WHAT EFFECT DOES CEO POWER AND GOVERNANCE HAVE OVER ACQUISITIONS?

Derek Oler*, Bradley Olson**, Christopher J. Skousen***

Abstract

We examine whether governance and CEO power matter for acquisitions. Acquisitions are frequently beneficial to the CEO of the acquiring firm, but can often be value-destructive to acquirer shareholders and other stakeholders such as employees. We find that corporate governance does not appear to influence whether a firm will become an acquirer after controlling for CEO power, but superior governance is associated with greater relatedness between the target and acquirer. We also find that the effect of CEO power on a firm's acquisition activity varies according to the source of that power. Our results suggest that the relationships between governance, CEO power, and acquisition activity are complex.

Keywords: Corporate Governance, Acquisitions, Diversification, CEO Power

**Texas Tech University, Box 42101, Lubbock, TX 79409-2101; derek.oler@ttu.edu; phone: 806-742-2354, fax: 806-742-3182.* *We thank Mitch Oler for his assistance with developing this paper. We also thank Joe Fisher and workshop participants at Utah State University and at the 2007 American Accounting Association Annual Conference in Chicago, Illinois for their helpful comments. Derek Oler acknowledges and thanks PriceWaterhouseCoopers for their financial support. We also thank Jin Dong Park, Lei Han, and Xiaohong Fan for their research assistance.*
***University of Lethbridge*
****School of Accountancy, Jon M. Huntsman School of Business, Utah State University*

1. Introduction

We examine the effect of both CEO power and governance on a firm's acquisition activity. Acquisitions may be pursued by CEOs because they provide personal benefits, such as an increased salary; however, they are often value-destructive to firm shareholders. A recent survey of executives finds that mergers and acquisitions are a major priority in their short term horizon (Krell, 2006). Even executives whose positions are eliminated receive hefty severance packages, such as Gillette's James Kilts who received a $163 million package (Thornton *et al.*, 2005). Furthermore, some research suggests that more diversifying acquisitions provide additional benefits to the CEO, such as decreased sensitivity of their compensation schemes to firm performance (Anderson *et al.*, 2000).

Acquisitions are a significant feature of the corporate landscape, and the most recent acquisition wave studied in the finance literature (from 1998 to 2001) appears to have resulted in the loss of about $240 billion dollars for U.S. shareholders (Moeller *et al.*, 2005). The AOL-Time Warner merger alone has cost shareholders more than $200 billion. One study found that "post" diversified firms decreased shareholder value by approximately 13 – 15 percent (Berger and Ofek, 1995). Thus, the effect of CEO power and governance on acquisition activity is an important question associated with billions of investment dollars.

Prior work on governance did not explicitly control for the CEO's power. We define power as the capacity to assert one's will; when applied to CEOs, power is the ability to exert one's will over the strategic direction of the firm (Finkelstein, 1992). Power allows a powerful CEO to take a firm in bold new directions that improve shareholder value (e.g., Steve Jobs at Apple), or conversely can reduce firm value while maximizing personal utility (e.g., Dennis Kozlowski at Tyco). Strong corporate governance mechanisms can serve as a check against CEO power; ideally, strong firm governance should mitigate the negative effects of CEO power. We examine the relationship between various measures of governance and CEO power on (1) whether the firm will pursue one or more acquisitions in a given year, and (2) the level of relatedness between the acquirer and target.

We find that our governance measures are strongly associated with the level of relatedness between the acquirer and target, where relatedness is defined using the firms' industry classifications. Our

measures of CEO power do not uniformly suggest a greater likelihood of an acquisition or suggest a more or less related acquisition; rather, the source of CEO power is a critical factor in determining the effect of that power on a firm's acquisition activity. CEO power is not a unified construct when it comes to acquisitions.

The remainder of the paper is organized as follows. Section 2 reviews related research and develops our hypotheses, and section 3 describes the sample and provides descriptive statistics. Section 4 reports our empirical findings, and section 5 summarizes and concludes the paper.

2. Review of Related Research and Hypothesis Development

2.1 CEO Benefits from Acquisitions

Acquisitions have been the subject of numerous studies focusing primarily on returns (see Agrawal and Jaffe, 2000, for reviews), and although initiating and overseeing acquisitions are primarily the CEO's responsibilities (Lehn and Zhao, 2006), comparatively little attention has been paid to the role that governance and CEO power plays in the acquisition activity of the firm.

