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Abstract

Scholars from multiplie fields have shown an increasing interest in the causes of value destruction in M&As, as recent empirical studies have found that many mergers and acquisitions fail to create value. In the current literature, the principle agency theory has been put in the center of attention to analyze the phenomenon of the relationship between management and shareholders. This fact has motivated us to develop a framework to organize the previous M&A literature in the context of the principal-agency theory assumptions, i.e. managerial self-interest, risk aversion, information asymmetries and goal conflict, to create the link between the agency relationship between CEO and shareholders and its impact on the level of value-destruction in M&As. The theoretical imperfections have been complemented by the behavioral finance theory, due to an increasing importance of psychology in the finance literature. The theoretical simplicity, together with the significant impact of external factors on human behavior, have created the motivation to develop the normative model, which adds value to the existing literature by generating a deeper and more profound understanding of the application of psychology in the agency relationship, to explain reasons behind value-destroying M&As. The situational analysis has revealed multiple conditions which moderate the level of value-destruction in M&As by capturing both externalities and human behavior patterns. The results of our work suggest the significant impact of the presence of social ties, market complexity & uncertainty and merger waves on the level of value destruction. The outcomes are discussed in relation to the unique approach, which has been undertaken to fulfil the existing gap both in psychology and finance literature.

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I. Introduction

For the fourth consecutive year, worldwide mergers and acquisitions activity has exceeded \$3tn, extending an unprecedented wave of deal-making that bankers say is set to accelerate this year (Massoudi, Fontanella-Khan, & Weinland, 2017). Moreover, the observation that mergers tend to cluster by time and industry may be one of the most consistent empirical regularities found in the merger literature and thus a reason to be of great focus in our master thesis. Industry merger waves can, in fact, be of impressive magnitudes. Assessing acquisitions of at least \$100 million, Harford (2005) has identified 35 waves from 1981 to 2000, with an average of 34 mergers per wave. Various theories have been put forth to explain this pervasive pattern.

Looking at a recent acquisition, Amazon.com Inc. has bought Whole Food Market for \$13.7 billion in 2017 (Goeffrey, 2017). While Whole Foods is all about an upscale experience, Amazon is about bargaining at the customer's own risk. As the business models and market positioning of the two organizations are almost exact opposites, the question arises whether the acquisition took place due to the pursuit of the manager's self-interest and thus may be prone to failure. As Amazon is not the only company engaging in M&As, where possible synergies might have been overestimated, the importance of this topic becomes clear. In fact and in accordance to Moini & Wang (2012), the failure rate of M&As lies within a range of 40-80 %. This striking result is difficult to reconcile with the neoclassical assumption with regards to the economic man being completely rational, so that a different approach, i.e. behavioral finance, must be introduced. This may be complemented by the principal agency theory, as the framework is very suitable to caption the relation between shareholders and the management in a M&A setting. Hereby, the management can be interpreted as the agent, whereas the principal is embodied by the shareholders. Reconciling these two theories is beneficial, as it places the agent's performance as well as motivation at the center of the agency model. This centralization is especially important in a M&A setting, as it is the management of the acquiring company deciding whether to engage in M&As or not. Thus, our thesis is about the implementation of both behavioral and agency theory in the M&A setting to generate the normative model, where the managerial M&A antecedents, which are most likely resulting in value destruction, are exposed to a situational analysis to reflect the M&A setting as realistically as possible.

The behavioral finance theory, which studies the effects of biases related to human judgment during the decision-making process, is built on the foundation concerning irrational behavior and will complement the analysis concerning the well-known case of managers thinking that they are maximizing shareholder value, when in fact the opposite is the case. This enhances the applicability of the principal agency theory in complex settings like M&As, since the original principal agency theory does not take these biases explicitly into account. Rather, it deals with problems that arise when cooperating parties have different goals and division of labor, by using the metaphor of a contract.

With regards to M&A antecedents, most research has focused on antecedents of M&A success, which is strategic complementarity, cultural fit and the degree of integration (Florian & Kurt, 2013). Focusing on the antecedents of M&A engagement (not only the success), the review of Haleblian, Devers, McNamara, Carpenter, & Davison (2009) has divided the antecedents into value creation, managerial self-interest, environmental factors as well as firm characteristics, which all have an influence on acquisition behavior. This acquisition behavior has a direct impact on the outcome of M&As, which is moderated by different factors, i.e. deal characteristics, managerial effects, firm characteristics and environmental factors. It has been found out that most of the moderators showed positive as well as negative effects on the acquisition-performance relationship. However, there has been no direct link made to the application of the principal agency theory as well to the moderating role of external factors on M&A antecedents rather than on M&A outcomes. In fact, in the future research part of Haleblian et al. (2009), it is suggested to develop a deeper understanding of the relative importance of different M&A drivers as well as the contingency conditions associated with those established drivers.

Thus, we came up with our problem statement to explain how the relationship between management and shareholders, characterized by self-driven M&A motives, explain value destruction in M&As, as accurately as possible, by the development of a normative model, which includes crucial and interesting external factors. Thereby, the creation of such a detailed and whole overview of a M&A setting from a principal agency theory lens should fill the research gap considering the accurate implementation of the principal agency theory in a M&A setting to assess the value-destroying antecedents of M&As.

During the development of our master thesis, we have particularly focused on the pre-merger phase of M&As rather than the process on its own or the post-merger performance. As a result, the management of the acquiring firm will be identified as the agent, whereas the shareholders are representing the principal in the application of the principal-agency theory in a M&A setting. Thus, we will not include all the other principal-agency relationships, which may occur in this particular setting, like the acquiring company being the principal and the target company being the agent. In this case, the principal would look for a low purchasing price and high utility, whereas the agent would look for a high purchasing price and low work effort. The reason for not taking this into account is due to our research problem, where we have decided to focus on M&A antecedents and their reaction to specific external factors, since it is during the pre-merger phase, where most of the behavioral biases might become apparent and result in value destruction. However, by pursuing M&As for the right reasons, we believe that this will also be reflected in the post-merger performance, so that there is an indirect link to the process as well as the post-merger phase of M&As.

The first part of the thesis deals with the theoretical approach of the principal agency theory as well as M&A antecedents. Afterwards, we want to make the principal agency theory more practical, by assessing the influence of different factors on the chosen M&A antecedents. This already contributes to our normative model development, where at last we want to give the whole overview of interactive factors which contribute to the phenomenon of the relation between shareholders and management in a M&A setting and the resulting value destruction level of these kind of transactions.

1.1 Structure

In this section, the overview of the structure will be provided together with the description of links between the specific sections.

The first section includes an introduction and a problem statement, which place the literature analysis into the context of prior research. The problem statement is followed by the description of research limitations and the methodology used to develop both the literature analysis and the normative model.

The point of the thesis, starting in Section 2, is to create the ***analysis of literature***, which is a special type of literature review. Firstly, the agency theory lens will be introduced and applied to ensure that the literature is relevant and is viewed from the same perspective. After the introduction of the theoretical lens, the thesis will apply it to behavioural finance and point out the relevance of the behavioural aspects in relation to M&A activity. The literature analysis through an agency theory lens will be positioned in various boxes, called the psychological antecedents of M&As. The antecedents will be defined as factors, which are present in the agency relationship between CEO and shareholders and which have a significant impact on the level of value destruction. The following aspects will be in-depth analysed.

What is more, Section 2 will question findings presented by scholars. The following will lead to interesting ***contradictions***, existing in the M&A and behavioural finance literature, which will be critically reflected upon to point out the most reliable papers, which will be used in the latter section to build a normative model.

Section 3 aims to develop a ***normative model*** which will be the main contribution to the existing literature. The term 'normative model' will be in-depth introduced in the methodology part. In the model, the previously analysed antecedents will be positioned and opposed to different external factors, defined as moderate conditions affecting the relationship between the CEO and shareholders in the M&A setting. Afterwards, the combination of the presence of external factors will be assessed, which will create our own contribution to the existing studies. What is more, the section will show interesting alleys for future research.

In section 4 the ***discussion of the findings, as well as the derived recommendations***, will be presented. The aim of the discussion is to present the relevance and the validity of the findings presented in section 2 and 3. The discussion part will be followed by general recommendations, suggestions for future research, as well as possibilities to limit the negative effect of managerial decisions under different scenarios in M&As. Section 5 will present ***the answers for both the problem statement and the sub-questions*** and will present ***an overall conclusion of the literature analysis and normative model***, which will end the thesis.

