

Accounting, Analysis and Governance in Complex Deals

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Governance in Complex Deals?

BMME303

Accounting, Analysis and Governance in Complex Deals

Corporate Governance

What & Why?

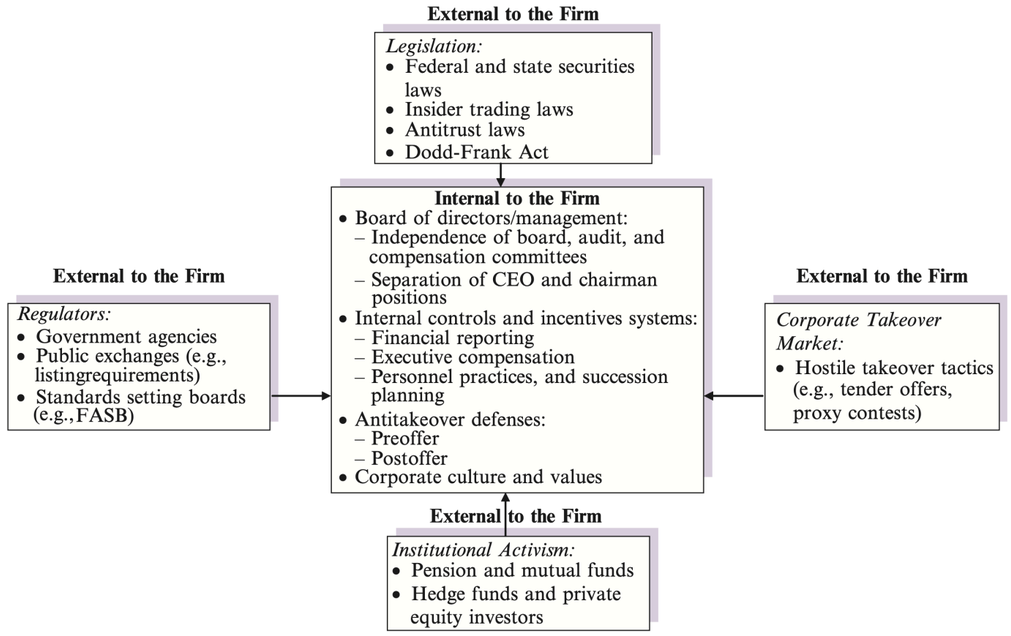


FIGURE 3.1 Factors that affect corporate governance.

Corporate Governance

"The rules and processes by which a business is controlled, regulated, or operated." DePamphilis (2025)

- Protect stakeholder interests against factors that are internal and external to the firm
- **Horizontally** balance interests between stakeholders
- **Vertically** balance interests with management

Horizontal Disputes

Balancing Interests between Stakeholders

Shareholder viewpoint

- Primary purpose of the firm: maximize **shareholder value**

Stakeholder viewpoint

- **Societal obligation** that somehow conflicts with maximizing shareholder value
- Employment safety, creditor protection, improvements to the community & environment

Are shareholder and stakeholder value maximization mutually exclusive?

“You can please some of the stakeholders all the time, all stakeholders some of the time, but you can’t please all of them all the time.”

Did Abraham Lincoln say that?

Are shareholder and stakeholder value maximization mutually exclusive?

Yes!

- **Conflicting Objectives**: Shareholder value focuses on financial returns, while stakeholder value includes broader societal and environmental goals, which may not always align.
- **Resource Allocation**: Prioritizing stakeholder interests might divert resources from profit-maximizing activities, potentially reducing shareholder returns.
- **Short-Term & Long-Term Performance**: pursuing stakeholder value often means sacrificing short-term results, leaving shareholders to absorb uncertainty about whether long-term gains will ultimately materialize.

Are shareholder and stakeholder value maximization mutually exclusive?

No!

- **Sustainable Growth**: Addressing stakeholder concerns (e.g., environmental sustainability) can lead to long-term profitability, benefiting shareholders as well.
- **Reputation and Trust**: Companies that prioritize stakeholder value often build stronger reputations, attracting customers and investors, which can enhance shareholder value.
- **Regulatory and Market Trends**: Increasing regulatory and market pressures favor companies that balance shareholder and stakeholder interests, aligning both goals over time.