Acquisitions are often value-destructive to acquirer shareholders (Morck *et al.*, 1990; Moeller *et al.*, 2005; Oler, 2008), but can provide significant benefits to the acquirer's CEO. For example, acquisitions increase the firm's size, and this in turn can decrease the CEO's employment risk and increase his personal compensation (Morck *et al.*, 1990). Diversifying acquisitions can be personally more beneficial to CEOs than nondiversifying acquisitions. Rose and Shepard (1997) show that the CEO's compensation is 13% higher in diversified firms vs. non-diversified firms. However, diversifying acquisitions may be more value-destructive to shareholders. Highly diverse firms operate in multiple markets, which increase the complexity of the firm's operations. This complexity decreases the firm's transparency of transactions within the firm's business units, and can provide top executives with an opportunity to engage in self-serving decisions with less risk of detection by shareholders. Unrelated acquisitions, i.e., acquisitions where the target is completely outside the traditional industry of the acquirer, often have negative outcomes (see Gaughn, 111; Berger and Ofek, 1995).

2.2 Corporate Governance

Corporate governance should help companies to control agency costs, including discouraging unhealthy acquisitions. We consider three measures of governance: the size of the board, the proportion of outside directors on the board, and the firm's general governance proxied by Bebchuk *et al.*'s (2004) E-score. The E-score consists of six corporate governance provisions related to executive entrenchment. These provisions include staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments.

The board oversees the strategic decisions of the firm, and can therefore act as a significant counterbalance to the CEO. Strong boards can be important in aligning the interests of the CEO with the shareholders. We operationalize board power as the number of board members and the proportion of independent board members (Sahlman, 1990).

Overall, we expect that relatively stronger corporate governance, proxied by the E score, the size of the board, and the proportion of independent directors, will result in less likelihood of an acquisition in a given year:

H1: The likelihood of a firm announcing at least one acquisition in a given year is decreasing in corporate governance strength.

In addition, because diversifying acquisitions are often viewed as more value-destructive than related acquisitions, we also expect to find that stronger governance is associated with reduced likelihood that a given acquisition will be unrelated (and greater likelihood that a given acquisition will be semi-related or related).

H2: Acquirers with stronger corporate governance are more likely to pursue a related or semi-related acquisition, and less likely to pursue an unrelated acquisition.

2.3 CEO power

Although board members approve acquisitions, the CEO usually initiates them and oversees their progress (Lehn and Zhao, 2006). Accordingly, acquisitions are more likely to be pursued by more powerful CEOs because more powerful CEOs are better able to overcome resistance from other sources, such as stronger corporate governance (Adams *et al.*, 2005). Therefore, acquisitions should be associated with CEO power.

Finkelstein (1992) provides a conceptual framework on how executive power can influence strategic outcomes. He defines power as the ability of individuals to exert their will in corporate decision-making and groups these types of CEO power into more fine-grained categories: expert power, prestige power, structural power and ownership power.

We argue that these forms of power will not be unidirectional in terms of the acquisitions that a firm pursues. Research by Chen *et al*. (2008) and Adams *et al*. (2005) indicates that more powerful CEOs are better able to implement their decisions without scrutiny than weaker CEOs; this can have a positive effect if the CEO makes good decisions, but a negative effect if the CEO makes poor decisions. Their work suggests that CEO power might not have a uniform effect on a firm's acquisition activity.

2.3.1 CEO Expert Power: CEO Tenure and Prior Functional Experience

Expert power encompasses the abilities necessary for success in the firm, and CEO tenure is one form of expert power. Longer tenure as CEO increases the likelihood of developing important relationships with key strategic decision makers. Also, because CEOs can be terminated because of poor strategic decisions (e.g., Lehn and Zhao, 2006), longer tenure may indicate greater competence and skill While CEOs holding more functional positions within the firm before becoming CEO will have more firm-specific knowledge of the firms operations and more contacts within the firm.

2.3.2 CEO Prestige Power: Elite Education and Other Directorships

Prestige power is based on the reputation of the CEO (Finkelstein, 1992). Elite education and other corporate directorships are both important forms of prestige power. Elite education provides individuals with valuable knowledge gained through their interaction with elite individuals and institutions (D'Aveni and Kesner, 1993). The reputation acquired through elite educational institutions is another source of prestige power.

Other board directorship appointments also lead to valuable experiences and knowledge, and increase the prestige of the CEO. Directorships give the CEO access to important external information (Pennings, 1980), contacts with other influential and important business elite (Useem, 1979), and ultimately give the CEO greater status and power within his own organization.