1.2 Problem Statement

Generally stated, the agency theory has been used by scholars as an explanation for underperforming outcomes of managerial decisions on shareholders' wealth. The outcome, that M&As are often unsatisfying for shareholders, have been witnessed in both empirical and theoretical findings and the behavioural finance has been addressed to complement on the agency theory's imperfections. The following triggers the motivation to further explore the phenomenon of the relationship between the principal and agent, in our setting: shareholders and CEO, from a different perspective, to generate further insights about the topic. The existence of external factors in complex strategic-decisions such as M&As seems to violate the agency theory assumptions, as management behaviour varies while being exposed to different externalities, and thus affect the level of value destruction in a M&A setting. To explain this reality, the need for the development of a normative model appears, to present a situational analysis of the principle agency relationship in a M&A setting. The following culminates to the main research question:

Does the principle-agency theory explain the value destruction in M&As, and if so, how can it be described and improved?

To be able to fully answer the question, the following sub-questions will be investigated, both in the literature analysis as well as in the normative model:

1. ***Which theoretical lens should be applied to best explain the value destruction in M&As?***
2. ***Why are the chosen agency theory antecedents relevant in the relationship between the CEO and shareholders in M&As and why is there a need to further investigate them?***
3. ***How can the behavioral finance theory complement on agency theory imperfections?***
4. ***What is the normative model and how can its development reflect the agency relationship between management and shareholders in a M&A setting?***
5. ***What is the reason behind choosing specific external factors to be applied in the model? How do those factors affect the agency relationship, between management and shareholders in a M&A setting, and the respective level of value destruction?***

Before answering the sub-questions, the discussion regarding the outcome of our analysis will be presented. The discussion will be followed by general recommendations for academic researchers, recommendations for future research as well as practical recommendations on how the value destruction in M&As could be mitigated

1.3 Limitations

Our thesis will place its emphasis on assessing the motives of the bidder (acquirer) and not of the target firm. This constitutes the first limitation of the development of our normative model, as aiming to accurately reflect the reality of a M&A setting should also include the view of the target company. However, doing this would disrupt the space limitation and would lead to a superficial analysis with no greater in-depth insights. What is more, this choice has been made with regards to the fact that the acquirer is the proactive participant in a M&A setting and thus generates more possibilities for the manifestation of M&A antecedents based on managerial self-interest and thus resulting in value destruction. This can be seen in the fact that research has found out that the acquirer is more likely to underperform relative to the target.

In addition, the thesis will stress motives for engaging in M&A transactions that are only linked to behavioural finance, thus leaving out the traditional economic theory. Even though the explanation of M&As through a traditional economic theory might have been of use, our choice to not explicitly mention them can be seen in the light of the fact that the effect of traditional economic theory is unquestionable and has already been firmly developed by in depth empirical studies conducted through prior research. What is more, the lack of a traditional economic theory lens is substituted by the behavioural finance theory, which is of greater importance for us, as we want to stress the psychological and irrational behaviour of acquirers in a M&A setting.

In our limitations section, it is also worth pointing out that we have been taking on the value maximization approach. Hence, decisions that might seem reasonable from the manager's point of view will only be regarded as successful if they create value for shareholders. This is in line with the principal agency theory, which is applied as our theoretical lens during the literature analysis, as well as the normative model development, where the shareholders' aim is value maximization.

Moreover, M&A transactions have the tendency of occurring as a sub-strategy in the broader growth strategy of a company (Sandy & Mike, 2008). As a way of enhancing the scope of the thesis, we will, however, disregard this aspect and thus treat M&As as individual observations.

What is more, it may be argued that the assessment of the psychological factors in a M&A setting through a principal agency theory could have been done through a qualitative case study, which most of the time has the potential to proof the existence, as well as significance, of behavioural finance in a M&A setting. However, to our opinion, our topic covers the areas which are too broad to be investigated through a qualitative case study. To our opinion, this is also the reason why the development of a normative model, derived from the state of the art of M&A literature, is the most accurate form of analysing our master thesis topic. By that we contribute to the current qualitative studies of M&A settings, as we consolidate them and thus create a new input on which we have based our normative model.

As in the case of most of the other literature regarding M&As, our thesis will implement a pragmatic language when it refers to any form of takeover activity. Hence, the thesis will implement terms as merger, acquisition and takeover interchangeably despite the difference, since the difference is of less importance regarding the scope and aim of the thesis. Thereby, the pragmatic language improves in increasing the readability of our master thesis.

Proceeding with the limitations of our master thesis and focusing on the corporate governance aspect of the M&A setting, it is worth mentioning that we have assumed an alignment of interests between shareholders and the boards of directors. This, however, is not always the case. In fact, there can also be another (besides the management and shareholders agency relationship), agency relationship between the board and the shareholders, where the board will play the agent role and the shareholders will be perveiced as principle. This relation gets even more severe, if the board gets closer to the management of the acquiring company. Therefore, to some extent, directors must be distinct and independent from management – yet must also be aligned with shareholders' interests. We have not included this aspect in the development of our normative model, since we want to generate in-depth insights regarding the relation between shareholders, represented by the boards of directors, and management. The relation between shareholders and boards of directors is not in scope of the thesis. Hence, the assumption that the board of directors is juxtaposed between the shareholders and the management. The directors are thus standing in a position of trust and confidence in relation to their corporation. They are fiduciary, in that they act reasonably, in good faith, and for the benefit of the company and its shareholders. Accordingly, directors and officers are prohibited to use their positions to receive personal gains at the expense or the detriment of the company. Nevertheless, the consideration of the principal agency relation between the board of directors and shareholders, during the development of a normative model of M&A settings, may be addressed by future researchers.

Next, the fact that investment decisions, like M&As, are normally based on the consensus of the top management team, so that it is not only the CEO deciding whether to enact the acquisition and/or merger, has not been addressed in the development of our normative model. Nevertheless, the role of a top management team (TMT) and the impact of its diversity on the firm performance and acquisition experience is presented in our literature analysis, to create a general understanding of this important aspect. The reason for not including TMTs in the development of our normative model is, again, due to the scope of our master thesis, as well as an in depth focus on the relationship between the CEO and shareholders, and not the relationship between the CEO and the top management team. Hence, the thesis will implement terms as CEO and management interchangeably despite the difference. Thereby, the pragmatic language improves in increasing the readability of our master thesis.

Moreover, after we have looked at the influence of each of the external factors on the M&A antecedents separately, we have consolidated the impact of social ties and market complexity during a merger wave. However, there has been no consolidation of all three external aspects, i.e. merger waves, social ties and market complexity, when regarding their combined impact on the M&A antecedents. Nevertheless, it could have been of use when regarding the fact that the aim of a normative model is to reflect the reality of a specific setting as accurately as possible.

Regarding the assessment of the impact of the external factors on the M&A antecedents, which we have presented in our literature analysis, we have chosen three external factors, i.e. social ties, market complexity (market competition and uncertainty) as well as merger waves. The reason for our choice is that social ties reflect quite accurately the social aspect of M&As and as are a useful tool to explain the board's behaviour. Market complexity is often a major reason for engaging in M&As and thus might have a crucial impact on the antecedents of M&As. Merger waves are insofar interesting, in that they pick up our major topic, i.e. mergers and acquisitions, in that they describe a period of time where there is a high engagement of companies in M&As. However, one could argue that the consideration of more external factors, for instance in which kind of industry the M&A is taking place, could be beneficial for the development of a normative model reflecting the reality of M&A settings. Nevertheless, doing so would, again, lead to the fact that no great in-depth results can be made, creating a rather shallow contribution of our developed normative model.

Proceeding, we have not provided any relation to past merger waves when analysing the impact of merger waves on the M&A antecedents and the respective value destruction. This is a limitation, as past merger waves might have generated a possible argumentation for the assumption of a certain impact of merger waves on a specific M&A antecedent.

Furthermore, during the development of our normative model, we have not distinguished between a friendly or hostile takeover. However, this could have generated additional information regarding the situational analysis of managerial self-interest motives for engaging in M&As, in that managerial overconfidence may be triggered even more when the takeover is hostile rather than friendly. The reason for not taking this into account, is, again, the scope of our thesis as well as the generation of in-depth insights of specific M&A antecedents in particular situations.