Vertical Disputes

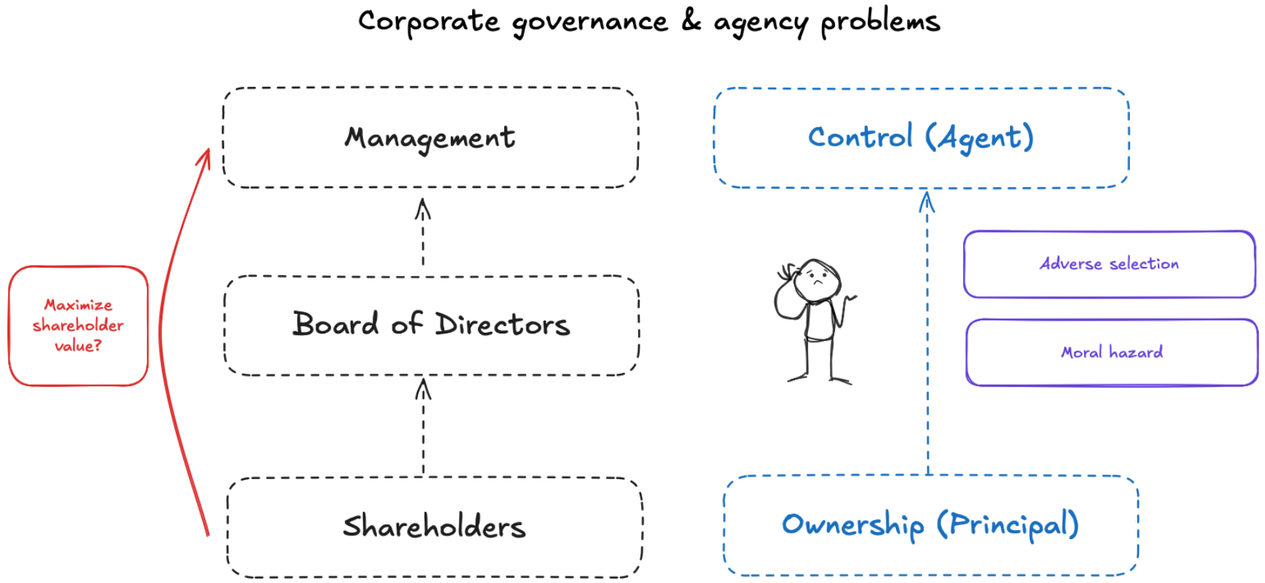
Balancing Interests with Management

- Vertical disputes arise from direct disagreement between management and shareholders
- Managers make decisions that may not align with shareholder interests, e.g. excessive risk-taking, empire-building, or misreporting performance

⇒ **brings us “back” to one of the most relevant theories in accounting! Which?**

Agency Theory

Corporate Governance



Agency Theory

- **Moral hazard**: "post-decision" (e.g., misreporting performance to shareholders)
- **Adverse selection**: "pre-decision" (e.g., CEO hiring/compensation)

Why do these issues arise?

Agency Theory

Corporate Governance

Information asymmetry

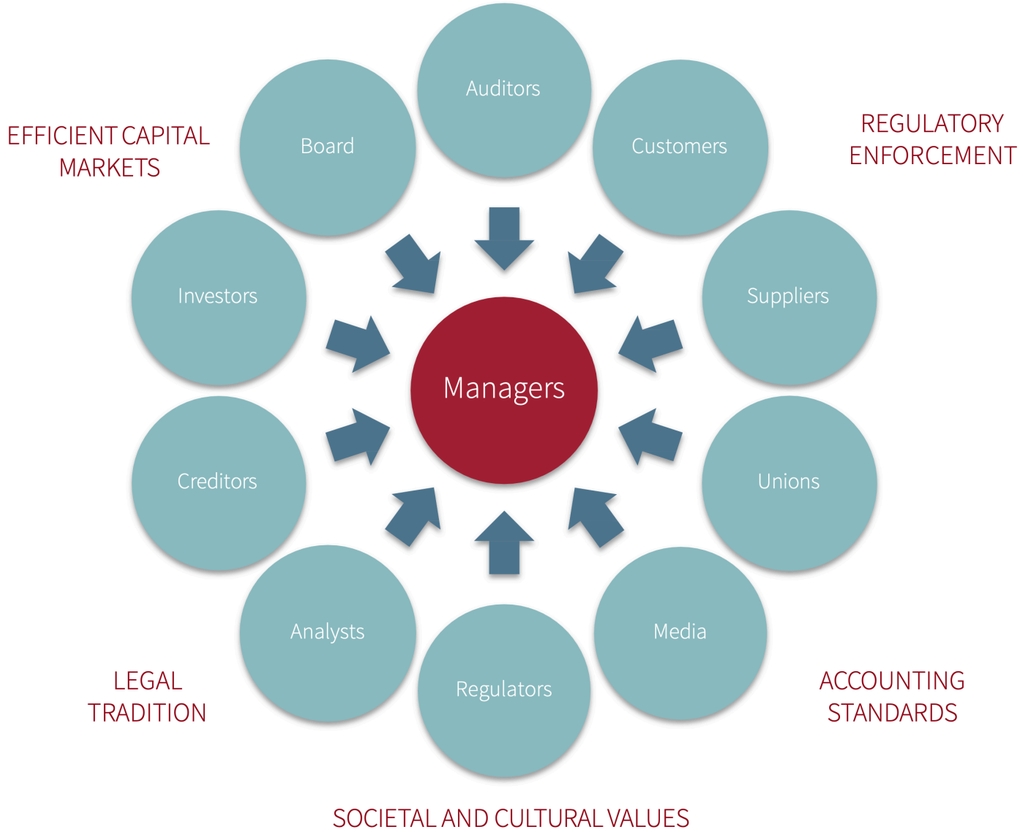
- Can shareholders perfectly observe what the management is doing? **No!**
- **Agency problem** → rational executives maximize their own utility and incentives are often not perfectly aligned with shareholders, leading to potential conflicts of interest and suboptimal decisions from the perspective of shareholders