We predict that expert and prestige power will have a similar effect on strategic decision making. These forms of power provide the CEO with knowledge and connections that can facilitate the pursuit of acquisitions. Further, expert and prestige power are likely to not be affected by the ultimate outcome of the acquisition – even if the stockholders lose money (for example, a CEO who is powerful because he has a long tenure or because he has an elite education will retain these power sources even if the acquisition proves disappointing). We hypothesize:

H3: The likelihood of a firm announcing at least one acquisition in a given year is increasing in CEO expert and prestige power; and,

H4: The degree of relatedness between the acquirer and target is increasing in CEO expert and prestige power.

2.3.3 CEO Structural Power: Board Chair

Besides informal expert and prestige power, the CEO can have formal structural power that provides legitimate decision making authority. Legitimate power represents formal authority from the individual's position within the firm. From a CEO power perspective, an independent chairperson can serve as an important check on the CEO's power (Baliga *et al.*, 1996). Thus, the structural power of the CEO increases when a firm consolidates the CEO and chair positions.

H5: The likelihood of a firm announcing at least one acquisition in a given year is decreasing in CEO structural power; and,

H6: The degree of relatedness between the acquirer and target is increasing in CEO structural power.

2.3.4 CEO Ownership Power: Shares Owned and Founder of Firm

Greater ownership in the firm's voting stock can affect CEO power in at least two ways. First, ownership gives the CEO increased legitimate power to influence management's decisions (Riahi-Belkaoui and Pavlik, 1993). With this legitimate power, the CEO can also influence the selection of board directors (Fredrickson *et al.*, 1988). Second, Shen and Cannella (2002) argue that ownership enhances the CEO image as a loyal employee that will seek the best interests of the firm, thus increasing the CEO's credibility. Pitcher *et al.* (2000) show that CEOs who have high ownership power are able to insulate themselves from unexpected or involuntary turnover.

H7: The likelihood of a firm announcing at least one acquisition in a given year is decreasing in CEO ownership power; and,

H8: The degree of relatedness between the acquirer and target is increasing in CEO ownership power.

3. Data and methodology

3.1 Sample

To build our sample, we randomly select 300 companies from the Fortune 1000 as of 2004 and collect CEO power, governance, and acquisitions data for the years 1998 to 2004. We eliminate firm-year observations without sufficient data, and therefore our likelihood of an acquisition sample has 271 firms and 1,639 firm-year observations and our level of diversification sample consists of 1,954 acquisitions, as shown in Table 1, Panels A and B.

3.2 Measurement of variables

3.2.1 Governance Variables

We measure the size of the board *(BOARD)* and the proportion of the board made up of outside directors *(OUTSIDE_DIRECTORS)*. We also use Bebchuck *et al.*'s (2004) "E" score as another measure of overall governance strength, transformed to be increasing in shareholder rights (and decreasing in CEO power) by taking 6 less the original E score.

3.2.2 Proxies for CEO Power

Expert power – We use two measures of expert power: the CEO's tenure as CEO (Combs and Skill, 2003), calculated as the natural log of the years the CEO has held his position (*CEO_TENURE*), and number of positions (*NUM_POSTIONS*) held prior to becoming a CEO (Finkelstein, 1992).

Prestige Power – We use two measures to estimate prestige power: elite education and corporate directorships. We define an elite education variable as 0 if the CEO had no degree from an elite institution and 1 if the CEO had an undergraduate and/or graduate degree from an elite institution (*ELITE*). We measure corporate directorships as the natural log of the number of for-profit boards (*OTHERBOARDS*) on which the CEO serves.

Structural Power - Structural power is based on whether the CEO is also the board chair. Our measure (*CHAIR*) is operationalized as 1 if the CEO also holds the position of chairperson of the board, and zero otherwise.

Ownership power – Two items are used to measure ownership power. Share ownership (*SHROWN*) is measured as the percentage of the firm's outstanding shares held by the CEO. We set a dummy (*FOUNDER*) to 0 if CEO is not the founder and 1 if the CEO is the founder of the firm.

3.2.3 Defining Relatedness

We define relatedness using three classifications: "related" acquisitions are those where the target and acquirer share at least the same first two digits of their primary SIC codes, "semi-related" acquisitions are those where the target and acquirer share only the first digit of their primary SIC codes and "unrelated" acquisitions are those where the target and acquirer do not share even the first digit of their primary SIC codes.

