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The effect of board size and CEO duality on shareholder value: Evidence from bank M&A in the US

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Abstract

This study investigates the performance implications of a major corporate governance mechanism, namely the board of directors, in the context of bank M&A. We also include in our analysis the interaction of board size with CEO duality, considering that the decision of a firm to combine (or not) the CEO and chairman roles affects the dynamics of the board and specifically its monitoring activity and decision-making (Jensen1993; Lasfer 2006). To address the study objectives, we investigate the wealth effects of M&A after the banking crisis (Laeven and Valencia, 2018) and draw important conclusions about the announcement period returns concerning board size. We utilize a dataset of 508 M&A bids announced by the US listed banks between 20122018, for which detailed information on board size was hand-collected from the annual reports on Form 10-K. Considering the results of the announcement of M&A, we provide evidence of a negative effect of board size on the wealth gains of acquiring banks. Furthermore, we show that banks with at least nine directors present worse results than banks with less than nine board members. The negative relationship between board size and acquirers' gains is consistent with agency theory (Lipton and Lorsch, 1992; Jensen, 1993; Yermack, 1996; Eisenberg et al., 1998; Coles et al., 2008). Considering the interaction of board size with CEO duality, the results show that the announcement of M&A is associated with gains for acquiring banks with large boards in case they combine the CEO and chairman roles. This finding indicates that the combination of the two internal corporate governance mechanisms (i.e., large board and CEO duality) can mitigate coordination and information costs (Yang and Zhao, 2014; Li et al., 2019), enhance the quality of decision making (Tanna et al., 2011; Pham et al. 2015), and lead to better responses to external events, such as M&A (Boyd, 1995; Mazzeo, 2004). Our study offers a novel, rigorous response to the fundamental challenge that board size should be explicitly determined. It is often unclear to what extent national or/and supranational organizations (i.e., issuers of corporate governance codes, see Aguilera and Cuervo-Cazurra, 2009) should let firms act freely or recommend the lower and upper limits of board size. We address this challenge, and thereby demonstrate that the optimal size of a board may be contingent on certain firm characteristics, implying that a "one-size-fits-all" approach to board size would be inappropriate.

Keywords: corporate governance; abnormal returns; agency theory; shareholder value