Interlocking Directors: Impact on Canadian M&A Outcomes

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Introduction

Given recent revelations of unscrupulous corporate governance practices, which led to the adoption of more stringent reporting and accounting standards, such as the Sarbanes-Oxley Act of 2002, investors are demanding more information about the governance of the firms in which they are invested.

This study explores the consequences (both positive and negative) of a specific corporate governance occurrence in the event of a Merger /Acquisition transaction – the **Interlocking Directorship**. An interlocking directorship occurs when one or more directors is a member of the board of governance of both the Acquirer as well as the Target firms.

Hypothesis

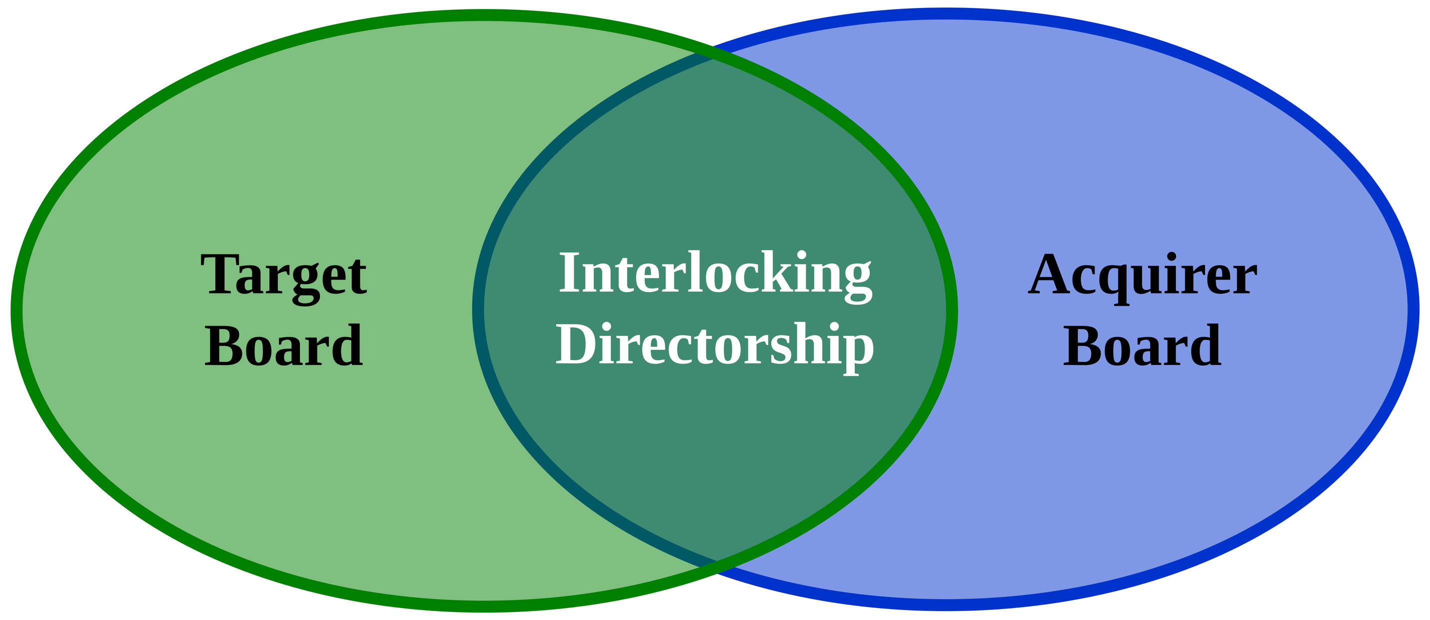
Risk in an M&A transactions is derived from **two** sources;

- **Asymmetry of Information** ~ can be eliminated with accurate information
  - Stand-alone value of the target
  - Value of the consideration offered (especially when payment is in stock)
- **Uncertainty of Future Synergies** ~ cannot be eliminated with accurate info
  - Potential future synergy

Since **Asymmetry of Information** is the only portion of M&A risk that can be eliminated, obtaining accurate information about the stand-alone value of the target (obtainable only from the target itself) and the value of the consideration offered (obtainable only from the bidder) should decrease the overall risk of the transaction.

However, since it is in the best interest of the target not to reveal its true value (so that it can receive as much from the bidder as possible) and it is in the best interest of the bidder not to reveal its true value of consideration (so that it can pay as least as possible for the bidder) – the information between the two entities is said to be **noisy** as each tries to keep the information asymmetry to their benefit.

