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Mergers and acquisitions: CEO duality, operating performance and stock returns in Vietnam

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ABSTRACT

The market for corporate control in Vietnam is characterized by the absence of major antitakeover provisions typically available in developed markets. The disciplinary threat of losing corporate control and additional monitoring mechanisms in the Vietnamese institutional setting reduce managerial entrenchment and other agency costs of CEO duality. This paper provides evidence in support of stewardship theory that CEO duality positively impacts M&A results in Vietnam. Specifically, CEO duality firms have significantly higher announcement abnormal returns and growth performance than those with separate CEO/Chairman roles. Robustness checks include two stage least square regressions and propensity score matching techniques.

1. Introduction

The lack of “anxious vigilance” and “negligence and profusion” is the way Adam Smith describes a typical manager of a corporation where ownership is separated from management (Smith, 1776). Will s/he be able to deliver what is expected? Will s/he act in the best interest of the shareholders? Will s/he be trusted to assume not only one but even two of the most important leadership roles in an organization, the Chief Executive Officer (CEO) and Chairman of the Board (COB) in the so-called “CEO duality” structure? How could a balance between

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monitoring and empowerment be achieved? Does CEO duality deliver superior operating performance and stock returns? This paper addresses these questions in the context of mergers and acquisitions (M&A) in Vietnam.

Masulis et al. (2007) find that CEO duality is negatively related to acquirer returns among US firms. Their findings suggest that CEOs at firms with more antitakeover provisions (ATPs) tend to make less profitable acquisitions as they do not face the disciplinary threat of loss of corporate control. They also find that CEO duality is negatively related to acquirer returns. Our study examines CEO duality and M&A in Vietnam where firms do not have well-established antitakeover provisions to insulate them from the market of corporate control. Unlike markets where US-style ATPs are prohibited (Humphery-Jenner & Powell, 2011) and weak statute-based anti-takeover provisions are supplemented by charter-based provisions (Hwang & Kim, 2012), both these forms of ATPs are scarce in Vietnam. Most listed companies in Vietnam simply adopt the *Model Charter 2007* promulgated by the State Securities Commission (SSC) (Le & Walker, 2008). Out of the 24 anti-takeover provisions available in the US (Gompers et al., 2003), only *Bylaw and Charter amendment limitations*[1] exists in the Vietnamese Model Charter 2007. If CEOs make adverse acquisitions, the firm will bear the threat of being taken over. Besides the Board of Directors (BOD), CEOs in listed Vietnamese firms are also monitored by the Supervisory Board, the local communist party committee at the firm and by the State as a shareholder. These additional monitoring mechanisms would reduce the likelihood of managerial entrenchment by CEO duality and CEOs making self-serving acquisitions.

Vietnam is a regional economic power with 90 million people and an average GDP growth forecast of 5.6% to 2017 (OECD, 2013). Since joining ASEAN[2] in 1995, the World Trade Organization in 2007 and the recent Trans-Pacific Partnership, Vietnam has improved its regulatory framework and market institutions in preparation for a full transformation to market economy. With the country's economic progress, M&A activity has grown substantially at an average annual growth rate of 65% in recent years (Vietnam Investment Review, 2013). It is an increasingly popular form of foreign direct investment (FDI) for raising capital, developing local entrepreneurship and reforming the state-owned sector.

Vietnam presents a unique setting for studying CEO duality as CEO duality has deep cultural, political and institutional roots here, rather than it being just a pure choice by firms. The corporate structures of an economy partly stem from the structures with which its economy started (Bebchuk & Roe, 2000). CEO duality in Vietnam is grounded on the political ideology of centralized power in a single-party state, the Confucian culture of respecting authority, and the duality practice among state-owned firms. The country followed a centrally planned economic system with heavy state-ownership and state-control of business until *Doi Moi (Reform)* in 1986. In 2010 there were 1207 wholly state-owned companies and 1900 partially privatized companies in which the State retained a controlling interest of at least 50% state equity (OECD, 2013). With substantial shareholding, the state has the right to appoint senior executives of these firms, similar to the Chinese market (M. Yu, 2013; W. Yu, 2013). According to the World Bank (2006), during the early years of the stock market, the majority of the Vietnamese state-owned companies appointed their CEO, who often represents the equity of the state, as COB immediately after public listing. Despite the recent pressure to separate the two roles, CEO duality remains popular among listed firms in Vietnam. This exemplifies *sticky governance* in emerging markets (Black et al., 2006) where firms that invest to improve corporate governance may not be rewarded by the market and therefore have little incentive to go beyond what is legally required (Doidge et al., 2007).

Our study adds to the limited literature on CEO duality–M&A nexus in emerging markets. From an institutional perspective, our findings suggest that CEO duality, under additional monitoring mechanisms and in the absence of corporate anti-takeover provisions, creates wealth for the shareholders from M&As. We find that Vietnamese acquirers with CEO duality outperform firms without in terms of abnormal returns on M&A announcement and growth performance post M&A. Our empirical findings are robust given the rich set of control variables employed to reflect various institutional, firm-specific and CEO characteristics. Our results are enhanced by econometric techniques such as two stage least square regressions and propensity score matching analysis to address the potential problem of endogeneity.

This paper is organized as follows. Section 2 reviews the literature and develops hypotheses. Section 3 discusses the research methods. Section 4 describes the sample. Section 5 presents our empirical analysis and findings. Lastly, Section 6 concludes the paper.

[1] This takes the form of a supermajority vote requirement for charter or bylaw amendments.

[2] ASEAN is the Association of Southeast Asian Nations with 600 million people, ten member countries and a combined GDP of $2.4 trillion in 2013 (Mahbubani & Severino, 2014).