CEO Compensation and Acquired and Acquiring Companies in Large Corporate Acquisitions

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Abstract

This paper examines the relative sensitivity of CEO compensation of both acquiring and acquired firms in the top 30 U.S. largest corporate acquisitions in each year for the period of 2003 to 2012. We find that total compensation and bonus granted to executive compensation for acquired companies, not acquiring companies, are significantly related to the amount of acquisition deal even after the size and firm performance are controlled for. Both acquiring and acquired CEOs are found to make the significantly higher compensation than the matched sample firms in the same industry and calendar year. We also find that executives with higher managerial power, as measured by a lower salary-based compensation mix, prior to a corporate acquisition are more likely to receive a higher executive pay in the year of acquisition. The association between executive compensation and managerial power seems to be stronger for acquired firms than for acquiring firms in corporate acquisition. Overall, our findings suggest that corporate acquisition has higher impacts on executive compensation for acquired firm CEOs than for acquiring firm CEOs.

Keywords: CEO, Compensation, Mergers, Acquisitions, Firm Performance

1. Introduction

Executive compensation contracts are often used to align managerial interests with those of shareholders. The literature on executive compensation proposes two competing theories -- *pay-for-performance* and *managerial power* – to explain the misalignment of agency costs between managers and shareholders. Proponents (e.g., Jensen and Meckling (1976); and Riahi-Belkao (1992)) of pay-for-performance, grounded in the notion of agency costs, argue that chief executive officer (CEO) compensation contract is relevant enough to align the link between CEO management and shareholder wealth. Proponents (e.g. Core et al. (1999); and Bebchuk and Fried (2004)) of managerial power theory, on the other hand, propose that executive pay is largely influenced by the power and self-interest of managers who use various opportunities to extract shareholder wealth for their own pay.

In a setting of corporate mergers and acquisitions, the relation between executive compensation and firm performance becomes empirically observable. Corporate combination provides an unique economic event to understand the opportunistic behavior of executives because combining firms, both acquirers and targets, have greater bargaining power to negotiate for their pay (Bugeja et al. (2012); and Raman and Shivakumar (2013)). For bidding firms, the potential for an increased size, synergistic resource, and growth opportunity offer executives good reasons to justify their pay increases (Harford and Li (2007)). Also, the complexity of acquisition deal, restructuring charge, and uncertain outcome provide a basis for acquiring firm CEOs to negotiate with compensation committee to shield their compensation from the adverse effects resulting from post-acquisition performance (Dechow et al. (1994); and Dorata (2008)). On the other hand, the interests of managers and shareholders in target (or acquired, if the deal is completed) firms are often divergent because acquired firms are likely to dissolve after acquisition; therefore, the CEOs of acquired firms have an opportunity to argue for golden parachutes for their exit pay to obtain a takeover premium whereas the shareholders of acquired firms may want to have the continued appreciation on the stocks traded in the corporation acquisition. The divergent interest between managers and shareholders in acquired firms is also supported by empirical evidence (e.g., Buchholtz and Ribbens (1994)), suggesting that the performance of executives for acquired firms prior to acquisition does not align with the maximization of

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shareholder wealth. As such, a target firm executive who faces a takeover bid and has no pressure from corporate governance is likely to impose large personal interests over shareholder wealth without being held responsible for succeeding performance (Jensen (1988)).

Most acquisition payout provision is lucrative to the CEOs of combining firms. Disproportional payouts for CEOs in corporate acquisitions are commonly seen in business media, particularly more easily observable for acquiring firm executives. For example, the chairman of the Chase Manhattan Corporation, Mr. Harrison, who had signed and overseen a deal to buy J. P. Morgan for $30.9 billion in mid-September 2000, received a special bonus of $20 million on the top of his $1 million salary and $5 million regular bonuses. Tyco International paid $10 million in cash to a board member to compensate him for his role in arranging Tyco's $9.5 billion acquisition of a financial service group, the CIT Group, in 2001.[1] Large exit payouts are also common for CEOs in acquired companies in corporate acquisitions, though less empirically examined. In a survey conducted in 2005 by BusinessWeek, it shows roughly a half of America's 100 largest corporations have promised merger-related packages with a provision of average of $28 million to their CEOs, if the company is acquired.[2] For example, AT&T ex-CEO, Mr. David Dorman, walked away with an estimated $55 million in cash, stock, and other benefits as a result of a merger with SBC Communication in 2005.

It is also a prevalent business practice in a deal of merger and acquisition where the executives for combing companies make a change-in-control arrangement. The severance and change-in-control provision is pivotal in a merger and acquisition proposal which often includes payments equal to two or three times annual salary plus bonus, accelerated vesting, immediate cash-out long-term incentives including stock options, and continuation of health and life insurance (Bickford (1997)). For example, the ex-executive at Spring enjoyed a $300 million windfall – on proposed acquisition with MCI WorldCom in 1999 but later disallowed by the government based on an anti-trust consideration – because the approval of shareholders for the proposed deal immediately triggered accelerating vesting so that the Sprint's executive could exercise his options even the merger never happened (Verreault et al. (2004)). While the SEC continues to impose new disclosure requirements for CEO pay and to obligate companies to make the severance and change-in-control provisions easier to decipher in proxy materials, large payouts for CEOs in mergers and acquisitions are still obscure to shareholders due to the facts that corporate combination is often involved with complicated contracts and lengthy negotiation process.