3.2.4 Other Control Variables

Following Harford (1999), we control for momentum *(MOMENTUM)*, proxied by size-adjusted buy-and-hold returns over the prior year, sales growth *(SALESGROWTH)*, leverage *(LEVERAGE)*, book-to-market *(BTM)*, size *(SIZE)*, and cash level *(CASHLEV)* in our models. To ensure that our results for CEO tenure are not attributable to older, more established firms buying up younger firms, we control for the firm's age *(FIRMAGE)*. Finally, we control for the pre-acquisition level of diversification of the company *(TOTAL_DIV)* following Palepu (1985).

4. Analysis and Results

4.1 Likelihood of an Acquisition

We present descriptive statistics for our variables in Panel C of Table 1. At first glance, it appears that stronger governance is associated with *greater* likelihood of a firm becoming an acquirer (mean E for acquirers is 3.7, vs. 3.5 for non-acquirers, $p<0.01$). This is contrary to our hypothesized relationship, but it is not possible to draw strong conclusions here because we have not controlled for other factors. With

respect to our CEO power measures, there is little relationship between our CEO power measures and the likelihood of a firm making an acquisition announcement. The one exception is shares owned by the CEO (SHROWN), which is significantly lower for acquirers (consistent with our expectations in H7).

Our univariate results suggest that acquirers have higher momentum and sales growth than non-acquirers. Acquirers are also larger than non-acquirers, and have higher cash levels (consistent with Harford, 1999). We also find that acquirers have lower leverage and lower book-to-market ratios, suggesting that acquirers are more likely to be less financially constrained and are more likely to be glamour firms. However, these univariate results may not hold in a multivariate setting.

We test H1, H3, and H5 using a logistic regression shown in Table 2. The dependent variable, ACQUIRER, equals one when the firm announces at least one acquisition during the year (whether or not it is ultimately consummated), and zero otherwise. Our regression includes year and industry dummies which are not tabulated. With respect to corporate governance, we do not find any significant relationship between governance (proxied by *BOARD*, *OUTSIDE_DIRECTORS*, and *E*) and the likelihood of an acquisition announcement, so H1 is not supported.

The likelihood of an acquisition increases with CEO tenure, supporting H3, but decreases with the number of positions within the firm held previously by the CEO. Thus, one of our proxies for expert power loads significantly with the expected coefficient sign, but the other loads marginally with the opposite sign. Having an elite education does not appear to have any effect on acquisitions, and interestingly *OTHERBOARDS* loads with a significantly negative coefficient. These results suggest that the more positions the CEO holds on the boards of other firms, the *less* likely the CEO will pursue an acquisition.

Turning to H5, *CHAIR* (our proxy for structural power), is marginally significant, suggesting that a firm where the CEO is also the board chair is less likely to become an acquirer (after controlling for other factors). *SHROWN* loads significantly negatively, with the expected sign, supporting H7; a firm where the CEO owns more of the company's stock is less likely to become an acquirer. However, *FOUNDER* is not significant.

These results suggest that the source of CEO power plays an important role in determining the likelihood of an acquisition, and that the relationship is complex. A CEO with longer tenure is more likely to undertake an acquisition, as expected, but if that CEO is more familiar with the pre-acquisition operations of the firm (proxied by the number of positions held prior to becoming CEO), has stronger relationships with other firms through other board seats, is the board chair, or has more personal wealth at risk, then the CEO is less likely to "rock the boat" by undertaking an acquisition.

4.2 Relatedness between Acquirer and Target

Table 3 reports our findings for relatedness. We consider 938 related acquisitions (based on the first 2-digits of the SIC codes), 354 semi-related acquisitions (1-digit), and 662 unrelated acquisitions in our dataset. We test H2, H4, H6, and H8 with a logistic regression using dummy variables for related, semi-related, or unrelated acquisitions.

We include the same control variables as those in Table 2, and add three more controls to pick up other aspects of the proposed acquisition. Specifically, we add a dummy *STOCK* that is set to one if the acquirer offers his own voting stock as consideration to target shareholders (and zero otherwise). We set a dummy *HOSTILE* to one if the acquisition was resisted by target managers, and we set *PUBLIC* to one if the target firm is publicly traded.

A comparison of estimated coefficients between our regressions suggests that there are significant differences in the factors that explain the relatedness of the acquirer and target. Specifically, a larger board is marginally more likely to pursue a related acquisition, but less likely to pursue a semi-related acquisition. In contrast, a board with more outside directors is less likely to pursue a related acquisition but more likely to pursue a semi-related acquisition, perhaps because an outside director is more likely to add greater familiarity with other industries that are still somewhat related to the firm. Overall corporate governance strength, proxied by E, is positively associated with related and semi-related acquisitions, and negatively associated with unrelated acquisitions, supporting H2. Stronger corporate governance appears to be effective in reducing the ability of a CEO to pursue an acquisition that is more likely to be value-destructive.