Lastly, the external factors could have been differentiated according to their level. For instance, high, middle and low market complexity and the respective influence of the different levels of the external factors on M&A antecedents. However, doing this would require strong assumptions, as there is little evidence on which one can assume different effects of different levels of a specific external factor. As a result, we identified this assessment as being out of the scope of our master thesis.

1.4 Methodology

During the development of our master thesis a qualitative approach will be implemented, however, the thesis will explore both qualitative and quantity studies. The scholar's interest in the field of M&As has been widely witnessed in the academic literature and the existence of agency problems in almost all types of organizations has made that theory one of the most important ones in the finance and strategic literature. Therefore, the combination of M&A and agency studies seems to be interesting to be further investigated.

The methodology part of our master thesis will be divded into two parts, namely the methodology regarding the literature analysis as well as the methodology of the development of our normative model.

Literature Analysis

Firstly, to be able to perform the previously described literature analysis, we have explored various books, journals, working papers and chapters. The materials were found in online databases such as Wiley, JSTOR, SAGE, Science Direct and Emerald, which allowed us to gather essential data to build our normative model in the latter section and fulfil the existing gap with the new perspective. The articles have been searched by various keywords, such as: agency theory, agency theory criticism, mergers & acquisitions, CEO-shareholder relationship in M&As, agency theory in M&As, intermediary in M&As, hubris, compensation, risk-aversion, information asymmetries or goal conflict. We were mostly focused on the articles from reputed journals, such as Journal of Financial Economics, Journal of Finance, and so on, to deliver a valuable quality of literature analysis and a solid baseline for our normative model. We have not limited ourselves with the date of publication of articles, therefore, the thesis includes articles from the beginning of the 19th century up to the recent works from 2017. The quality of the papers has been critically reflected upon. The number of references, the amount of times the paper has been cited, the quality of samples used, and the scholar's background have been investigated. In case of contradictive findings in the quality papers, the different directions have been presented. After doing so, we have either agreed with one of the perspectives, or suggested alleys for future research to further investigate which perspective seems to be more viable.

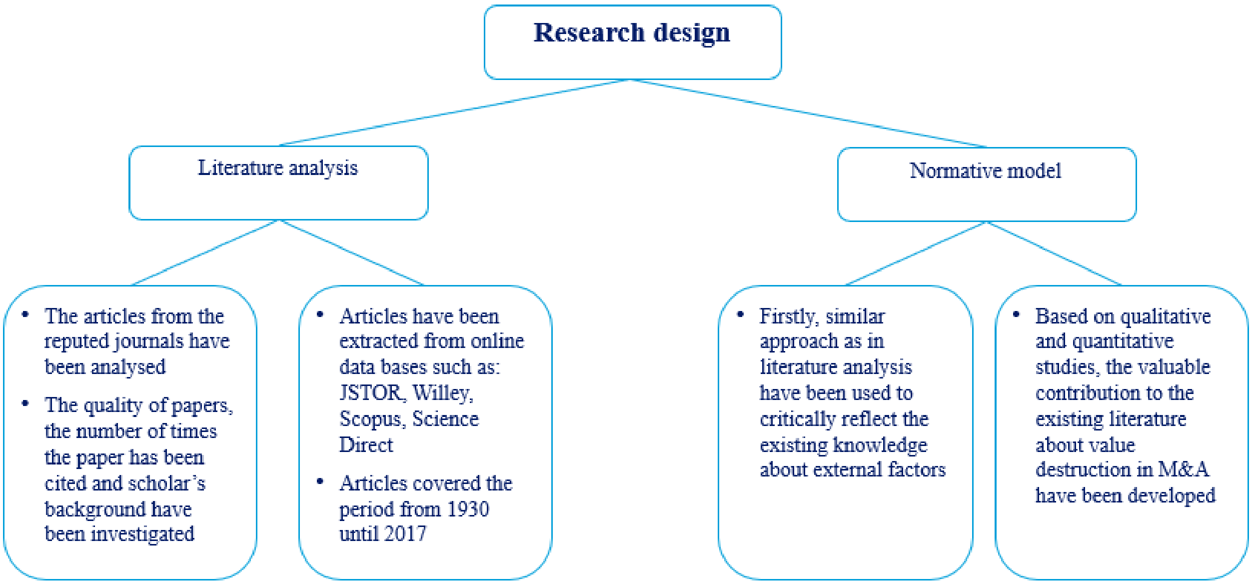
Normative Model

Secondly, based on the previously investigated literature, the normative model has been built. The reason why, and how the normative model has been created seems to be essential to mention at the beginning, to allow the reader to fully understand the key point of the thesis.

According to Baron (2012), normative models are described as complements to theoretical assumptions. Referring to Baron (2004), a normative model aims to focus its attention on relevant issues and further investigate them form a completely new perspective. The need for the development of a normative model appears when the biases, which are defined as deviations from theoretical assumptions or models, are present. The model aims to explain the deviations by finding a new way to correct them and improve the quality of judgements (Larrick, 2008).The following definition can be applied to the 'Psychology of Value Destruction in M&As'. The literature analysis will be used as a tool to point out not only the agency theory's relevance but also its generality, while applied to M&As, which can confirm the existence of deviations from the theoretical assumptions in the phenomenon of the relationship between CEO and shareholders. The normative model will be built due to the need for a further investigation of the phenomenon from a new perspective. This unique approach will be taken on during the thesis to improve the quality of understanding the value destruction in M&As through the lens of agency theory. Nevertheless, the question why such an approach should be chosen may still appear. The aim for a normative model is to present the most realistic perception of value destruction in M&As, by complementing on theoretical simplicity and creating a valuable contribution to the literature by filling the exisiting gap. The normative model aims to combine the existing knowledge and elaborate on it. To achieve that, the previously analysed antecedents will be positioned and opposed to different external factors, defined as moderate conditions affecting the relationship between the CEO and shareholders in a M&A setting. Afterwards, the combination of the presence of external factors will be assessed, which will create our own contribution to the existing qualitative studies. What is more, the section will show interesting alleys for future research.

The methodology used in our normative model has been divided into two steps. Similarly, as in the literature analysis, the knowledge about external factors affecting the relationship between CEO-shareholders in a M&A setting has been critically investigated. The articles have been searched by various keywords, such as external factors in M&As, social ties, CEO & boards of directors in M&As, market complexity, competition, merger waves, agency theory in merger waves or social ties. The materials have been found in online databases such as Wiley, JSTOR, SAGE, Science Direct and Emerald and the quality of papers has been critically reflected upon. The results of the quantitative and qualitative studies have provided the basis for a valid discussion of the theoretical findings. After creating a solid baseline, the topic has been further assessed and a new input, closing the existing literature gap, has been created.

Figure 1 - Methodology



Source: Own creation

The subject of our thesis, together with its contribution, provides an excellent basis for the behavioural explanation of the agency theory imperfections in the relationship between the CEO and shareholders in a M&A setting.

II. Literature Analysis

The aim of this section is to create ***the analysis of literature*** related to the psychology and behavioural finance of M&As through a specific theoretical lens, namely the principal agency theory. The literature will be positioned in various boxes, called value-destructive M&A antecedents, in other words, the factors which are present in the relationship between CEO and shareholders from both psychological and agency perspective and which most likely lead to an increased level of value destruction resulting from the engagement in M&As. The quality of the papers has been critically assessed. Moreover, the number of references, the amount of times the paper has been cited, the quality of samples used together with the scholar's background, have been taken into account before presenting the theory as valid.

2.1 Introduction of the Theoretical Lens: Agency Theory

During our literature review, regarding the psychological antecedents of mergers and acquisitions, we have taken on the principal-agency theory perspective. In the first part of the introduction of the principal-agent theory as our theoretical lens, we will present definitions of M&As and the principal-agency theory to ensure that the reader has the right understanding of these notions. Afterwards, the relevance of this perspective in analyzing the M&A literature will be described. Finally, a closer look will be taken on the particular influence of the principal agency theory on M&As, as well as short description of the main antecedents of M&As, derived from the principal-agency theory, will be presented, which will be further assessed in the next part of our master thesis.

M&As often enable a company to develop a competitive advantage, in that they enhance flexibility, growth, and shareholder value. Referring to Marsch (2015), common reasons for M&As include strategic growth, talent growth, preparation for an IPO or exit, and entering a new geographic or demographic market. Both mergers and acquisitions describe a mean of corporate expansion and growth, and even though they have important distinctive features, in that mergers define the combination of two or more companies to form a single entity under a consolidated management and ownership, and acquisitions describe the purchase of a company or parts of it, so that the target company usually loses its independence, for the further progression we will not explicitly distinguish between these two.