In the literature of executive compensation, studies often examine the association of executive pay with corporate combinations without clearly distinguishing the differences between acquiring and acquired firms. For example, prior studies (e.g., Harford and Li (2007)) focus more on the misalignment of wealth of CEOs, particularly for acquiring CEOs, with firm performance.[3] However, the relationship between pay increase and post-acquisition firm performance for acquiring firm executives are still mixed (e.g., Girma et al. (2006); and Bliss and Rosen (2001)). The studies on target companies in mergers and acquisitions are relatively limited and examine more on the association of takeover resistance and managerial entrenchment with executive pay (e.g., Chakraborty and Sheikh (2010); and Buchholtz et al. (1994)). Since corporate acquisition involves with both combining firms, the behaviors and motives of executives for target and acquiring firms are expected to be different. As such, this paper proposes that corporate acquisitions may have disproportionate and asymmetric effects on firm performance and executive incentive for acquiring and target firms.

This paper investigates the relative sensitivity of CEO compensation to an acquisition deal for acquiring and acquired companies collected from the 30 largest corporate acquisitions in each year from 2003 to 2012.

[1] This source is written by Andrew Ross Sorkin, "Executive Pay: A special report; those sweet trips to merger mall" in *The New York Times*, April 07, 2002.

[2] Many executives in acquired firms receive large payouts to exit. The ex-CEO in struggling Toys 'R' US Inc. received cash and benefits worth about $63 million as part of deal purchased by an investment group. The CEO of MBNA Corp. was promised to receive compensation valued at $102 million in connection with the acquisition by Bank of America Corp. Please refer to "Fat Merger Payouts for CEOs", by Emily Thornton, *BusinessWeek Magazine*, December 11, 2005.

[3] Fewer studies examining executive compensation for acquired companies are seen in the literature on executive compensation perhaps because corporate acquisitions often result in change-in-control and dissolutions of the acquired firm.

This study populates that while corporate acquisition positively affects executive compensation for both combining firms, the acquisition deal has a stronger effect on CEO compensation for acquired firms than for acquiring firms. Specifically, this paper proposes that acquiring firm executives are more likely to weigh more on pay-for-performance than on managerial power, as compared to acquired firm executives, in negotiating executive compensation in corporate acquisitions. This proposition is argued on the basis that the acquiring firm executives are still subject to shareholder monitor and post-acquisition performance, whereas the acquired firm executives are expected to weigh more on exit pay or takeover resistance.

We find that total compensation and bonus granted to executive compensation for acquired companies, not for acquiring firms, are significantly related to the amount of deal of corporate acquisitions even after size and firm performance are controlled for. This study supports that both acquiring and acquired companies earn significantly higher compensation than the control sample matched with the same industry code and calendar year. This study also finds that combining firms, both acquiring and acquired firms, involved in the largest corporate acquisitions tend to have a lower ratio of base salary to total compensations prior to the acquisition deal. This paper contributes to studies on executive compensation and corporate acquisition in terms of adding the understanding on disproportional post-acquisition CEO compensation between acquiring and acquired firms. This finding implies that acquiring and acquired companies may weigh pay-for-performance and managerial power to the different extent when considering a corporate acquisition.

2. Literature Review and Hypothesis Development

The compensation package and incentive contract are designed to align CEO pay with observable performance measures so that agency costs derived from divergent interests between executive and shareholder can be mitigated. The *pay-for-performance theory* is generally consistent with the *managerial power theory* in the agreement that firm performance is one of essential criteria to form an executive compensation contract. Proponents of the *pay-for-performance theory* assume that competitive market and corporate governance are efficient enough to ensure the alignment of the interest between CEO and shareholder wealth. For example, Lambert and Larcker (1987) maintain that increase in CEO compensation and wealth are observed only if an acquisition deal increases shareholder wealth. They also support that the top executives who make large and infrequent acquisitions do not increase the level of their wealth by selecting acquisitions that adversely affect shareholder wealth. Lehn and Zhao (2006) find that CEOs who made an acquisition decision resulting in decrease in shareholder wealth are more likely to be replaced subsequently.

It is implicitly assumed amongst proponents of the *managerial power* theory that CEOs often seek opportunities to extract rent from shareholders (Bebchuk and Fried (2003)), particularly so when the corporate governance of a firm is week, managers have more power over the board and/or an undertaking business project is complicated to discern. Business combination and diversification happen to provide a special economic event to examine the misalignment between CEO and shareholder interests (Bugejia et al. (2012)). The process of a takeover bid is often lengthy and complicated that most shareholders have difficulty in understanding. It is more so when a takeover bid is connected with the negotiation of acquisition-related executive payouts. Executives involved with corporate acquisitions are often rewarded a huge incentive to complete the deal, while shareholders may not fully recognize the complicated deal and face steep breakup fees if the approved deal is killed.

The empirical literature on business combination suggests that a majority of takeovers do not improve firm profitability nor benefit shareholder wealth for acquiring firms (Hughes, 1989)). However, the literature also shows that acquiring firms are on average rewarded with higher absolute compensation following acquisitions (Girma et al. (2006); and Harford and Li (2007)). Evidence on whether bad acquisitions result in pay increases is mixed. Evidence on whether sound corporate governance mitigates agency costs in corporate combination is also mixed (Guest (2009)). For example, CEO compensation and wealth is found to increase significantly after large bank mergers even if the acquiring firm's stock price declines (Bliss and Rosen (2001); and Hartford and Li (2007)), a finding that is inconsistent with proponents of pay-for-performance.