An acquisition is marginally less likely to be related if the CEO has longer tenure, but the relationship between CEO tenure and a semi-related or unrelated acquisition is not significant. This implies that a CEO with longer tenure is less likely to pursue a related acquisition. A CEO with an elite education is marginally less likely to pursue a related acquisition and significantly more likely to pursue an unrelated acquisition, partially supporting H4.

CEOs who are also board chairs are marginally more likely to pursue a related acquisition, significantly less likely to pursue a semi-related acquisition, but marginally more likely to pursue an unrelated acquisition. These confusing results do not support H6. The likelihood of a semi-related acquisition is marginally higher in CEO stock ownership and a CEO who is also the firm founder is more likely to pursue a related acquisition. These results partially support H8.

If the target is also publicly traded, the acquisition is more likely to be related and less likely to be unrelated. Firms that are already highly diversified are marginally less likely to pursue a related acquisition, more likely to pursue a semi-related acquisition, but less likely to pursue an unrelated acquisition.

4.3 Additional analysis

As additional analysis, we look at the market response to acquisitions announcements based on the market-adjusted (using CRSP's equal-weighted market return) cumulative acquirer return from day -5 to day +5 relative to the announcement. Our results (not shown) suggest that the market appears to value CEO experience positively in acquisitions. If the CEO is also the founder, the market response is significantly lower, suggesting that the market may prefer a founding CEO to "stick to the knitting" (i.e., what he presumably knows best), rather than acquire other firms. Consistent with Moeller *et al.* (2004), the announcement of the acquisition of a public target firm elicits a significantly lower market response than that for a private target.

5. Conclusions

We investigate the relationship between various measures of corporate governance, CEO power, and acquisitions. We show that our measures of governance do not appear to affect whether a firm undertakes an acquisition, but that stronger governance (as proxied by a higher "E" score) are associated with a greater likelihood of a related or semi-related acquisition and with reduced likelihood of an unrelated acquisition. These results are consistent with governance restricting the CEO from pursuing an acquisition that is more likely to be value-destructive (Gaughn, 2002).

Our results vary considerably depending on the source of CEO power: the likelihood of an acquisition is increasing in CEO tenure, but decreasing in the number of positions the CEO held prior to his appointment. CEOs who have gained a wider perspective of the firm from past positions such as vice president of operations and marketing may not want to risk changing the firm's operations (and, by so doing, render their prior experience obsolete).

Acquisitions are also less likely if the CEO sits on the boards of other firms, if the CEO is also board chair, and if the CEO holds more of the company's stock. CEOs who sit on other boards may not want an increase in workload related to an acquisition placed on their already hectic schedules. These CEOs may also prefer to form relationships with other firms through less radical means (such as sitting on their boards). CEOs with more wealth tied to firm performance likely do not wish to jeopardize that wealth by pursuing an acquisition.

With respect to the degree of relatedness between the acquirer and target, CEOs with an elite education are marginally less likely to pursue a related acquisition and significantly more likely to pursue an unrelated acquisition. Investors/boards seeking to diversify a company's holdings may want to consider a CEO educated from an elite institution.

CEOs who are also chairman of the board are marginally more likely to pursue a related acquisition, significantly less likely to pursue a semi-related acquisition, but marginally more likely to pursue an unrelated acquisition. Although these results generally support our argument that CEO duality will increase the chances of related diversification strategies, the results indicating that a CEO/chairperson will pursue unrelated diversification strategies is contrary to our argument. The relationship between the CEO/Chair combination and the relatedness of the target firm appears to be complex, and future research may help explain our results. We encourage future researchers to consider expanding on our study to include the entire top management team instead of just the CEO. We believe this might provide greater insight into the real influence a CEO has.

If the CEO is also the firm's founder, a given acquisition is significantly more likely to be related. This finding is expected as founders are often highly specialized in a specific industry and understand what it takes to succeed in that industry. Founding CEOs also would likely prefer to not delve into areas where they have reduced expertise.

Overall, our results suggest that governance matters with respect to the relatedness between the target and acquirer. Our results also suggest that the source of CEO power has a significant impact on how that power affects the firm's acquisition activity. However, the relationship between CEO power

and acquisition is complex: One cannot simply say that a more powerful CEO is more likely to pursue an acquisition, or is more likely to pursue a diversifying acquisition. Investors concerned with the potential of value-destructive acquisitions should consider the combination of governance and CEO power.