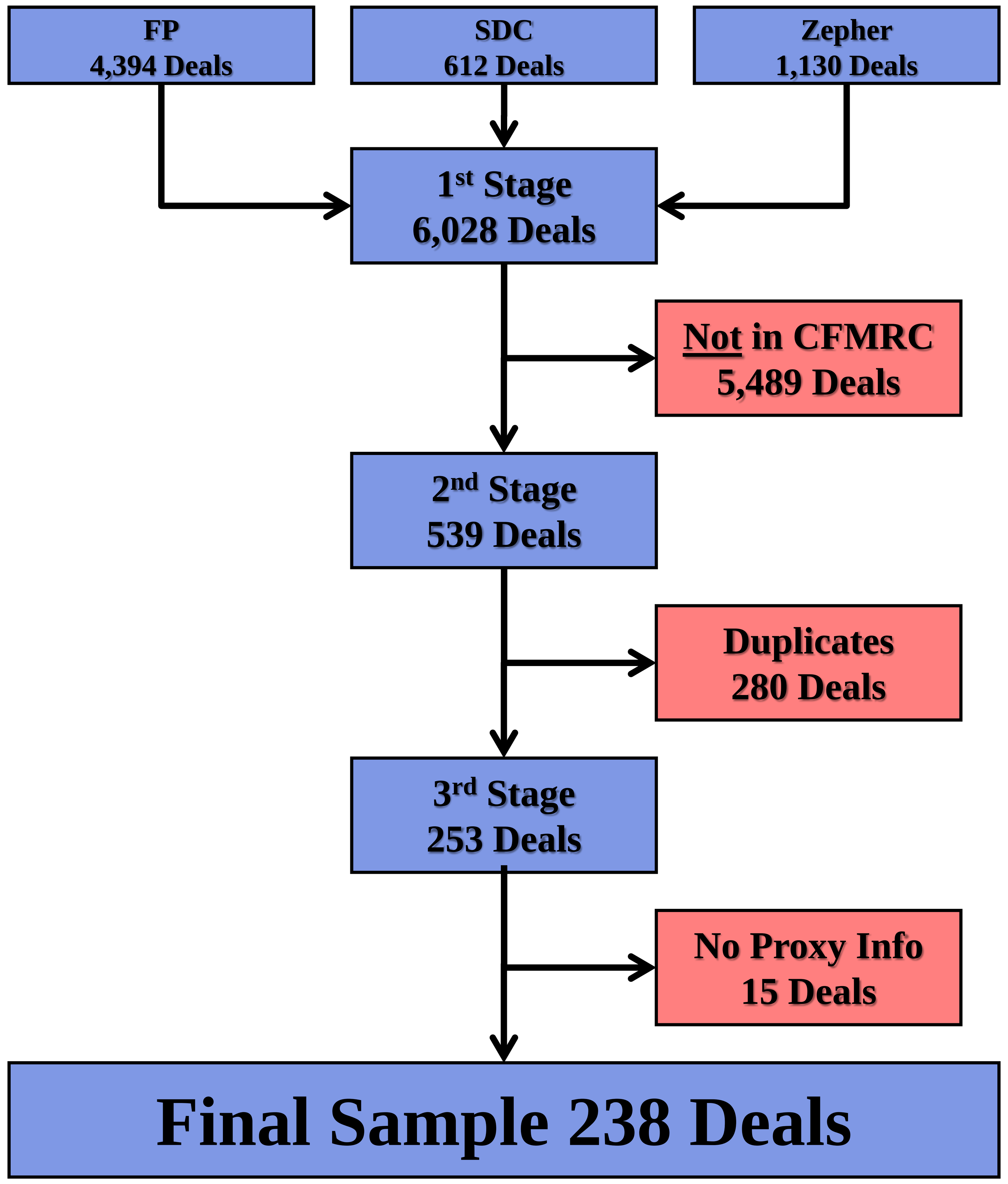
In the presence of interlocking directorships **how** is this information asymmetry is altered? – I hypothesise that information asymmetry will decrease, and the results should be manifested in the **cumulative abnormal returns** (CARs) that both firms' shareholders receive at the end of a deal