The mixed empirical evidence manifests that corporate mergers and acquisitions are involved in a complicated negation process between acquiring and target companies. The relations between executive compensation and corporate acquisition are influenced by many different considerations faced by both combining companies. In a business combination, empirical evidence shows that CEO pay is found to relate to risk-taking behavior (e.g., Hagendorff and Vallascas (2011)), managerial power (e.g., Grinstein and Hribar (2004)), increases in firm size (Girma, et al. (2006)), post-acquisition performance (e.g., Bliss and Rosen (2001), earnings quality (Raman et al. (2013)), managerial entrenchment (Chakraborty (2010)), restructuring charges (Dechow et al. (1994)), and CEO compensation mix (Datta et al. (2001)).

This study proposes that executives for acquiring firms and acquired firms have different considerations in the process of takeover bidding. It is expected that acquisition deals have different impacts on acquisition-related executive incentive pay for acquiring firm executives than for acquired firm executives. Literature review to separate acquiring firms from acquired firms in mergers and acquisitions is listed below to support our proposition.

2.1 Acquiring Firm CEOs

The empirical literature on takeover and executive compensation seems to focus more on acquiring firm CEOs than on acquired firm CEOs. Research avenues on the CEOs of acquiring firms often examine the association of executive compensation with post-acquisition performance and corporate governance. Acquiring firm CEOs are held responsible for undertaking and initiating an acquisition and for subsequent restructuring and performance (Bugeja et al. (2012)). For acquiring firm CEOs, the relation between executive pay and performance-based evaluation, as emphasized in pay-for-performance theory, is a focal research topic because acquiring firm CEOs are still subject to the evaluation and monitor of shareholders after the acquisition.

Acquiring firm CEOs are found financially better off from making acquisition decisions (Bliss and Rosen (2001) and Harford and Li (2007)). However, acquiring firm CEOs are found to be rewarded equally for bad and good acquisitions despite their level of corporate governance (Guest (2009)). The association of mergers and acquisitions with an increase in CEO remuneration attributes to an increase in firm size, not to post-acquisition company performance (Girma, et al. (2006)). Jensen and Ruback (1983) find a positive relationship between the compensation of acquiring mangers and the stock price effects on corporate takeover decisions. Datta et al. (2001) find a positive relationship between equity-based compensation of executives and company stock price performance after acquisitions. Equity-based executive compensation is found to be used to reduce the non-value maximizing behavior of acquiring mangers (Shleifer and Vishny (2003)).

Corporate governance and managerial power are also found to relate to executive pay for acquiring firms. O'Neil et al. (2013) find that the greater the extent of shareholder governance to monitor managers, the lower the level of takeover related agency conflicts. CEOs with more power also tend to engage in larger deals relative to the size of their own firms, and the market responds more negatively to their acquisition announcement (Grinstein and Hribar (2004)). Grinstein and Hribar (2004) also find that acquiring CEOs with more power to influence board decisions receive significantly larger acquisition-related bonuses.

Harford and Li (2007) propose some explanations for possible opportunist behaviors of the CEOs of bidding firms, suggesting that the increase in size, complexity, and growth opportunity resulting from the takeover offers the CEOs a chance to argue for more pay which may be less sensitive to firm performance for the first few years following the acquisitions. Also, acquiring CEO compensation is found to be shielded from the negative effects of restructuring charges and asset impairments resulted from acquisition of target firm's stock (Dorata (2008)). As such, acquiring CEOs are expected to have an opportunistic situation to extract more incentives from a corporate acquisition while being under shareholder monitor.

2.2 Acquired Firm CEOs

Agency theory (e.g., Jensen and Meckling (1976)) postulates that golden parachutes are adopted in mergers and acquisitions to reimburse managers for job loss from a change of control. Golden parachutes are found to positively relate to corporate governance. Firms with weak corporate governance such as small firms (Wade et al. (1990)), the dispersion of stock ownership (Hoskisson

and Turk (1990)), high CEO power (Wade et. al (1990)) are more likely to adopt a golden parachute. Buchholtz and Ribbens (1994) find a negative relationship between golden parachutes and takeover resistance, suggesting that the greater the level of CEO stock ownership, the lower the likelihood of takeover resistance because the higher CEO stock ownership provides managers with additional gains through a takeover premium. However, Morck et al. (1988) find the level of top officers' stock ownership is not significantly related to a firm's being a target in a hostile takeover. Shleifer and Vishny (2003) use an analytic model to analyze the stock market's relative valuation of merging firms and predict that managers of targets in stock acquisitions are likely to have relatively short horizon or get paid for agreeing to the deal.

Prior to 2006, the SEC regulations on executive compensation were substantially lacking and CEOs' exit packages were not required to be disclosed to the public. The mandated executive compensation disclosure in 2006 significantly expanded the regulations regarding retirement benefits, change-in-control, and other termination compensation packages. The overhaul of compensation discussion and analysis was designated to help investors better understand and monitor firms' compensation practices (Cox (2006)). After 2006, some studies find that the mandated compensation disclosure indeed affects the pay-performance relationships. For example, disclosure noncompliance on CEO compensation is positively associated with excess CEO compensation (Robinson, et al. (2011)) and firms with CEO pay exceeding the benchmark pay are found to have a more difficult Compensation Discussion and Analysis (CD&A) to read (Laksmana et al. (2012)). In deals of mergers and acquisitions, CEOs' pay is found to become more sensitive to poor performance after regulation became effective (Wang, et al. (2014)). This study extends this line of investigations on the relationship between executive compensation and the largest deals of mergers and acquisitions before and after the SEC compensation disclosure regulations. More specifically, this study aims at examining whether a deal of merger and acquisition may cause any differences on CEO pay for acquiring and acquired firms at the time before and after the compensation disclosure regulations became effective.