References

1. Adams, R., Almeida, H., and Ferreira, D. (2005), "Powerful CEOs and their impact on corporate Performance", *The Review of Financial Studies*, Vol. 18, pp. 1403-1432.
2. Agrawal, A., and Jaffe, J. F. (2000), "The post-merger performance puzzle", *Advances in Mergers and Acquisitions* Elsevier Science, pp. 7-41.
3. Anderson, R., Bates T., Bizjak, J., and Lemmon, M. (2000), "Corporate governance and firm diversification", *Financial Management*, Vol. 29, pp. 5–22.
4. Baliga, R., Moyer, C., and Rao, R. (1996), "CEO duality and firm performance: what's the fuss?", *Strategic Management Journal*, Vol. 17, pp. 41–57.
5. Bebchuk, L., Cohen, A., and Ferrell, A. (2004), "What matters in corporate governance?", Working Paper, Harvard University.
6. Berger, P. G., and Ofek, E. (1995), "Diversification's effect on firm value", *Journal of Financial Economics*, Vol. 37 No. 1, pp. 39-65.
7. Chen, C., Lin, J. B., and Yi, B. (2008), "CEO duality and firm performance-an endogenous issue", *Corporate Ownership & Control*, Vol. 6, pp. 58-65.
8. Combs, J., and Skill, M. (2003), "Managerialist and human capital explanations for key executive pay premiums: a contingency perspective", *Academy of Management Journal*, Vol. 46, pp. 63-73.
9. D'Aveni, R., and Kesner, I. (1993), "Top managerial prestige, power and tender offer response: a study of elite social networks and target firm cooperation during takeovers", *Organization Science*, Vol. 4, pp. 123-151.
10. Finkelstein, S. (1992), "Power in top management teams: dimensions, measurement, and validation", *Academy of Management Journal*, Vol. 35, pp. 505-538.
11. Fredrickson, J., Hambrick, D., and Baumrin, S. (1988), "A model of CEO dismissal", *Academy of Management Review*, Vol. 13, pp. 255-270.
12. Gaughn, P. A. 2002. *Mergers, acquisitions, and corporate restructurings*. New York: John Wiley and Sons.
13. Harford, J. (1999), "Corporate cash reserves and acquisitions", *Journal of Finance*, Vol. 54, pp. 1969-1997.
14. Krell, E. (2006), "2006 Career & compensation survey", *Business Finance*, Vol. 12, pp. 19-30.
15. Lehn, K. M., and Zhao, M. (2006), "CEO turnover after acquisitions: are bad bidders fired?", *Journal of Finance*, Vol. 61, pp. 1759-1811.
16. Moeller, S. B., Schlingemann, F. P., and Stulz, R. M. (2004), "Do shareholders of acquiring firms gain from acquisitions?", *Journal of Financial Economics*, Vol. 73, pp. 201-228.
17. Moeller, S. B., Schlingemann, F. P., and Stulz, R. M. (2005), "Wealth destruction on a massive scale? A study of acquiring-firm returns in the recent merger wave", *Journal of Finance*, Vol. 60, pp. 757-782.
18. Morck, R., Shleifer, A., and Vishny, R. W. (1990) "Do managerial objectives drive bad acquisitions?" *Journal of Finance*, Vol. 45, pp. 31-48.
19. Oler, D. K. (2008), "Does Acquirer Cash Level Predict Post-Acquisition Returns?", *Review of Accounting Studies*, Vol. 13 No. 4, pp. 479-511.
20. Palepu, K. G. (1985), "Diversification strategy, profit performance, and the entropy measure", *Strategic Management Journal*, Vol. 6, pp. 239-255.
21. Pennings, J. (1980), *Interlocking directorates*, Washington, D.C.: Jossey-Bass.
22. Pitcher, P., Chreim, S., and Kisfalvi, V. (2000), "CEO succession research: methodological bridges over troubled waters", *Strategic Management Journal*, Vol. 21, pp. 625-648.
23. Riahi-Belkaoui, A., and Pavlik, E. (1993), "Effects of ownership structure, firm performance, size and diversification strategy on CEO compensation: a path analysis", *Managerial Finance*, Vol. 19, pp. 33-54.
24. Rose, N. and Shepard, A. (1997), "Firm diversification and CEO compensation: managerial ability or executive entrenchment?", *Rand Journal of Economics*, Vol. 28, pp. 489-514.
25. Sahlman, W. (1990), "The structure and governance of venture-capital organizations", *Journal of Financial Economics*, Vol. 27, pp. 473–522.
26. Shen, W., and Cannella, A. (2002), "Power dynamics within top management and their impacts on CEO dismissal followed by inside succession", *Academy of Management Journal*, Vol. 45, pp. 1195-1206.