Next, we will proceed with a description of the principal-agency theory as well as its main assumptions and conclusions. Referring to Eisenhardt (1989), the so-called agency problem arises when cooperating parties have different goals and division of labor. Specifically, agency theory refers to the ubiquitous agency relationship, in which one party (i.e. the principal) delegates work to another (the agent), who performs that work. Within agency theory, this relationship is grasped by using the metaphor of a contract. Generally, agency theory addresses the resolution of two problems that can appear in agency relationships. The first one is due to when the principal and agent have different attitudes towards risk and can be referred to as the ***problem of risk sharing***. The problem here is that the agent and principal can favor different actions because of different risk preferences. The second one is the ***agency problem*** that occurs when there is a conflict between the desires or goals of the different parties (i.e. principal and agent) and it is expensive or difficult for the principal to investigate whether the agent has behaved appropriately. The costs associated with this kind of verification are a part of agency costs, which include, referring to Jensen & Meckling (1976), the monitoring expenditures by the principal, the bonding expenditures by the agent as well as the residual loss. The principal-agent theory focuses on the determination of the most efficient contract governing the principal-agent relationship given assumptions about people (e.g. self-interest, bounded rationality, risk aversion), organizations (e.g. goal conflict among members), and information (e.g., information as a commodity). The theory tries to assess whether a behavior-oriented contract (e.g. salaries, hierarchical governance) is more efficient than an outcome-oriented contract (e.g. commissions, stock options, transfer of property rights, market governance). Regarding the application of the principal-agent theory, it can be said that it has been implemented to organizational phenomena such as compensation (e.g., Eisenhardt, 1985), acquisition and diversification strategies (e.g., Amihud & Lev, 1981), boards relationships (e.g., Fama & Jensen, 1983), ownership and financing structure (e.g., Jensen & Meckling, 2012), vertical integration, and innovation.

The reason for the importance of analyzing the previous M&A literature from this perspective lies in the fact that the emergence of the psychological and human side in the research on mergers and acquisitions becomes more and more apparent. According to Vaara's (2002) review of prior research, the success or failure of a merger or acquisition process is determined by: (1) strategic fit, (2) cultural fit, (3) the management of a merger or acquisition process, (4) employee resistance, and (5) other reasons, such as: environmental factors, management turnover, method of financing, relative size of the organizations, prior acquisition experience, pre-merger performance of the acquirer, and organizational age. In conclusion, it can be said that the principal-agency problem has a big influence on M&As. Referring to Parvinen (2003), it can be said that agency theory assumes a central role as the intellectual underpinning of the M&A discourse.

Hereby, our goal is to reconcile the economic perspective with the management perspective of the principal agency theory in the specific case of M&As. Whereas the economic perspective focuses on the examination of the efficacy of contracts with the goal of managing agents efficiently as well as with the examination of incentives which align the behavior of agents with those of principals, the management perspective deals with 'deviations' from the strict negative assumptions regarding the behavior of individuals of the economic perspective. In the management perspective, these 'deviations' are central to behavioral research (Wright, Mukherji, & Kroll, 2001).

Generally stated, there are a lot of principal agency relationships in M&As. Within the context of M&A antecedents, it can be said that the management can be identified as the agent, which carries out an effort on behalf of the stockholders, the principals. This relationship is a classic problem in corporate governance and is defined as the type 1 agency problem (Thomsen, 2008). Here, the asymmetric information problem arises since the manager has superior information of the business prospects compared to shareholders, in that he or she is usually better informed about the daily operations of the firm and business opportunities than the owners (Hendrikse, 2003). The reduction of this information gap by collecting the same kind of information comes at a cost and may result in a negative net effect. What is more, there is a conflict of interest because managers may pursue other objectives than maximizing shareholder value, for instance when they act for their own financial interest or personal best. Applied on the specific case of M&As, managers might try to create an illusion of the possible synergies in a transaction, and thus overpay for targets because of own interest, resulting in value-destroying M&As. In the principal-agency theory, this behavior is defined as opportunism. What is more, managers may be inclined to increase the size of the firm through M&As due to both tangible and intangible benefits, which we will further assess in the part of the psychological antecedents of M&As. Moreover, as managers are risk averse in their acquisition strategy, risky M&As which might yield a higher NPV will not be accepted (Brealey, Myers & Allen, 2008). Also, managers may favor a diversification strategy in M&As only to ensure job security. Another source of agency costs with respect to M&As is the managers' tendency to entrench themselves by engaging in manager-specific investments. An example for this could be sequences of acquisitions, which are a part of a broader strategy and thus will be costly to withdraw from. The entrenchment effect can be even more enforced by external circumstances like a merger wave, where the financing accessibility is increased. All of these factors are only a short description of the possible conflicts of interests between the CEO and shareholders in the specific case of M&As and will be further analyzed in the light of the psychological antecedents of M&As derived from the assumptions of the principal-agency theory and most likely resulting in value destruction.

In the context of the M&A process, the acquirer can be identified as a principal and the target as the agent since the acquirer is the uninformed party and the agent the informed party, so that the agent is able to take advantage of this information asymmetry. In the case of an acquisition, the principal is looking for a low purchasing prices and high utility, whereas the agent's aim is to get a high purchasing price and low work effort. Since the principal can't assess the characteristics and qualities of the agent before the contract is made, the so called adverse selection problem occurs, which describes the risk of selecting a bad agent, who is only in the pursuit of his or her utility maximization, disregarding the value maximization of the acquirer. As the principal's return depends on the agent's qualities, it's in the principal's interest to find a good-skilled agent. To minimize the risk of selecting a bad target, principals may offer an average purchasing price, so that they can restrict the loss if the quality of the target is bad. However, this can lead to the fact that only bad-skilled agents will engage in the acquisition since they feel well-paid. This contrasts with the high-quality agents, who expect better quotations and thus, restrain from the acquisition. According to Akerlof (1970), this is known as the 'lemon-problem'. Besides the hidden characteristics problem, leading to the adverse selection problem, hidden action can also occur. Here, the problem arises since the principal cannot judge if the results of the agents' actions are the consequences of the agents' effort or the result of favorable circumstances. This phenomenon occurs when the agent expects a higher return by acting (unnoticed) non-conforming and is defined as the moral hazard problem (Hoelmstrom, 1979). Applied on M&A transactions, the target's CEO may receive information about changing economic circumstances, which the CEO of the acquiring company does not have. If this is the case, the management of the acquirer can observe the activities of the target, but they are not able to evaluate the result.

Here, it is worth pointing out that the M&A process is out of the scope of our thesis and that the focus will be put on the agency relationship between CEO and shareholders, and thus on the value destroying antecedents of M&As.

2.2 Psychological Antecedents of M&As Through the Lens of Agency Theory

As mentioned above, we will now explicitly focus on the psychological and value-destroying antecedents of M&As and thus take an internal perspective of the acquiring company, in that we look at the relation between the CEO and the shareholders. By clustering the previous M&A literature into different aspects, we will try to make a link between the assumptions of the principal agency theory and the value-destroying antecedents of M&As. Hereby, it is important to us that there will be a great focus on the psychological factors which lead to M&As. To be critical, we will point out the contradictions as well as alleys for future research in all the agency-theory related and value-destroying M&A antecedents. This will constitute the basis for the development of our normative model, which has the aim to enhance the principal agency theory when applied to the value-destroying antecedents of M&As.

2.2.1 Managerial Self-Interest in M&As

Generally stated, agency theory assumes the pursuit of self-interest at the individual level (Eisenhardt, 1989). Looking at the context of M&As, it is the manager whose actions are marked by self-interest since he or she is the decision-maker who initiates and implements the decisions of the firm without being the real bearer of the wealth effects of their choices. According to Haleblian et al. (2009), managerial self-interest as a possible value-destroying antecedent of M&As can be divided into four components, namely ***compensation, hubris and target defense tactics***. However, as our focus lies on the behavioral agency theory, stressing the agent as the main component of the principal-agent relationship as well as his or her ability, motivation and perfect opportunity, we will also include the ***'empire building'*** as well as the ***'managerial entrenchment'*** aspect in the analysis of the managerial self-interest as an antecedent of M&As derived from the principal-agency theory.