Some examples of agency problems

- Manipulating financial reports or taking excessive risks to increase bonus or stock price
- **Empire-building** → overinvestment in unprofitable projects, incl. **acquisitions**

Control Mechanisms

Corporate Governance



From Corporate Governance to Complex Deals

Control Mechanisms



Board of Directors

- Advise and monitor management: set incentive-compatible pay
- **Approves major decisions, such as acquisitions**
- If **target**, consider antitakeover defenses[1] to negotiate higher purchase price

Corporate Governance in Complex Deals

Takeaways

- Corporate governance is an important device to balance interests
- In the context of complex deals, corporate governance gains relevance for the …
  - … **Board of Directors**, which has a major influence on decisions such as acquisitions, and negotiates on behalf of shareholders in the event of a takeover attempt
  - … **Shareholders**, who can influence corporate policies through voting rights and activism
  - … **CEO**, whose *professional* role as agent may conflict with shareholder interests when pursuing acquisitions. What about a CEO's *private* life?

GameStop’s Push to Acquire Ebay

Things People Love?

GameStop's Push to Acquire Ebay

Things People Love?

Gamestop's CEO, Ryan Cohen, expressed interest in acquiring Ebay

- The May/4 move surprised many given the companies' different business models and market positions
- The next day, he gave an interview to CNBC which earned him the headline ***"GameStop's Ryan Cohen is either the new Buffett or the anti-Buffett"*** (FT & FT Summary)

⇒ Watch the Video on Youtube (or Canvas)!

⇒ We will revert back to this example regularly throughout the course!

GameStop's Push to Acquire Ebay

Things People Love?

Governance Questions (among others)

⇒ When asked about why the deal is "unsolicited" [1:50], Cohen replies that "there's all kinds of perverse financial incentives for the board and management" *Which?*

⇒ Which aspect discussed in the interview [e.g., 12:00] raises the question whether this is a case of a CEO pursuing an acquisition that may not align with shareholder interests?

A CEO’s Personal Life

Should the personal life of a CEO be part of corporate governance?

Corporate Governance

Should the personal life of a CEO be part of corporate governance?

Current Regulatory Landscape

- No explicit disclosure requirements for private matters, other than general “financial materiality”
- Companies determine materiality case-by-case
- Inconsistent disclosure across companies

The Case for Disclosure

- Information asymmetry might create inefficient capital allocation
- Material information is decision useful for investors
- Executive position demands enhanced accountability

Trigger warning. Subsequent slides contain sensitive content.

Should the personal life of a CEO be part of corporate governance?

Corporate Governance

Steve Jobs (Apple, 2008)

- Appeared visibly ill at product announcement
- Stock moved on his appearance alone
- Company refused to comment on his health
- Later revealed he had pancreatic cancer
- Created significant stock volatility

Should the personal life of a CEO be part of corporate governance?

Corporate Governance

Charles Bell (McDonald's, 2004)

- Diagnosed with colorectal cancer as new CEO
- Company immediately disclosed his condition
- Resigned within months
- Died shortly thereafter
- Created leadership transition challenges

Should the personal life of a CEO be part of corporate governance?

Corporate Governance

John Browne (BP, 2007)

- Successful CEO who transformed BP
- Career ended when newspaper published article about his relationship
- Unexpected resignation damaged leadership continuity
- Created significant reputational impact

Should the personal life of a CEO be part of corporate governance?