2.3 Hypothesis

This paper proposes that while corporate acquisition affects both combining firms, executives of acquired and acquiring firms are expected to have different extent of reaction to a takeover deal. In a completed acquisition deal, CEOs of acquiring firms, as compared to acquired firms, weigh relatively more on pay-for-performance to contract executive pay because acquiring firms are still subject to the influence of market reaction and the monitor of shareholders. As such, this study proposes the following hypothesis:

H_1: *The effects of corporate acquisition have higher impacts on the CEO compensation for acquired companies than for acquiring companies.*

This study examines three different effects of corporate acquisition on executive compensation; namely, the value of acquisition deal, the level of various managerial incentives relative to a control sample, and the CEO's prior-acquisition compensation mix, for both acquiring and acquired firms. These three measures represent as a crude yet valid proxy to examine the relative sensitivity of combining firms to a corporate acquisition shock.

Our proposition is based on prior empirical findings that a large acquisition deal (as measured by the value of acquisition deal), a completed acquisition (as measured by executive pays of combining firms relative to a control sample) and more managerial power (as measured by the ratio of total salary to total compensation in executive compensation) have significantly influenced on executive compensation for merging companies. Thus, we expect to observe (1) a positive relation between the value of acquisition deal and executive compensation, (2) higher CEO compensation around acquisitions, and (3) executives with lower prior-acquisition salary-based compensation (or higher equity-based and other incentive-based compensation) to have higher executive pay following acquisitions. Moreover, we expect these effects resulting from corporate acquisitions are relatively higher for acquired firms than for acquiring firms.

3. Sample and Methodology

3.1 Sample

The sample of this study is based on a collection of the 30 largest corporate acquisitions completed in each year for the period from 2003 to 2012. The annual 30 largest corporate acquisitions were obtained and compiled from *Bloomburg Financial Data on the* basis of the value of corporate acquisitions announced and completed in each

year. Two additional criteria were set for our sample selection: acquisition type and executive position. This study only considers corporate acquisitions, not diversifications or spinning-offs, to make the sample homogenous and comparable because other forms of change-in-control involve different negotiation processes other than acquirer-target bidding. The sample of this study was also restricted to CEOs of acquiring and acquired companies, not other top managers, because other top managers such as CFOs are influenced by job complexity and other performance evaluations (Balsam et al. (2012)). Accounting data and share prices were collected from Compustat, and executive compensations were retrieved from Standard & Poor's ExecuComp dataset for the period of 2003–2012.

3.2 Descriptive Statistics

Table 1 shows the descriptive statistics of our sample. Panel A of Table 1 shows that the sample of this study consists of total 125 acquiring and 124 acquired companies with completed acquisitions announced during the period of 2003 to 2012 after deleting firms without Cusip number or compensation data. All accounting and compensation variables were obtained at the fiscal year-end of combining firms. The accounting and compensation data for acquired companies were obtained from their last available proxy materials reported in ExecuComp before corporate acquisitions because most acquired firms dissolve after the takeover.

Panel B of Table 1 reports descriptive statistics of acquisition deals and executive compensation used in this study. The mean of the value of acquisition deals used in our study is $16,060.05 million with standard deviation equal to $15,637.13 million. The result indicates that the 30 largest corporate acquisitions vary largely in value. Panel A of Table 1 reports the mean (median) of total compensation to CEOs in this study is $10,720,780 ($8,595,290). Chakraborty (2010) documents the median of total compensation and current compensation (salary and bonus) used in their study is $2,114,800 and $851,000, respectively for the period of 1992-2007. Hartford and Li (2007) report for the median of total compensation is $2,449,000 for the period of 1993 to 2000. The total compensation in our sample appears to be larger than prior studies perhaps because our sample was selected from the 30 largest corporate acquisition deals and from different sample years.

Table 1: Descriptive Statistics

Panel A: The Total Number of Firms in Analysis

	Acquirer	*Acquired*	*Total*
Firm-years of Largest Acquisition	300	300	600
No CUSIP Number	(110)	(61)	(171)
No Compensation Data	(65)	(115)	(180)
Total	125	124	249

Panel B: Descriptive Statistic of Acquisition Deals and Firm Characteristics

	Mean	*Median*	*Standard Deviation*	*25%*	*75%*
Deals of Acquisition (in millions)	16,060.05	10,171.68	15,637.13	6,136.27	19,993.64
Compensations (in 000)					
Total Compensations	10,720.78	8,595.29	8,241.36	4,698.27	14,437.63
Salary	1,053.66	1,000.00	482.57	805.96	1,250.00
Firm Characteristics					
Total Assets (in 000)	51,073.31	19,921.40	101,107.74	8,262.53	46,638.00
EPS	2.132	2.055	2.683	1.060	3.350
Operating Incomes	3,226.59	1,242.00	4,521.12	638.00	4,101.00
Stock Return (%)	16.31	11.87	44.90	-7.5%	33.57%

Note: The sample in this study was collected from *Bloomburg* on the basis of the largest 30 merger and acquisition deals announced and completed in each year from 2003 to 2012.

Size denotes a firm's total assets. EPS denotes a firm's primary earnings per share excluding extraordinary items. Stock return is calculated as the change of year-end closing stock prices scaled by the price at the previous year. Operating income represents a firm's operating income after deducting expenses for cost of goods sold, selling, general, and administrative expenses, and depreciation. Change of earnings per share, ΔEPS, is computed as the difference of year-end EPS scaled by lagged EPS. The same definition for control and compensation variables is used throughout all of the tables in this study.

