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Director compensation incentives and acquisition performance

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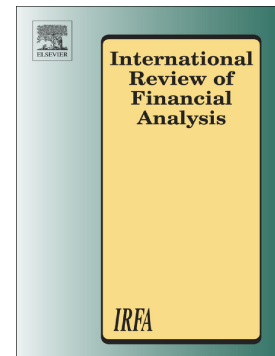
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Director Compensation Incentives and Acquisition Performance

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Abstract

This paper investigates the relation between director compensation structure and shareholder interests in the context of acquisitions. Our evidence suggests that acquirer firms that compensate their directors with a higher proportion of incentive-based compensation have significantly higher stock returns around the announcement. Compared to acquirers in the low equity-based compensation group, acquirers in the high equity-based compensation group outperform by 9.54% in a five-day period surrounding the announcement date. These results hold even after controlling for endogeneity issues. We further find that acquirers with higher equity-based pay exhibit greater improvements in stock price and operating performance in the three years following acquisitions. An increase in director equity-based pay also results in a lower acquisition premium for targets. These results indicate that equity-based compensation provides incentives for directors to make decisions that meet the interests of shareholders.

JEL classification: G30, G34.

Keywords: Board of directors; Compensation; Director incentives; Acquisitions; Bargaining power; Agency theory

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