Compensation

Referring to Harford & Li (2007), the costs and benefits to bidding firm CEOs shed light on the forces that determine when and why takeovers are implemented. In fact, acquisitions provide a natural opportunity for the CEO and the boards to restructure their compensation, in that the CEO may argue for more pay and for pay that is less sensitive to performance for the first few years of the acquisition due to the increase in size and complexity of integrating the two companies. This is enforced by the uncertainty and information environment surrounding an acquisition which enable the CEO to have more leeway. It was shown that acquiring CEO's post-acquisition compensation generally increases, irrespective of the resulting performance of the acquisition. Potential decreases of acquiring the

CEO's wealth are offset through liberal post-acquisition equity-based pay grants (Harford & Li, 2007), bonuses (Grinstein & Hribar, 2004), and other compensation (Bliss & Rosen, 2001). As a result, a ***paradox*** can be identified, in that the result of the study of Harford & Li (2007) is inconsistent with the incentive alignment hypothesis in corporate acquisitions, which states that managers with greater ownership or managers with more equity-based incentives are less inclined to take value-destroying actions. Thus, current compensation schemes may be less effective in reducing the agency conflict than previously thought, especially when regarding the fact that the study of Harford & Li (2007) has been empirically conducted with a sample of 370 completed acquisitions. What is more, referring to Haleblian et al. (2009), the frequency of acquisitions is strongly linked to upper echelon compensation and ownership. In fact, managers' desire for increased compensation enforces strong, self-interest motivations to acquire. This is in line with the research of Agrawal & Walkling (1994), where it has been shown that industries with higher CEO compensation generally indicate greater acquisition activity.

CEO Hubris:

CEO hubris, i.e. exaggerated self-confidence, as an acquisition motive was firstly introduced by finance scholars (Roll, 1986). Referring to Malmendier & Tate (2002), there are ***three reasons for managers to display overconfidence***. The first one is the ***illusion of control***, where, according to the psychology literature, individuals are more overconfident about outcomes that they believe are under their control. Applying to mergers, it can be said that the CEO gains control of the target. Second, managers appear to be especially overconfident if there is a ***high commitment towards the outcomes of their investment***. This is often the case in typical compensation contracts of CEOs, where their personal wealth is linked to the company's stock price. The managerial commitment is even more amplified due to the sensitivity of the CEO's reputational capital to the firm's performance. Third, there is a higher probability of overconfidence within managers when there is ***an abstract reference point***. The last reason has been described by Doukas & Petmezas (2007), who stress that overconfidence in acquisition is even stronger for targets with limited disclosed information like private companies since managers are more inclined to rely on their own assessment and beliefs. Besides, overconfidence is often linked to excessive optimism. Referring to Shefrin (2005), managers overestimate the probability of favorable outcomes and underestimate the likelihood of facing unfavorable outcomes. Furthermore, the CEO's overconfidence might be enforced during his or her life due to the self-attribution bias, which is the tendency of CEOs to take the credit for successful acquisitions but to refuse taking responsibility for failures, increasing the confidence about their abilities over time (Doukas & Petmezas, 2007). Hubris also conforms to the 'better-than-average' effect, which defines the belief of individuals to have superior abilities (Shefrin, 2005), and the 'narrow confidence interval' that describes that CEOs set the probability distribution for uncertain events like mergers too tight (Doukas & Petmezas, 2007).

In different research studies, different measures of CEO overconfidence have been generated. For instance, in the research of Malmendier & Tate (2008) overconfidence has been defined based on press coverage and extensive holdings of stock options. According to Doukas & Petmezas (2007), CEOs are identified as overconfident when they accomplished five or more acquisitions within three years. Another measure of overconfidence has been based on the CEO's purchase of his or her own firm's shares and the earning of a negative abnormal return over the next 180 days and has been used in the study of Kolasinski & Li (2013). Nevertheless, there is still the pressing need for a psychometrically grounded and validated construct for studying extreme self-confidence in executives. Thus, the research paper of Hiller & Hambrick (2005) suggests the concept of 'core self-evaluation', which concisely encompasses and consolidates the common, overlapping portions of four previously unconnected personality dimensions, i.e. self-esteem, self-efficacy, locus of control and emotional stability, as a robust and well-validated umbrella construct for research on executive self-concept. Most notably, a very high level of 'core self-evaluation' may exactly correspond to what is colloquially referred to as hubris.

CEO Hubris and M&A Performance:

According to Shefrin (2007), people affected by hubris tend to overestimate their contribution to their own company, which is why managers view their company as undervalued by outside investors. Moreover, Malmendier & Tate (2002) state that besides overvaluing their contribution to their own company, overconfident CEOs are likely to overvalue the acquisition of a target company (i.e. bidding firms paying too much for their targets) since they overestimate the returns they can generate in the combined firm. This overpayment may be even enforced if the CEO of the target company is also overconfident, as the conducted takeover will more likely result in a hostile takeover (John et al., 2011). Additionally, overconfident managers are more likely to engage in diversifying mergers compared to rational CEOs due to their overestimation of potential synergies of the acquisition as well as their underestimation of the risk associated with the acquisition (Malmendier & Tate, 2008; Shefrin, 2005). Thus, overconfident CEOs are unambiguously more inclined to make lower-quality acquisitions in case their firm has abundant internal resources. ***All in one, research findings generally suggest that firms with overconfident CEOs pay higher premiums, rely on internal rather than external financing, miss their own forecasts of earnings, and undertake more value-destroying mergers.*** With respect to high and low market valuation periods and the effect to bidders' shareholders wealth, Croci, Petmezas, & Vagenas-Nanos (2010) have showed empirically that, in contrast to overconfident managers, non-overconfident managers execute value-creating acquisition deals in all valuation periods. In their research study they have used a sample of UK acquisitions in the period 1990-2005. What is more, when controlling for acquirer and deal characteristics, it has been proved that bidders with non-overconfident managers gain the most in high valuation periods, while firms are better off without overconfident managers in any type of market conditions.

Nevertheless, these findings may be challenged, when considering that, according to Deaves, Lüders, & Schröder (2010), people do show some degree of rational learning, so that frequent acquirers who overpaid for a target in the past, may be less inclined to overpay again. This statement supports the empirical findings of Aktas, De Bodt, & Roll (2005), where it has been shown that M&As undertaken by hubris-infected CEOs reveal a positive trend of cumulative abnormal returns from deal to deal. A possible reason for that could be that investors respond negatively to previous excessive M&A activities by overconfident CEOs, so that managers are required to become more cautious. In addition, the findings of Alexandridis, Mavrovitis, & Travlos (2012) also suggest that managers may have learned from the experience of the fifth merger cycle. This factor was not included in the research of Malmendier & Tate (2002), where overconfidence is regarded as being persistent over a person's lifetime. Another factor worth nothing here is the implicit assumption of CEO power when assuming hubris-infected CEOs. This, however, is not always the case as decision processes are complex and may be sometimes the result of a consensus which is achieved by the top executives (Adams, Almeida, & Ferreira, 2005). Thus, it is possible that the CEO himself is not overbidding for the target, however, the fellow board members are due to their overconfidence. What is more, overconfidence is sometimes perceived to create shareholder value since CEOs are, for instance, more inclined to take debt and make use of tax shield advantages as they are less risk averse (Shefrin, 2005). Moreover, the study of Kaplan, Klebanov, & Sorensen (2012), where an OLS regression of indicated success measures on specified managerial characteristics has been conducted, has showed that CEO's resoluteness and overconfidence has a positive relation to a better overall company performance.

Nevertheless, current research shows negative consequences of CEO hubris in the context of M&As. As a result, it would be interesting to do more research on the positive aspects of CEO hubris as well as to assess in which circumstances the positive impact of CEO hubris as a M&A antecedent can outweigh the much researched negative one.