3.3 Methodology

Following to prior studies (e.g., Bugeja et al. (2012)), this study uses an independent variable, IV, and firm performance variables to examine the relation between CEO compensation and corporate acquisitions. We estimate the following regression over the sample of the 30 largest corporate acquisitions over the period from 2003 to 2012:

Model : $DV = a_0 + b_1 IV_t + b_2 TA_t + b_3 \Delta EPS_t + b_4 EPS_t + b_5 PRICE + b_6 OI_t + b_7 RETURN_t + e_1$ (1)

The dependent variable, DV, in equation (1) is a compensation variable representing different types of compensation paid to CEOs of acquiring or acquired firm *i* at the end of year *t* when the acquisition is completed. This study uses five measures of levels of CEO compensation; namely, total compensation, salary, bonus, options, and restricted stocks granted, as different dependent variables in our analysis. Total compensation includes salary, bonus, other annual compensation, restricted stock grants, long-term incentive payments, and the value of options exercised. Option compensation is the value computed by applying Black-Scholes (1973) option valuation method. Salary or cash compensation comprises CEO salary and bonus for a given year.

In addition, we use six variables to control for firm performance: total assets (TA), change in EPS (ΔEPS), earnings per share (EPS), stock price (PRICE), operating income (OI), and stock return (RETURN). Size denotes a firm's total assets. EPS denotes a firm's primary earnings per share excluding extraordinary items. Stock price is a firm's year-end closing stock price. Stock return is calculated as the change of year-end closing stock prices scaled by the price at the previous year. Operating income represents a firm's operating income after deducting expenses for cost of goods sold, selling, general, and administrative expenses, and depreciation. Change of earnings per share, ΔEPS, is computed as the differences of year-end EPS scaled by lagged EPS.

The most important variable of interest in our analysis is the Independent variable, IV, used in equation (1). Three different independent variables are used: Value, Control and Rank. Value variable denotes the value of the completed acquisition deal. Control variable is a dichotomous variable with a value equal to 1 for firms in the 30 largest acquisitions and 0 for a comparable matched market with the same industry code and calendar year. Rank variable is a categorical variable to indicate the level of base salary to total compensation and is measured by ranking the annual ratio of base salary to total compensation into five groups (0 is the lowest and 4 is the highest) in each year based on each industry prior to a corporate acquisition.

4. Empirical Results

Table 2 compares the executive compensation and firm's performance between acquiring and acquired firms in the 30 largest yearly corporate acquisitions. Generally, the acquiring firm CEOs earn significantly more in salary (mean = $1,116,100) and total compensation (mean = $12,235,400) than acquired firm CEOs (the means of salary = $990,700 and of total compensation = $9,918,700, respectively). Note that compensation in options, bonus and restricted stocks are not significantly different between acquiring and acquired firms. Also, the firm performance for acquiring firms is significantly stronger than for acquired firms. Acquiring firms have larger size, higher earnings, better stock returns and stronger operating incomes than acquired firms.

Table 2: The Comparisons of Acquiring and Acquired Firms

	Acquiring	*Acquired*	*Difference*
Numbers of Executive-Firm-Years	125	124	
Executive Compensations (in 000)			
Salary	1,116.1	990.7	125.4 (2.06)†
Bonus	1,263.3	958.0	305.3 (1.35)
Options	4,890.1	4,192.1	698.0 (0.57)
Restricted Stocks	1,953.8	1,627.4	326.5 (0.40)
Total Compensations	12,235.4	9,918.7	2,316.6 (1.95)*
Firm Characteristics			
Size (Total Assets)	68,475.2	32,075.0	36,400.2 (2.75)*
EPS	2.691	1.511	1.180 (3.36)*
Stock Price	50.091	38.607	11.484 (1.95)‡
Operating Incomes	4,904.4	1,393.5	3,510.9 (6.32)*
Returns (%)	17.910	14.550	3.360 (0.57)

Note: Total compensation consists of salary, bonus, other annul compensations, restricted stock grants, long-term incentive

payment, value of options grants, and all other compensations. All the variable definitions are the same as Table 1.

The symbol "†" and "*"indicates that the statistical result reaches the significant level of 5% and 1%, respectively.

Table 3 reports the value of acquisition deal affects only executive compensation for acquired firms, not for acquiring firms. The independent variable, VALUE, is used to denote the value of acquisition deal in the regression analysis where different types of compensation are used as a dependent variable. Panel A of Table 3 shows that the value of acquisition deal has no impact on executive pay for acquiring firms regardless of different types of compensation that are examined. The coefficient on this variable, VALUE (β1), is insignificant across different compensation variables, suggesting that the value of acquisition deal has no influence on executive compensation for acquiring firms.

Panel B of Table 3 reports the value of acquisition deal significantly and positively relates to total compensation (β1= 0.147 with t = 3.32 at a significant level of 0.01) and bonus (β1= 0.050 with t = 4.48 at a significant level of 0.01) for acquired firm CEOs. Therefore, Table 3 shows that the executive compensation for acquired firms has a stronger relation with the value of acquisition deal than that for acquiring firms. Also note that the explanatory power of the analysis, as measured by adjusted R^2, for acquired firms are higher than for acquiring firms. This result suggests that the value of acquisition deal provides higher additional explanatory power over firm performance for acquired firms as compared to acquiring firms.

