy in compliance with section 954. H.R. 4173, 111th Cong. § 954 (2011). To date, however, only a company restatement triggers this clawback policy. *Id.* This article argues firms should broaden the application of clawbacks and implement clawback provisions to recapture CEO pay linked with acquisitions, including bonuses.

117. Anna Bergman Brown et al., *M&A Decisions and US Firms' Voluntary Adoptions of Clawback Provisions in Executive Compensation Contracts*, 42 J. BUS. FIN. & ACCT. 237, 268 (2015); *see also* Yan Liu et al., *Corporate Governance, Bank Mergers and Executive*

clawback provision would serve to sever, or at least weaken, the link between growing a firm and growing a paycheck, permitting only successful deals to contribute to the latter.

Implementing clawback provisions will encourage CEOs to listen to the market and make more informed acquisition decisions. A study by Professors Anna B. Brown, Paquita Y. Davis-Friday, Lale Guler, and Carol Marquardt indicates that board decision-making may improve after adopting clawback provisions.[118] The authors found that when M&A announcement returns were negative, firms were more likely to adopt clawback provisions.[119] Additionally, firms that adopted clawback provisions experienced more favorable announcement returns after the clawback adoption.[120] The authors hypothesized this "suggest[ed] that [a] clawback adoption significantly improves managerial decision-making" and leads to a higher likelihood of financial success in subsequent acquisitions.[121] This may result from the correlation between adoption of clawback provisions and reductions in information asymmetry.[122] As noted previously, such information asymmetry often obstructs board involvement and may prevent boards from effectively reviewing proposed acquisitions.

Compensation 3, 5, 10, 13 (Henley Bus. Sch., Univ. of Reading, Discussion Paper No. ICM-2014-18, 2014) https://www.henley.ac.uk/files/pdf/research/papers-publications/ICM-2014-18%2 0Liu%20et%20al.pdf (finding that, in a study of 478 U.S. bank mergers from 1995 to 2012, post-merger changes in CEO bonuses were significantly negatively correlated with the strength of corporate governance within the bidding bank, suggesting that bonus compensation is not consistent with optimal contracting and that firms might benefit from new compensation structures).

118. Anna Bergman Brown et al., *supra* note 117, at 268. The sample drew primarily from the Corporate Library 2010 clawback database. *Id.* at 239. The original sample contained 736 firms of which 98 were coded as not having clawbacks and eliminated, reducing the sample to 638 firms. *Id.* at 251. The author further eliminated 199 firms that received funding as part of the Troubled Asset Relief Program (TARP). *Id.* The study included only variables that significantly explained the likelihood of transaction completion and, therefore, would benefit from adoption of clawback provisions. *Id.* at 246–47. In addition to the Corporate Library clawback sample of 519 firms, the authors also identified 58 firms that mention the word clawback in their proxy statements and adopted provisions by 2010. *Id.* at 251. They added these hand collected firms to the Corporate Library sample. *Id.* This yielded an initial voluntary clawback adoption sample of 577 firms with adoption dates ranging from 2001 to 2010. *Id.*

119. *Id*. at 268.

120. *Id.*

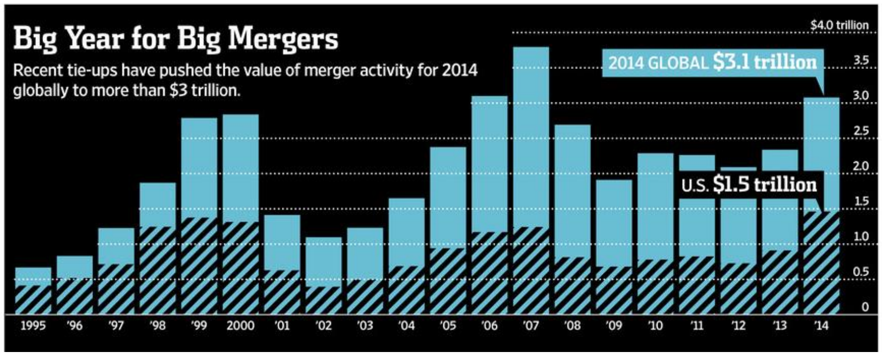
121. *Id.* at 239.

122. *Id.* at 268; Mai Iskandar-Datta & Yonghong Jia, *Valuation Consequences of Clawback Provisions*, 88 ACCT. REV. 171, 191 (2013) ("[T]he adoption of clawback policy reduces information asymmetry.").

CONCLUSION

Despite continued evidence controverting the value of acquisitions, the strategic choice to subsume additional, smaller entities is one that will continue—embedded in the past and future of corporate strategy. This does not mean, however, that boards must accept the continuing negative returns. Instead, boards engaged in acquisitive strategies should recognize and identify the key private drivers listed in this paper, deciphering these impacts on CEO decision making, and analyzing how such drivers might derail returns on acquisitions. By creating a matrix that illuminates the presence of such drivers and estimates the impact each might have on the CEO's decision making, the board empowers itself to conscientiously adopt a level of scrutiny appropriate for each transaction. Additionally, the board can implement changes to the acquisition process, requiring CEOs to vet potential targets at an initial board review—in essence requiring board approval before the courting phase begins. Further, the compensation committee can adopt clawback provisions and adjust firm size when determining CEO compensation packages. Discounting firm size when setting comparative firms for compensation determination remains a unique mechanism for incentivizing strong acquisitions and eliminating unjust rewards for financially unsuccessful deals. These strategies may work to curb potentially dangerous drivers and to achieve better decision making and stronger corporate governance in acquisitive firms.

APPENDIX A



Source: *Deal Boom Feeds on Surging Stocks*, WALL ST. J. (Nov. 17, 2014), http://online.wsj.com/articles/deal-boom-feeds-on-surging-stocks-1416270817.