CEO Hubris and M&A Frequency:

According to Malmendier & Tate (2008), when considering potential mergers, the following two manifestations of managerial hubris constitute a trade-off. On the one hand the overestimation of the synergy potential of mergers increases the willingness to acquire other firms, whereas on the other hand the overestimation of stand-alone value generates perceived financing costs, i.e. potential lenders want an increased interest rate and potential new shareholders demand lower issuance prices than what the CEO perceives as appropriate given future returns. The latter can result in the fact that the CEO may forgo value-creating mergers he or she sees as too costly to finance. What is more, mergers and acquisitions are even less likely to be finalized in the case of a target company with an overconfident CEO, since the CEO of the target company might perceive the bidding price of the acquirer as too low. ***Thus, there is no clear positive or negative relation of the net effect of overconfidence on merger frequency***. ***However, when there is no need to finance the M&A deal by accessing external capital markets, overconfidence indeed unambiguously predicts a higher merger frequency.***

Empire Building:

Referring to Brealey et al. (2008), it is more prestigious for managers to control and manage a large company than a small one. What is more, managerial payment as well as the decrease of takeover risk is often positively correlated with the size of the company (Thomsen, 2008). As a result, there are both tangible and intangible advantages by increasing the size of the firm and thus conduct M&As, which can put shareholders under exposure to empire building, if managers do not have proper long-term incentives, and other corporate governance mechanisms are not sufficient. The risk of such behavior increases in companies with high cash, unused borrowing capacity as well as large free cash flow (Jensen, 1986). The empire building problem can be defined as a typical moral hazard problem, in that it stems from differences in preferences between the boards of directors and executives, in conjunction with the lack of observability.

Managerial Entrenchment

Another source of agency costs resulting from managers pursuing their self-interest is the managers' tendency to entrench themselves. This agency problem emerges when the managers make themselves valuable to shareholders and costly to replace. ***Linking managerial entrenchment to the antecedents of M&As, it can be said that managers chose investments with higher value under their wings, however these investments are not value maximizing ex-ante***. Thus, if managers regard themselves as relatively better in managing acquisitions, they might enact them even though they know it is value-destroying. Such manager-specific investments make shareholders retain them since they know the acquisition strategy best. In that way, this behavior supports the risk aversion of managers as they consciously make it costly to replace themselves and thus protect themselves against dismissal. It is important to mention here, that mergers and acquisitions chosen based on managerial entrenchment are not automatically value-destroying. Yet, the problem arises when the manager acquires beyond the value-maximizing level, which may be even more the case during a merger wave, for instance, the financing accessibility is high.

Managerial entrenchment may also be seen in the manager's preference for subsequent acquisitions as his/her experience and skills lie within acquisitions.

2.2.2 Bounded Rationality in M&As

Generally stated agency theory assumes that individuals are bounded rational, which falls into one of the theory’s assumptions about humans (Eisenhardt, 1989). Firstly, the difference between bounded and economic rationality will be addressed. Secondly, the reason why bounded rationality is a relevant antecedent to apply and how it can lead to value destruction in M&As will be addressed.

According to (Zarri, 2014), economic rationality assume that humans are fully rational, and their main goal is to maximize utility. It is based on the selection of the best alternative while using all available information (Zarri, 2014). However, according to (Guthrie & Parke, 2012), the real word is characterized by uncertainty, competition, dynamic interactions between individuals and therefore economic rationality seems to be abstracted from it. According to (Simon, 1991), who is known for creating the beginning of the theory of bounded rationality, the decision-making processes in the real word are characterized by bounded rather than economic rationality as humans are prone to biases in the decision-making processes.

Both psychology and economics provide various evidence why bounded rationality is important and suggest that emotional factors play a significant role in the decision-making process (Conlisk, 2014). In real life, decision making processes should be combined with cognitive and emotional factors (Daniel, Hirshleifer, & Teoh, 2002). According to (Mumby & Putnam, 1992), bounded rationality can be explained as a modified form of economic rationality based on satisfaction rather than optimazation. It assumes that humans make their decisions based on incomplete information, while facing only a limited number of alternatives under a limited time. The following assumption is confirmed by (Gigerenzer, 2008), who states that bounded rationality assumes the question: ***'How do people make judgments and decisions in everyday life, when time and information is limited and the future uncertain?***' Gigerenzer's (2008) assumption can be perfectly applied to M&As, as management have to make decision whether to acquire or not under a limited time and limited access to information, while facing an uncertain future. Uncertainty, combined with limited access to information can lead to undertaking M&As, which do not necessarly create value.

Looking at the context of M&As, there is a growing evidence that humans who are expected to behave in a rational manner, do not entirely follow that assumption (Lee, Shleifer, & Thaler, 1991). According to (Thaler, 1994), they do not act irrationally but quasi-rationally. What is more, in M&As quasi rational behaviour exist as in some situations management make decisions that are substantively different from decisions predicted by the economic model (Lee et al., 1991). Organizational management theory provides a proof that bounded rationality is a way to show how managers make decisions in real life (Xu & Jiang, 2017). Bounded rationality is especially relevant during M&As, since the management of the acquiring company must make assumptions regarding how their investment will develop over time and which value it will create for shareholders. Managers engaging in M&As might believe that they are maximizing the overall value for shareholders, but this can be far from the case due to bounds of rationality and limited information processing (Arnau et.al, 2014). With an increasing scale of investment and the complexity of decision, the negative effect of wrong decisions lead to a significant increase in value destruction.

2.2.3 Information Asymmetries in M&As

Information asymmetries is another assumption of agency theory and its relevance to managerial value destruction in M&A will be analysed. Agency theory is known to be initiated by the findings of Ross (1973), Berhold (1971) and M. Jensen & Meckling (1976), who have addressed that control problems come as a result of information asymmetries between the agent and principal. Since management has superior information about the project and company compared to shareholders, the asymmetric information problem is very likely to appear in acquisitions (Sudarsanam & Lai, 2001).

According to Hendrikse (2003), information asymmetries characterize the situation when the agent has superior information regarding the provision of effort. According to Arrow et al., (1995), information asymmetries are what makes the principal-agency relationship interesting. Two problems have been described by scholars with accordance to information asymmetry, namely the hidden action and hidden characteristics problem. In other words, the shareholders cannot monitor the competences (hidden characteristics) and the actions (hidden action) of the managers/CEO. What is more, the shareholders cannot monitor the manager's knowledge (hidden knowledge) and his or her intentions (hidden intensions).

Existing research provides confirmation that M&As are strongly correlated to the agency problem of information asymmetries and to the board's supervisory role (M. C. Jensen, 1986; Harford, 1999). Therefore, the board of directors has been nominated to control that the managerial actions are in the interest of shareholders and that the information asymmetries are limited. The board of directors is known to have a dual role in the relationship with the CEO: ***the role of advisory as well as the role of monitoring the CEO's strategic decision-making process, such as M&As***. The dual role of the board of directors will be further investigated in the next section. According to Adams & Ferreira (2007), the dual role of the board of directors creates a ***trade-off for the CEO***: weather to disclose the superior information or hide it and keep it secret. We assume that the following statement is especially relevant in a M&A setting. In the situation prior to the acquisition the CEO faces the following dilemma: weather to reveal the secret information to get a better advice from the board of directors but at the same time to get more control and monitoring or keep the information secret, which will result in the opposite situation (Adams, 2007). The correlation between information asymmetries and the role of the board of directors points out the need to introduce them as an intermediary in the relationship between CEO-shareholders. The following will be further analysed in the later stage of our thesis.

Connecting the information asymmetry problem between management and shareholders to value-destroying M&A antecedents, we have assumed that management might decide to engage in M&As since he or she is aware of the fact that the shareholders cannot monitor the competences (hidden characteristics) and the actions (hidden action) of the managers/CEO. Thus, we have interpreted the information asymmetry assumption of the principal agency theory as one of the antecedents, which can lead to value destruction in M&A.

2.2.4 Risk Aversion in M&As

The reason for identifying risk aversion as a M&A antecedent, possibly leading to value destruction, lies in the fact that depending on the risk aversion level of the manager, he or she, will choose to acquire a target company or forgo an acquisition which might have been of value for the shareholders. What is more, managers might choose to engage in M&As since M&A activities can be used as a tool, of risk averse managers, to reduce other risks they are facing.

According to Jemison (1987), March & Shapira (1987), Wright et al., (2001), individuals are in general assumed to be risk averse. Agency theory relaxes the following assumption, presenting the principals as risk-neutral, contrary to risk-averse agents. There is a lot of PAT relationships in M&As, as the principal (shareholders) needs the agent (managers/CEO) for special tasks. Shareholders are considered risk neutral as they have the possibility to diversify their shares across different firms (Wiseman & Gomez-Mejia, 1998), while managers are assumed to be risk averse due to their income and employment security, which are tied to a particular company (Donaldson, 1961; Williamson, 1963).