Table 3: The Effect of the Value of Corporate Acquisition on Executive Compensation

Model 1: $DV = a_0 + b_1 VALUE_t + b_2 TA_t + b_3 \Delta EPS_t + b_4 EPS_t + b_5 PRICE + b_6 OI_t + b_7 RETURN_t + e_2$

Panel A: Acquiring Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	11,090 (6.81)*	1,077.097(13.42)*	753..632 (2.57)*	2,790.755 (0.96)	3,339.933 (1.99)†
Value (β_1)	0.006 (0.10)	0.002 (0.50)	-0.002 (-0.16)	0.009 (0.13)	-0.030 (-0.71)
Size (β_2)	-0.001 (-0.11)	-0.000 (-1.13)	0.002 (2.21)*	-0.002 (-0.34)	0.001 (0.50)
ΔEPS (β_3)	-2,745.876 (-0.19)	-734.296 (-1.09)	-419.076 (-0.17)	5,693.751(0.35)	7,360.199 (0.78)
EPS (β_4)	175.412 (0.31)	-3.953 (-0.14)	-43.870 (-0.44)	-726.458 (-0.96)	208.625 (0.46)
Price (β_5)	-35.563 (-1.19)	-1.807 (-1.23)	-2.053 (-0.38)	75.357 (0.90)	-29.247 (-0.59)
OI (β_6)	0.384 (1.95)†	0.028 (2.93)*	0.086 (2.43)*	0.106 (0.47)	-0.065 (-0.48)
Return (β_7)	1,756.271 (0.62)	144.792 (1.05)	564.498 (1.12)	767.967 (0.20)	-2,517.583 (-1.10)
Adj. R^2	1.88%	8.90%	14.16%	0.04%	0.07%

Panel B: Acquired Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	4,850.446 (3.74)*	901.134 (10.07)*	219.761 (0.66)	1,130.234 (0.48)	267.463 (0.25)
Value(β_1)	0.147 (3.32)*	0.003 (1.30)	0.050 (4.48)*	0.039 (0.44)	-0.018 (-0.46)
Size (β_2)	0.015 (2.76)*	-0.000 (-0.54)	0.001 (0.76)	0.024 (0.88)	-0.013 (-1.07)
ΔEPS (β_3)	268.875 (4.21)*	-6.781 (-1.54)	-2.273 (-0.14)	-27.733 (-0.05)	804.332 (2.95)*
EPS (β_4)	-23.546(-0.13)	-6.062(-0.47)	52.295 (1.09)	-532.133 (-0.52)	-121.439 (-0.27)
Price (β_5)	22.625 (0.83)	1.051 (0.56)	-0.330 (-0.05)	104.137 (1.43)	-8.263 (-0.25)
OI (β_6)	0.338 (0.79)	0.027 (0.93)	-0.051 (-0.47)	-0.802 (-0.60)	1.002 (1.68)
Return (β_7)	1,095.018 (4.25)*	-27.067 (-1.52)	-8.912 (-0.13)	-118.889 (-0.05)	3,260.848 (2.96)*
Adj. R^2	41.55%	2.90%	17.22%	0.68%	51.39%

Note: VALUE denotes the value of the completed acquisition deal in this study. All other variables have the same definition as previous tables.

Table 4 shows that the comparisons of CEO compensation of the top 30 largest corporate acquisitions in each year with the control sample matched with the same industry and the same calendar year. Panel A of Table 4 supports that acquiring firm executive compensation is, on average, higher than the matched sample. A dichotomous variable, CONTROL, is used to separate combining firms from the control sample which is matched with the experimental firms with the same industry code and calendar year. The positive and significant coefficient on the indicator variable among different models shows that ceteris paribus, CEO pay, regardless measured in total compensation (β1= 5,411,898 with a *t*-value = 4.78), salary (β1= 448,916 with a *t*-value = 8.19), bonus (β1= 1,239,926 with a *t*-value = 4.48), or options (β1= 2,453,113 with a *t*-value = 4.08), in the top 30 largest annual corporate acquisitions is higher than that of the comparable industry rivals. This positive effect is absent for using restricted stock as a compensation measure, suggesting that executive pay in restricted stocks is not as significantly related to corporate acquisitions as is for other types of compensation.

Table 4: The Comparisons of CEO Compensation between the Largest Corporate Acquisitions and the Matched Market

Model 1: $DV = a_0 + b_1 CONROL_t + b_2 TA_t + b_3 \Delta EPS_t + b_4 EPS_t + b_5 PRICE + b_6 OI_t + b_7 RETURN_t + e_2$

Panel A: Acquiring Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	4,278.128 (12.50)*	566.259(34.17)*	718..052 (8.57)*	1,754.348 (9.64)*	839.617 (5.23)*
Control (β_1)	5, 411.898 (4.78)*	448.916 (8.19)*	1,239.926 (4.48)*	2,453.113 (4.08)*	-307.336 (-0.58)
Size (β_2)	0.003 (0.85)	-0.001 (-2.12)*	0.005 (5.15)*	0.003 (0.17)	0.001 (0.21)
ΔEPS (β_3)	-165.373 (-0.58)	4.902 (0.36)	0.758 (0.01)	-76.024(-0.50)	-52.891 (-0.40)
EPS (β_4)	44.360 (1.03)	1.782 (0.85)	10.158 (0.96)	1.788 (0.08)	12.368 (0.61)
Price (β_5)	4.167 (0.67)	0.485 (1.61)	1.145 (0.75)	1.588 (0.48)	-0.526 (-0.18)
OI (β_6)	0.452 (4.59)*	0.035 (7.37)*	0.054 (2.27)*	0.083 (1.59)	0.154 (3.34)*
Return (β_7)	18.675 (0.81)	-1.023 (-0.92)	-0.176 (-0.03)	3.904 (0.32)	9.265 (0.86)
Adj. R^2	13.51%	22.88%	17.83%	3.58%	2.70%