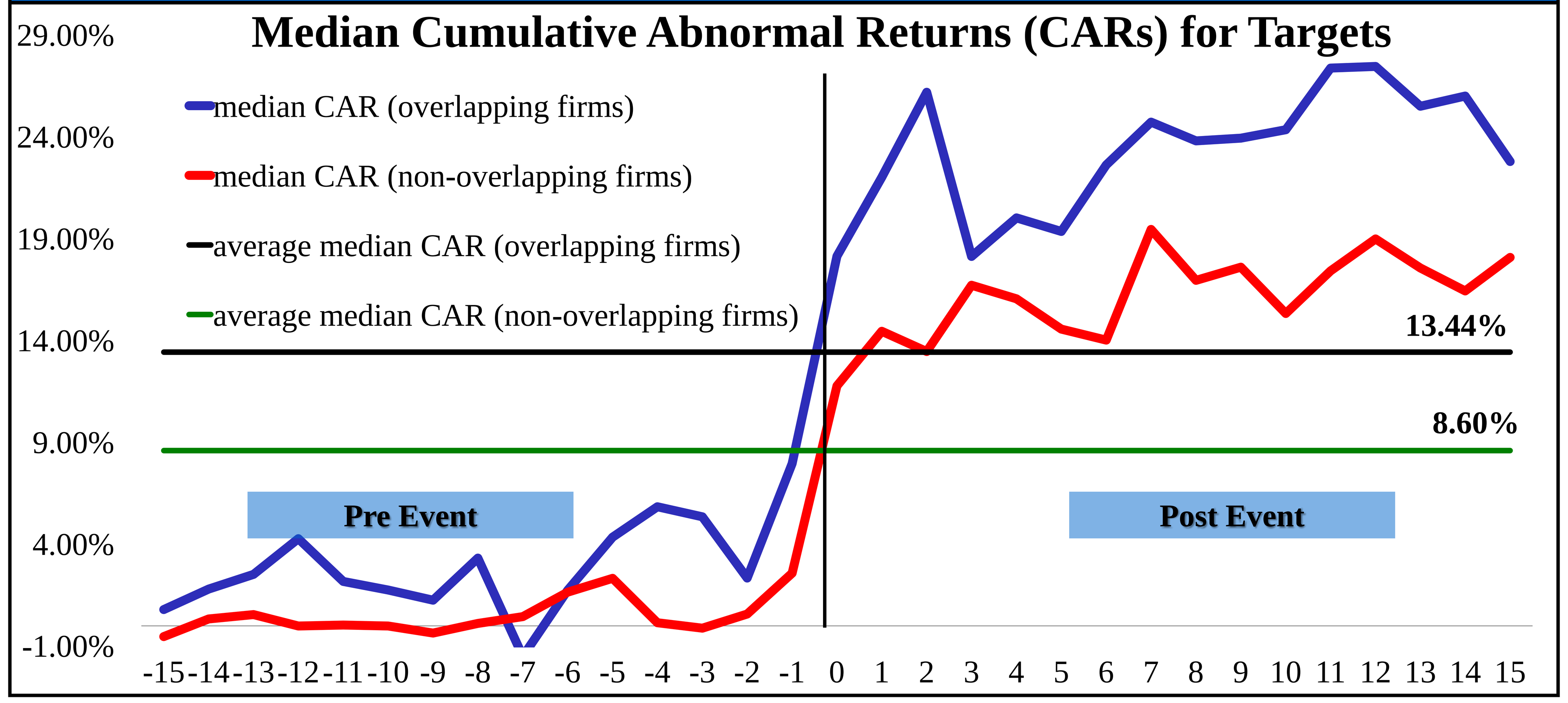
Data Collection & Methodology

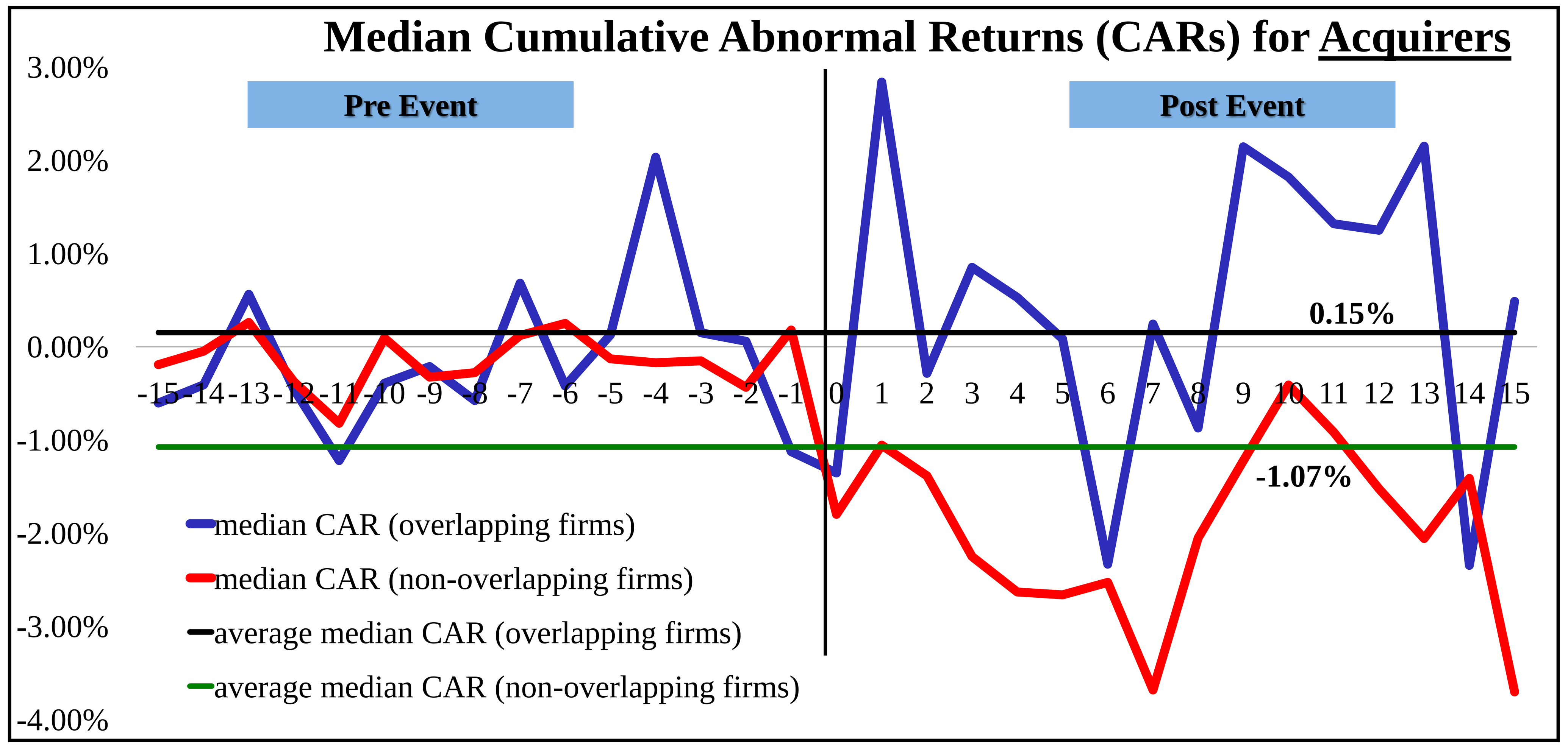
1. Locate all Canadian mergers from 1997-2003. Three sources.
   a. Securities Data Company (SDC) database
   b. Financial Post (FP) database
   c. Zepher database.
2. Match remaining firms with their stock information on the Canadian Financial Markets Research Centre (CFMRC)
3. Eliminate any duplicate deals
4. Document deal details via information on news-wire (Factiva database)
5. Collect board directors' information from company proxy statements filed on the System for Electronic Document Analysis and Retrieval (SEDAR)
   a. Directors' names (first / middle / last)
   b. Principle occupation
   c. Association with the firm (insider / outsider / grey)
   d. Stock & Option ownership (common shares / preferred shares)
6. Conduct **event study** – where the even is the deal announcement date – and compare returns for deals with interlocking boards versus those with no interlocking boards.

Current Data Sample



Preliminary Results





Interlocking Relationship + Pay in Cash = LOWEST Information Asymmetry = HIGHEST CARs in Total (both WIN!)	**NO Interlocking Relation + Pay in Cash = MODERATE Information Asymmetry = MODERATE CARs in Total**
Interlocking Relationship + Pay in Stock (or Mix) = MODERATE Information Asymmetry = MODERATE CARs in Total	**NO Interlocking Relation + Pay in Stock = HIGHEST Information Asymmetry = LOWEST CARs in Total (both LOSE!)**

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Contact Information

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General Information on M&A Theory

The read should note that there are **2 generally** accepted findings in M&A literature that are relevant to current

- Bidders, on average, exhibit **negative** CARs (they overbid) and targets show positive CARs (they are overpriced)
- Paying in cash is viewed as confidence (bidder knows the targets value well). Stock payments are the inverse.