Agency theory has been criticized for being too narrow when it comes to risk aversion (Wright et al., 2001). The paper of Wright et al., (2001) is, hereby, assumed as especially valuable due to quality of the references used, the scholar's background, the fact that the paper has been cited around 200 times and the significant relevance to the topic of master thesis. The behavioural theories will be used to complement on the contrary findings presented by scholars regarding the risk aversion antecedent.

Challenged View of Risk Aversion in Agency Theory in M&As

The assumptions of risk aversion have been challenged by scholars in the recent literature, which presents interesting ***contradictions*** to discuss. Child (1974), Eisenhardt (1989), Hambrick & Mason (1984), MacCrimmon, Stanbury, & Wehrung (1986), argue that individuals vary in their risk attitudes. Those differences in risk aversion affect the M&A performance, as they impact the corporate decision-making process and individual's actions (Amihud & Lev, 1981; Wally & Baum, 1994). Scholars argue that the risk aversion level of managers differs by wealth, educational level, age and sex (Halek & Eisenhauer, 2001; Hilary & Hui, 2009; Powell & Ansic, 1997). In their studies, it has been proved that men are considered less risk averse than women and older people are more risk averse than young people. Hambrick & Manson (1984) support the finding that some younger agents are not considered as risk-averse at all.

Gomez-Mejia (1998) challenged the risk assumptions in agency theory. According to their theory, the risk aversion level remains undeveloped within agency theory and various explanations have been presented. Here it is worth to point out that the agency relationship in the above studies has been examined in a context of an individual agent or principle, however, according to M. Jensen & Meckling (1976), the generality of agency theory can be relevant for organizations, as relationships are essential for companies to exist and they are present in 'every level of management'. In accordance to their findings, CEO's choice of risk during M&As may be affected and influenced by their prior success at selecting risky alternatives which makes it biased to determinate the risk-aversion level.

According to Haleblian et al., (2009), environmental factors are one of the reasons for why firms acquire. There is a specific correlation between environmental factors and risk aversion. The external environment can affect the agents' risk-taking preferences (Tushman, 1997). For example, shareholders may avoid building the relationship with risk-averse managers in favour of risk-neutral ones, while acquiring in turbulent environments such as a crisis. Under those conditions risk-averse CEO's may be considered as incapable of dealing with changing environments, new threats and opportunities. This example shows that the agency theory assumptions do not always apply to the agent's risk aversion assumption when it comes to M&As. What is more, the non-risk averse managers can also form agency relationships under specific circumstances.

Managerial Risk Aversion (Acquiring CEO)

According to scholars, the risk aversion level of the acquiring CEO, known as managerial risk aversion, has a significant impact on decision making, particularly on the M&A behaviour (Amihud and Lev, 1981; Wally & Baum, 1994). Graham, Harvey, & Puri (2015), found out that CEOs are the dominant decision makers when it comes to M&As, which confirms that managerial risk aversion may have a significant impact on M&A decisions. According to Roll (1986), M&As reflect the individual’s decisions. The purpose of this section is to provide an overview of theoretical and empirical studies regarding the assumption above. The factors affecting the CEO’s risk aversion level will be presented.

Halek & Eisenhauer (2001), A. S. Miller & Hoffmann (1995), H. R. Miller (1992), Renneboog & Spaenjersf (2012), have found a positive relation between the religiosity and risk aversion level, especially when it comes to firm behaviour and the M&A process. The following relationship has been confirmed by Hilary & Hui (2009). Contrary to that, a negative relationship between entrepreneurship and the level of risk aversion has been presented by scholars (Begley & Boyd, 1987; Kihlstrom & Laffont, 1979). Companies with CEOs as founders are therefore more prone to show riskier M&A behaviour than non-entrepreneurial CEOs.

M&A as a Risk-Return Trade Off

M&A activities can be used as a tool of risk averse managers, to reduce other risks they are facing. The third interesting finding presented by Hitt et al. (1996) and regarding risk aversion, suggests a positive relationship between risk aversion and M&A activity in innovative companies. Risk aversion is suggested to reduce the innovation commitment, which means that managers are more prone to use the company’s debt for M&As rather than undertake internal innovation activities, as innovation involves assets, which cannot be redeployed. Another example is when managers decide to undertake M&A activities to reduce their employment risk. The following finding has been presented by Amihud and Lev (1981). They argue that the employment income is connected to the firm’s performance and therefore to the firm’s risks. Risks related to human capital cannot be diversified in financial markets. Therefore, risk averse managers, which want to reduce their employment risk, solve the existing problem by engaging into M&A activities.

The important question is whether the managerial attempt to reduce other risks by undertaking M&A activities can maximize shareholders' gains, who are assumed to be risk neutral. In the case of facing 'other' risks, risk averse agents look for strategies which can minimize them. For example, some of the managers perceive M&As as a way to stabilize the firm's income stream when it comes to minimizing employment risks (Amihud and Lev, 1981). By doing so, they reduce their probability of losing their jobs (Wright, 2001). However, an interesting ***paradox*** should be mentioned here. While choosing a bid price for the target, managers must take into consideration two probabilities, namely the probability of the takeover being successful versus the probability of being fired (Aktas et al., 2005). In the following situation, when the risk-averse CEO seeks to engage in M&As, his interest is to increase the probability of a successful deal with the right target. As a result, CEO tempts to increase the bid price in order to deliver the best offer and be able to acquire (Aktas et al., 2005). While choosing a bid price, CEOs must consider three possibilities: the deal will not be successful due to the competitor's better price, the proposed bid price will allow the CEOs to succeed in the transaction or the deal will end up in the CEOs being fired (Aktas et al., 2005). This action, according to the fact that the CEO is supposed to perform in the interest of shareholders, could increase the probability of being fired because of the overpayment. Shareholders may perceive the overpayment as value-destroying for the firm, which according to Jensen (1986), leads to a real risk.

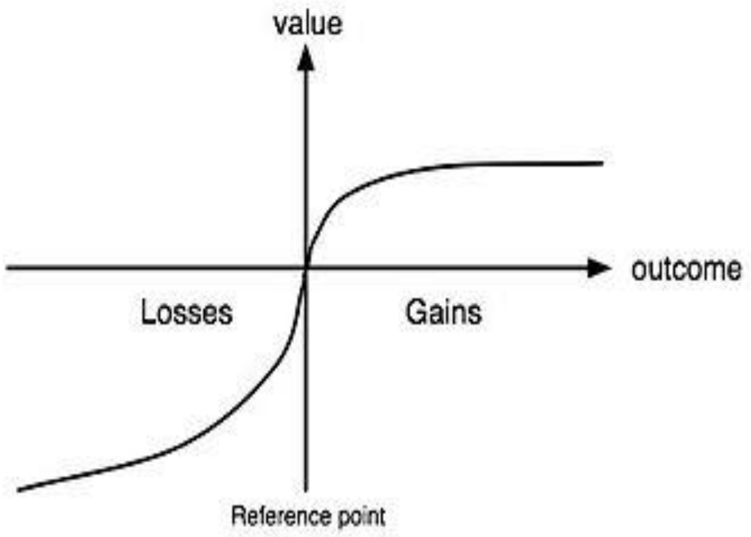
That means that risk-averse agents, using M&As to reduce 'other' risks and decrease their probability of being fired could, in turn, increase this probability (Aktas et al., 2005), which presents a very interesting risk-return trade off.

Loss Aversion, Regret Avoidance and Escalation of Commitment

Loss aversion is one of the important antecedents analysed in the prospect theory, which describes how people behave and choose between alternatives, which involves risk-taking decisions under uncertainty. Being confronted with different situations agents show different attitudes towards risk. Kahneman & Tversky (1979) argue that decisions made by individuals are affected by their attitude towards facing losses, as individuals tend to experience a loss with more impact compared to the gain of the same size. Therefore, individuals will not want to continue the action when the size of the loss is increasing. Risk-averse managers will choose to invest in a project with a lower return and lower risk. According to Kahneman (1979), when gains and losses are both possible, loss aversion can be a cause for risk aversion. Loss aversion can lead not only to risk aversion but also to risk-seeking behaviour. Loss aversion shows that managers are willing to undertake risks to avoid loses (they become less risk averse). Aversion to sure loss shows, that managers are willing to make new, sometimes irrational, investments to avoid sure loses, which is not in the best interest of shareholders.

Tversky & Kahneman (1986) found an interesting correlation between regret avoidance, loss aversion and bounded rationality. The following correlation will be presented in the graph, which illustrates the loss aversion.