Corporate Governance

Steve Appleton (Micron Technology, 2012)

- CEO and aviation enthusiast killed in experimental plane crash
- Had previous plane crash in 2004 but continued flying high-risk aircraft
- Trading halted after news broke
- Stock had risen 26% that year before the crash
- Company faced unexpected leadership transition
- Raised questions about limits on executive risk-taking behaviors

CEO Personal Risk-Taking and Corporate Policies

Cain and McKeon (2016)

Research Question

Is personal risk-taking of CEOs associated with firm risk, specifically corporate policies such as **acquisitions**?

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Findings

- CEOs with private pilot licenses (proxy for personal risk-taking) lead riskier firms with higher equity return volatility.
- Elevated firm risk stems from policies like leverage and acquisition activity.
- Nonpecuniary risk preferences outside the firm influence project selection and corporate policies.

CEO Personal Risk-Taking and Corporate Policies

Cain and McKeon (2016)

Acquisitiveness of Pilot CEOs

Table 5 reports the results of logit models in which the dependent variable equals 1 if the firm announces a successful merger bid in a given year, and 0 otherwise. A constant is included in all models. Independent variables are defined in the Appendix. Coefficients are reported as odds ratios. *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

Independent Variables	1	2	3	4
Panel A. CEO Characteristics				
PILOT	1.267* (0.071)	1.389** (0.026)	1.332** (0.038)	1.593** (0.047)
MILITARY		0.842 (0.233)	0.932 (0.608)	0.842 (0.398)
AGE_40–49		1.385 (0.309)	1.494 (0.198)	1.775 (0.133)
AGE_50–59		1.265 (0.468)	1.454 (0.233)	1.604 (0.238)
AGE $\geq$ 60		1.023 (0.945)	1.203 (0.564)	1.364 (0.453)
ln(TENURE)		1.181*** (0.000)	1.166*** (0.001)	1.163*** (0.009)
VEGA	1.222* (0.083)	1.117 (0.389)	0.931 (0.562)	0.993 (0.966)
DELTA	1.103* (0.061)	1.180*** (0.009)	1.152** (0.018)	1.163* (0.061)

CEO Personal Risk-Taking and Corporate Policies

Cain and McKeon (2016)

Pilot CEOs and M&A Announcement Returns

Table 7 reports the results of OLS regressions with bidder announcement returns as the dependent variable. Abnormal returns are calculated over the window from 1 day prior to 1 day following merger announcements (−1, +1), using the S&P 500 Index as the expected return. A constant is included in all models. Independent variables are defined in the Appendix; all bidder characteristics are lagged by 1 year. Standard errors are clustered by firm and year, and *p*-values are in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% levels, respectively.

	Full Sample		Low-BM Bidders		High-BM Bidders	
Independent Variables	1	2	3	4	5	6
Panel A. CEO Characteristics						
PILOT	0.444 (0.330)	0.342 (0.484)	0.299 (0.699)	0.206 (0.783)	0.825* (0.079)	0.851* (0.094)
MILITARY	−0.112 (0.821)	−0.169 (0.739)	−0.208 (0.788)	−0.201 (0.808)	0.020 (0.972)	−0.319 (0.598)
VEGA	0.073 (0.596)	0.039 (0.783)	0.061 (0.694)	−0.005 (0.976)	0.328 (0.674)	−0.074 (0.910)
DELTA	0.660*** (0.002)	0.630*** (0.003)	0.854** (0.030)	0.788* (0.054)	0.277 (0.146)	0.366** (0.018)
AGE_40–49	−1.497 (0.494)	−1.522 (0.515)	−2.093 (0.521)	−1.965 (0.564)	−0.911 (0.528)	−0.823 (0.596)
AGE_50–59	−1.276 (0.581)	−1.311 (0.592)	−1.512 (0.656)	−1.417 (0.690)	−1.158 (0.384)	−1.129 (0.447)
AGE ≥ 60	−1.574 (0.485)	−1.624 (0.501)	−1.864 (0.573)	−1.674 (0.629)	−1.204 (0.492)	−1.234 (0.514)
ln(TENURE)	−0.447*** (0.006)	−0.344** (0.037)	−0.659*** (0.010)	−0.467* (0.075)	−0.234 (0.279)	−0.115 (0.625)

Corporate Governance

Takeaways

- **Governance Essentials**: Corporate governance provides the framework to control businesses, primarily aiming to balance interests vertically and horizontally
- **Agency Theory 101**: A key fundamental of corporate governance is that it addresses agency problems that are fueled by information asymmetry
- **Who's in Charge?**: Key players include shareholders, the Board of Directors (monitoring, approving major decisions, incentivizing management), and CEOs
- **Beyond the Boardroom**: A CEO's personal life and risk appetite can significantly influence corporate decisions, including M&A (these deals don't necessarily yield better announcement returns)

Thank You!

RSM Ezafung

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English

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