Panel B: Acquired Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	3,709.245 (13.06)*	598.822 (37.76)*	709.825 (10.01)*	1,332.592 (8.70)*	707.566 (5.76)*
Control (β_1)	3,973.319 (3.81)*	383.510 (6.58)*	885.572 (3.40)*	2,251.606 (4.00)*	217.737 (0.48)
Size (β_2)	-0.019 (-5.10)*	-0.001 (-6.64)*	0.001 (0.64)	-0.008 (-4.29)*	-0.002 (-1.68)
ΔEPS (β_3)	2.177 (0.70)	0.297 (1.71)	1.341 (1.72)	3.332 (1.98)†	-2.162 (-1.60)
EPS (β_4)	-536.578 (-4.69)*	-56.126(-8.78)*	-147.121(-5.14)*	-402.177 (-6.51)*	25.571 (0.52)
Price (β_5)	30.621 (4.02)*	3.409 (8.02)*	8.723 (4.59)*	23.825 (5.81)*	-2.847 (-0.87)
OI (β_6)	1.571 (10.79)*	0.090 (11.14)*	0.241 (6.64)*	0.592 (7.54)*	0.316 (5.03)*
Return (β_7)	12.379 (1.06)	1.069 (1.64)	3.351 (1.15)	7.552 (1.20)	2.524 (0.50)
Adj. R^2	21.00%	23.90%	22.73%	12.64%	9.20%

Note: The total number of largest corporate acquisitions firm is 125 and 124 for acquiring and acquired companies respectively and the comparable market participants with the same industry code and calendar year was 578 and 771 respectively. CONTROL is a dichotomous variable with a value equal to 1 for firms in the 30 largest acquisitions and 0 for a comparable matched market which

has the same industry codes and calendar year.

As compared with the result shown in Panel A, Panel B of Table 4 provides the similar finding and has higher adjusted R^2s across different compensation proxies. Overall, Panels A and B support the hypothesis that CEOs for combining firms, both acquirers and targets, in the 30 largest annual acquisitions earn higher compensation than the comparable control sample. Our finding is consistent with Bliss and Rosen (2001) and Harford and Li (2007) that acquiring CEOs are financially better off from corporate acquisitions. The results of Table 4 are robust after adding variables of firm performance, suggesting that combining firm executives may use their managerial power and acquisition deal to gain takeover premiums.

Table 5: The Effect of Compensation Mix on CEO Compensation in the Largest Corporate Acquisition

Model 1: $DV = a_0 + b_1 RANK_{t-1} + b_2 TA_t + b_3 \Delta EPS_t + b_4 EPS_t + b_5 PRICE + b_6 OI_t + b_7 RETURN_t + e_2$

Panel A: Acquiring Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	14,288.000 (6.84)*	1,233.500(12.63)*	2,810.346 (8.17)*	4,468.956 (4.97)*	3,540.489 (4.08)*
Rank (β_1)	-1,920.461 (-2.48)*	20.107 (0.55)	-340.362 (-2.67)*	-705.766 (-2.12)*	-195.467 (-0.61)
Size (β_2)	-0.001 (-0.40)	-0.000 (-1.54)	0.004 (5.20)*	-0.001 (-0.41)	0.001 (0.69)
ΔEPS (β_3)	-21,226.000 (-1.81)	-105.508 (-0.19)	-1,491.129 (-0.77)	2,730.499 (0.54)	3,839.532 (0.79)
EPS (β_4)	2,143.524 (4.13)*	-25.072 (-1.03)	269.145 (3.15)*	-187.363 (-0.84)	225.156 (1.04)
Price (β_5)	-125.219 (-2.05)*	-7.990 (-2.80)*	-23.610 (-2.35)*	7.065 (0.27)	-35.955 (-1.42)
OI (β_6)	0.148 (0.89)	0.047 (6.07)*	0.039 (1.46)	0.060 (0.84)	-0.069 (-1.01)
Return (β_7)	-2,859.370 (-0.99)	177.535 (1.31)	-626.734 (-1.32)	-587.684 (-0.47)	-1,967.583 (-1.64)
Adj. R^2	15.44%	25.48%	40.94%	0.31%	1.55%

Panel B: Acquired Companies

	Dependent Variables – Executive Compensations				
	Total Comp	*Salary*	*Bonus*	*Options*	*Restr. Stocks*
Intercept (α_0)	7,295.604 (5.51)*	1,015.194 (13.60)*	954.523 (3.46)*	4,953.543 (4.44)*	33.646 (0.07)
Rank (β_1)	-1,731.090 (-5.00)*	-14.927 (-0.76)	-166.076 (-2.30)*	-1,440.564 (-4.93)*	55.858 (0.42)
Size (β_2)	-0.015 (-1.20)	-0.004 (-6.56)*	0.010 (3.84)*	0.013 (1.29)	-0.017 (-3.56)*
ΔEPS (β_3)	1,47365.874 (5.19)*	-6.478 (-0.40)	279.489 (4.72)*	-4.068 (-0.02)	912.144 (8.36)*
EPS (β_4)	354.397 (0.80)	-28.833 (-1.16)	303.059 (3.30)*	-187.138 (-0.50)	-162.242 (-0.96)
Price (β_5)	24.298 (0.72)	-0.497 (-0.26)	-7.506 (-1.07)	59.495 (2.08)*	-8.757 (-0.67)
OI (β_6)	1.517 (3.56)*	0.209 (8.70)*	0.182 (2.06)*	-0.434 (-1.21)	0.993 (6.06)*
Return (β_7)	5,970.588 (5.20)*	-25.998 (-0.40)	1,131.850 (4.73)*	-18.860 (-0.02)	3,696.121 (8.39)*
Adj. R^2	32.91%	25.89%	42.62%	14.29%	60.16%

Rank is a categorical variable to indicate the level of base salary to total compensation and was measured by ranking the annual ratio of base salary to total compensation into five groups (0 is the lowest and 4 is the highest) based on each industry prior to corporate acquisitions.