27. Useem, M. (1979), "The social organization of the American business elite and participation of corporation directors in the governance of American institutes", *American Sociological Review*, Vol. 44, pp. 553-572.
28. Thornton, E., Symonds, W. S., Barrett, A., Foust, D., and Grow, B. (2005), "Fat merger payouts for CEOs", *Business Week*, Vol. 3963, pp. 34-37.

Appendices

Table 1 - Sample Selection and Descriptive Statistics

Panel A: Likelihood of an Acquisition Sample Selection

	Likelihood of an Acquisition
Randomly Selected firms from Fortune 1000	300
Collected data for years 1998 to 2004	7
Total number of firm year observations	2100
Less observations missing data	461
Total number of firm years	1639
Number of acquisition announcement firm years	773
Number of non-acquisition announcement firm years	866
Total number of firm years	1639

Panel B: Likelihood of Diversification Sample Selection

	Likelihood of Diverisfication
Randomly selected firms from Fortune 1000	300
Less firms without an acquisition	68
Number of firms announcing an acquisition	232
Total number of acquisition announcements	1954
Related Acquisitions (same 2-digit SIC)	938
Semi-Related Diversifications (different 2-digit, same 1-digit SIC)	354
Unrelated Diversifications (different 1-digit SIC)	662
Total number of acquisition announcements	1954

Table 1 - Sample Selection and Descriptive Statistics (*Continued)*

Panel C: Descriptive Statistics
The sample consists of 1,639 firm-years (773 acquisition announcement firm-years and 866 non-acquisition announcement firm-years) from 1998-2004.

	Acquirer		Non-Acquirer		*p* -value
Variable	Mean	Std Dev	Mean	Std Dev	t-test
Governance					
BOARD	2.4490	0.2287	2.4338	0.2196	0.1707
OUTSIDE_DIRECTORS	0.7718	0.1593	0.7799	0.1693	0.3194
E	3.6843	1.3384	3.4711	1.3333	0.0013
Exper Power					
CEO_TENURE	1.6805	0.8958	1.6233	0.9201	0.2033
NUM_POSITIONS	2.5977	2.3174	2.5069	2.3232	0.4295
Prestige Power					
ELITE	0.4049	0.4912	0.4030	0.4908	0.9372
OTHERBOARDS	0.7347	0.5686	0.7495	0.5779	0.6017
Structural Power					
CHAIR	0.7361	0.4410	0.7667	0.4231	0.1515
Ownership Power					
SHROWN	0.0082	0.0268	0.0131	0.0410	0.0047
FOUNDER	0.0957	0.2944	0.0889	0.2848	0.6341
Control Variables					
MOMENTUM	0.1034	0.5209	0.0171	0.4452	0.0003
SALESGROWTH	0.1411	0.3057	0.0990	0.3107	0.0058
LEVERAGE	0.8408	1.1527	1.0024	1.4882	0.0149
BTM	0.3813	0.2678	0.5189	0.4280	<0.0001
SIZE	8.8802	1.2763	8.7048	1.2528	0.0051
CASHLEV	0.0896	0.1226	0.0783	0.1163	0.0550
FIRMAGE	3.2346	0.8003	3.2512	0.8068	0.6766
TOTAL_DIV	1.2604	0.4210	1.1505	0.4229	<0.0001

*Variable definitions are povided on pages 9 and 10.

Table 2: Results of Logistic Regression Analysis on the Likelihood of an Acquisition
The dependent variable is Acquirer; it equals 1 for firms announcing at least one acquisition during the year and 0 otherwise. The sample consists of 1,639 firm-years (773 acquisition firm-years and 866 non-acquisition firm-years) during the years 1998-2004. P-values less then 0.05 are in bold; p-values between 0.10 and 0.05 are in italics.

Variables	Hypotheses/ Predictions	Estimate	Pr > ChiSq
Governance			
BOARD	H1 (-)	0.338	0.267
OUTSIDE_DIRECTORS	H1 (-)	-0.406	0.258
E	H1 (-)	0.005	0.906
Expert Power			
CEO_TENURE	H3 (+)	0.198	**0.008**
NUM_POSITIONS	H3 (+)	-0.051	*0.051*
Prestige Power			
ELITE	H3 (+)	-0.117	0.331
OTHERBOARDS	H3 (+)	-0.221	**0.035**
Structural Power			
CHAIR	H5 (-)	-0.280	*0.056*
Owernship Power			
SHROWN	H7 (-)	-7.433	**<0.001**
FOUNDER	H7 (-)	0.155	0.499
Control Variables			
MOMENTUM		0.199	0.116
SALESGROWTH		0.484	**0.015**
LEVERAGE		-0.111	**0.011**
BTM		-0.921	**<0.001**
SIZE		0.383	**<0.001**
CASHLEV		-0.003	0.995
FIRMAGE		-0.021	0.773
TOTAL_DIV		0.051	0.734
INTERCEPT		-0.896	**<0.001**
		Chi-Square	Pr > ChiSq
Likelihood ratio test		252.753	<0.001
Max-Rescaled R^2			0.191
Sample Size (total firms)			1639
Acquistion Firm-years			773
Non-Acquisition Firm-years			866

*Variable definitions are provided on pages 9 and 10. Year and industry dummy variables are omitted from the table.

Table 3: Results of Logistic Regression Analysis - Related, Semi-Related, and Unrelated Acquisitions
The dependent variables are set to 1 for related (acquirer and target share the first 2 digits of their primary SIC code), semi-related (acquirer and target share only the first digit of their SIC code), and unrelated (where the acquirer and target do not share any common digits in their SIC code) acquisitions respectively. P-values of less than 0.05 are in bold; p-values between 0.10 and 0.05 are in italix.

	Hypotheses/	Related		Semi-Related		Hypotheses/	Unrelated	
Variables	Predictions	Estimate	Pr > ChiSq	Estimate	Pr > ChiSq	Predictions	Estimate	Pr > ChiSq
Governance								
BOARD	H2 (+)	0.466	*0.095*	-0.876	**0.015**	H2 (-)	0.277	0.330
OUTSIDE_DIRECTORS	H2 (+)	-0.841	**0.040**	1.485	**0.018**	H2 (-)	-0.048	0.910
E	H2 (+)	0.121	**0.004**	0.170	**0.002**	H2 (-)	-0.224	**<0.001**
Expert Power								
CEO_TENURE	H4 (-)	-0.130	*0.060*	0.028	0.761	H4 (+)	0.094	0.190
NUM_POSITIONS	H4 (-)	0.036	0.174	-0.024	0.485	H4 (+)	-0.020	0.464
Prestige Power								
ELITE	H4 (-)	-0.187	*0.094*	-0.146	0.317	H4 (+)	0.295	**0.011**
OTHERBOARDS	H4 (-)	-0.004	0.965	0.135	0.322	H4 (+)	-0.086	0.401
Structural Power								
CHAIR	H6 (+)	0.227	*0.079*	-0.658	**<0.001**	H6 (-)	0.252	*0.066*
Owernship Power								
SHROWN	H8 (+)	-2.215	0.424	5.691	*0.081*	H8 (-)	-0.660	0.820
FOUNDER	H8 (+)	0.466	**0.025**	-0.477	0.117	H8 (-)	-0.253	0.249
Control Variables								
MOMENTUM		-0.030	0.779	0.417	**0.003**		-0.250	**0.035**
SALESGROWTH		0.105	0.588	-0.170	0.499		-0.086	0.694
LEVERAGE		0.005	0.934	0.113	0.117		-0.098	0.116
BTM		0.676	**0.008**	-0.143	0.673		-0.782	**0.007**
SIZE		-0.184	**0.001**	0.120	0.075		0.077	0.155
CASHLEV		-1.396	**0.008**	2.159	**0.001**		0.032	0.952
FIRMAGE		0.040	0.616	0.137	0.198		-0.093	0.261
STOCK		-0.329	0.108	0.157	0.585		0.331	0.112
HOSTILE		-0.183	0.776	0.077	0.916		0.259	0.717
PUBLIC		0.480	**0.002**	-0.007	0.974		-0.511	**0.002**
TOTAL_DIV		-0.272	*0.051*	1.101	**<0.001**		-0.348	**0.017**
INTERCEPT		-0.130	0.573	-0.918	**0.003**		-1.175	**<0.001**
		Chi-Square	Pr > ChiSq	Chi-Square	Pr > ChiSq		Chi-Square	Pr > ChiSq
Likelihood ratio test		264.368	<0.001	321.280	<0.001		177.471	<0.001
Max-Rescaled R^2			0.169		0.248			0.120
Sample Size (total acquisitions)			1954		1954			1954
Related (Model 2), Semi-Related (3), and Unrelated (4)			938		354			662
Other Acquisitions			1016		1600			1292

*Variable definitions are provided on pages 9 and 10. Year and industry dummy variables are omitted from the tables.