Table 5 demonstrates the effect of managerial power, as measured by a CEO's compensation mix, prior to acquisition on CEO compensation in the year of corporate acquisitions. A categorical variable, RANK, is used to indicate the level of base salary to total compensation. RANK is measured by ranking the ratios of base salary to total compensation of all sample firms at one year prior to the announced acquisition into five groups (with 0 lowest and 1 highest) for each industry and each year. The higher the ratio (i.e., base salary to total compensation)

indicates the lower equity-based or other compensation-based compensation mix for combining firm executives. Note that this measure of executive compensation mix is comparably similar to the study of Bugeja et al. (2012) who used the average ratios of CEO bonus to their salary and to their total compensation around acquisitions in their Australia sample. Bugeja et al. (2012) report the average CEO bonus to total compensation is 13.29% one year before the deal and increases to 15.69% in the year of the deal. The more stock a CEO owns is found to have the lower likelihood of a target firm to resist a bidding offer (Buchholtz and Ribbens (1994)). Datta et al. (2001) document a strong positive relation between acquiring managers' equity-based compensation and merger performance. This study uses the ratios of base salary to total compensation to measure managerial power because equity-based and/or other incentive-based compensation (e.g., bonus or acquisition-related payout) may also attribute to increase in executive pay around corporate acquisitions.

Table 5 supports the hypothesis that executive compensation mix one-year before acquisition deal has a significant relationship with executive compensation in both combining firms. The managerial power proxy – a categorical variable measured by the percentage of CEO base salary to total compensation, RANK, – is significantly negative in both Panel A and B in regressions with total compensation, bonus, and options as a dependent variable for CEO compensation. Panel A of Table 5, for example, shows that RANK variable (β1) has -1,920.461 (with t-value = -2.48 at the significant level of 0.01). This negative and significant regression coefficient indicates that the higher the ratio of base salary to total compensation for acquiring firms, as compared to their industry participants on a yearly basis, the less the likelihood to earn the higher total compensation in a large corporate acquisition in the following year. Similarly, this study finds significantly negative regression coefficients β1= -340.362 (with a *t*-value = -2.67) and β1= -705.766 (with a *t*-value = -2.12) when CEO bonus and options are used as an executive compensation measure, respectively. The result suggests the lower the ratio of base salary to total compensation for acquiring CEOs before a takeover, the higher bonus and options executives can earn from a corporate acquisition in the following year.

Panel B of Table 5 shows that acquired firm CEOs with the higher managerial power (i.e., the lower the ratio of base salary to total compensation) before acquisitions are more likely to earn higher total compensation (β1 = -1,731,604 with a with a *t*-value = -5.00), bonus (β1= -166.076 with a *t*-value = -2.30) and options (β1= -1,440.564 with a *t*-value = -4.93) in a subsequent acquisition. These results are robust after variables of firm performance are controlled. Also note that the adjusted R^2s of the regression analysis for acquired companies in Panel B are higher than that for acquiring companies in Panel A across different compensation measures. This result implies that the explanatory power of managerial power in relating to executive pay in following acquisitions may be stronger for acquired companies than for acquiring companies.

5. Conclusion

Business combination is viewed as an adjustment and realignment in the market in response to firm performance and industry shocks, such as antitrust policy or deregulation (Jovanoic and Rousseua (2002)). However, business combination is also involved with a complicated and obscure negotiation process which may lead executives of combining firms to extract takeover premiums over shareholder wealth for their own interest. Prior studies on executive compensation and mergers and acquisitions find corporate governance, compensation mix, firm size, firm performance, acquisition deal, golden parachute, and quality of acquisition important in analyzing business combinations. The mixed results on literature, however, reaffirm the complication of business combinations.

While prior studies focus on either acquiring or target companies to examine the relation between business combination and executive pay, this study proposes that the relative sensitivity of executive compensation for merging companies to corporate acquisition may be different. This study examines the 30 largest yearly corporate acquisitions for the period of 2003 to 2012 and restricts the sample selection to include only the acquisition type of business combination and the CEO position among top managers. Executive compensation for both acquired and acquiring firms are compared in this study. This study finds total compensation and bonus granted to executive compensation for acquired, not for acquiring, companies are significantly related to the value of acquisition deal. Both acquiring and acquired firm CEOs earn significantly higher compensation than a matched sample with the same industry code and calendar year. In addition, this study finds that executives with lower salary-based

compensation prior-acquisition have a negative relation with their pay at the year of the acquisition deal. In other words, executive with higher equity-based or other incentive-based compensation prior to acquisition are more likely to earn higher compensation at the time of acquisition. This study contributes to the recent empirical literature examining the relation between managerial incentives and corporate acquisitions. Specifically, this study supports the hypothesis that asymmetric incentives are paid to CEOs for acquiring and acquired CEOs in response to corporate acquisitions.

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