Figure 2 - Illustration of Loss Aversion



Source: Kahneman and Tversky (1986)

As seen in the graph, individuals are proved to feel the negative effect of experiencing losses more compared to the positive effect of a gain of the same size. Loss aversion is proved to lead to regret avoidance, as loss will have a higher negative impact compared to the positive effect of the comparable gain. Regret avoidance is one of the reasons for manager's irrational decision making process, as they are willing to do everything to avoid a loss, which is especially relevant in M&As (Møller & Nielsen, 2005).

When it comes to M&As, loss aversion seems to be most visible after the transaction, as it leads to an escalation of commitment. Scholars identified a positive relationship between loss aversion and the escalation of commitment (EOC). EOC is presented as a human behaviour pattern, when agents (CEO/manager) face negative outcomes from previously made decisions. However, agents decide to continue the course of action to avoid loss and sunk costs. The sunk cost fallacy is correlated to risk aversion as decision makers are focused on minimizing resources, which have been already wasted, rather than maximizing future utility. This is very common in M&As, when managers who are responsible for a transaction's failure are trying to find evidence that their decision was not wrong. They do not recognize sunk costs and keep investing, as they have already invested too much to quit (Stracca, 2002). The following behaviour results in excessive risk taking and value-destroying actions.

According to Keynes (1936), the greater the M&A transaction the greater the escalation of commitment can be. However, scholars have identified that when the loss is really high and sunk costs increase significantly, the EOC might start decreasing (Juliusson, 2006). However, this switching point is yet to be analysed.

Escalation of Commitment during Merger Waves

Loss aversion becomes a very relevant concept during merger waves, especially when it leads to escalation of commitment. In M&As, this trend is generally most visible upon the completion of the transaction. The escalation of commitment is also higher when the M&A decision has been publicised. In the following situation, due to reputation and the attempt to be perceived as consistent with the prior decision, managers keep investing into the M&A project to avoid the regret of previous decisions and the feeling of losing the invested money (Bazerman & Moore, 2009). The following behaviour is usually not rational and is not consistent with the shareholders' interests from the agency perspective.

In recent literature the significant correlation between merger waves and behavioural finance has been described. The behavioural hypothesis relies on stock market values to understand M&A activity (Rhodes-Kropf et al., 2004). Merger waves are correlated to high stock valuation and overvalued equity, which initiate merger waves (Harford, 2005). The escalation of commitment is the ex-post action, which has a value-destroying effect on M&A activity and its performance. According to the accuracy of merger waves content in the setting of our thesis, the topic will be further investigated in the normative model, where the impact of waves on the relationship between CEO and shareholders will be further investigated.

Sub-Conclusion

The aim of the session was to present the risk aversion as a value-destroying M&A antecedent in the relationship between CEO and the company's shareholders. The strict assumption of the agent's risk aversion, stated in agency theory, has been evolved and the criticism, analysed and described by scholars, has been presented, which creates interesting contradictions with the need of being further investigated. We agree with the findings that agency theory can be too narrow and with the argument that the assumption of a risk-averse agent should be relaxed when it comes to M&As. From the behavioural economics point of view, agents are not fully rational and differ in their risk preferences. The literature related to behavioural finance helps to explain the difference in risk preferences and can significantly affect M&A behaviour.

Based on that, a paradox regarding risk-return trade-off has been found:

Paradox: ***Risk-averse agents, using M&As to reduce 'other' risks such as employment risks and reduce the probability of losing their jobs, could increase this probability by engaging in value-destroying M&A transactions. The will to quickly engage in M&A transaction could result in overpayment, which could lead to managers being fired as the shareholders might consider the bid price as too high, which does not create value for them.***

2.2.5 Goal Conflict in M&As

Goal conflict is another strong assumption of agency theory and can be identified as possible value-destroying M&A antecedent as it results from all of the above mentioned managerial and value-destroying M&A antecedents (managerial self-interest, bounded rationality, information asymmetry and risk aversion). According to the concept of the agency theory, the principal and agent are assumed to have two different goals (Wright, Ferris, Sarin and Awasthi, 1996). The reason for the goal conflict between management/CEO and shareholders is the separation of ownership and control. According to Avery, Chevalier and Schaefer (1998), the conflict of interests between both parties is one of the most prominent conflict in the decision-making process, weather to acquire a company or not.

Goal Conflict between CEO/Management and Shareholders in the Lens of Agency Theory

Agency theory is mainly examined in the context of an individual principle and agent. However, as mentioned before, various scholars have presented that those assumptions can also be applied for larger groups, such as companies (M. Jensen & Meckling, 1976). Scholars argue that the agency problems increase with the size of the company, as bigger groups show a greater potential for agency conflicts. Jensen and Meckling (1976) also argue that both the vertical and horizontal integration, which lead to an increasing number of groups within an organization, increase the potential for the presence of agency costs. In accordance to that, we can assume that the assumptions made by scholars and the criticism can be applied to M&As, as there is the agency type I relationship between shareholders and CEOs, as CEOs differ in their goals and attitude towards shareholders. Therefore, the findings regarding individuals will be applied to the company level and the M&A setting in the following part.

Agency theory assumes a goal conflict between the principal and agent. The goal of the principle is to get the financial benefits while dealing with financial costs. Contrary to that, the agent (manager/CEO) has additional, non-financial goals, which are not present in the principle's (shareholder) consumption (Jensen & Meckling, 1976). Those non-financial benefits, such as knowledge and business-understanding, are meant to compensate for the effort. The agency theory assumes that the goal conflict is present due to differences in utility functions, since managerial decisions occur to be costly for the shareholders.

Challenged View of Goal Conflict in M&As

Similarly to risk aversion, the assumption of goal conflict has been challenged by scholars in the recent literature, which presents an interesting ***paradox*** to discuss. Wright (2001) argues that individuals may vary in their goals, as they may present different behaviours and attitudes towards work. Those differences in management/CEOs' goals and behavioural attitudes towards shareholders, have a strong effect on the M&A setting, as those individuals have a significant impact on the corporate decision-making process and the actions of individuals (Wally & Baum, 1994).

Some individuals may have a goal of maximizing their own utility. Therefore, they can be perceived as work averse and do not show a high level of responsibility regarding their jobs. According to Jensen & Meckling (1976), the attitude of those individuals is consistent with the assumption of agency theory. Thus, shirking might be visible in their behaviour as an attempt to lower their disutility. However, here, the agency theory has been criticized for being too narrow. As a result, we propose that the strict assumption of goal conflict between shareholders and management should be relaxed, as managers differ in their personal goals and behaviours. For instance, some agents may not be work-averse. Contrary, they may be responsible for their jobs and they may feel the need for development, achievement, respect and the feeling of being ‘loved’ (McClelland, 1960). The utility they get from their achievement overcoms the effort they need to put in it. According to McClelland (1960), those agents care more about non-financial benefits than about financial ones, and therefore they may not even seek for extra compensation. The following relaxation can be applied to the M&A setting, as some of the managers feel a connection to the company and they are focused on long-term goals. Those kinds of managers will focus on the delivery of the best effort to succeed in M&As and create value to gain the board’s and shareholder's respect. The following finding shows, that the agency theory assumption about goal conflict does not always apply and can be relaxed in some situations.

However, scholars argue that the goal conflict could also be present for agents, who show a respectful and ‘loving’ behaviour towards others (Jensen & Meckling, 1976). According to Wright (2001), those agents miss the norms of obligation and thus seek for selfish benefits, which are in their own interest and the interest of other colleagues, to whom agents shows respect and ‘love’, but occur at the expense of the principle. Scholars argue that the assumption could also be relaxed as other type of agents could aim to receive respect and build a good relationship with the principle. However, Fukuyama (1995) and M. Granovetter (1992) present the arguments for why the assumption of goal conflict should be relaxed. According to Fukuyama (1995), exchanges are based on social norms of obligation and reciprocity. Therefore, the agent who feels the need for respect and ‘love’ may positively affect the enterprise in a social content. This generated goodwill can increase the prospects of the company, which increases the value of the principle’s part (Granovetter, 1985). Being faithful is a way to increase managerial reputation. Donaldson (1990) argues that each person may benefit from the actions of those dutiful agents, who want to achieve their goals, and those benefits could also include shareholders when it comes to M&As.

The following section provides criticism and presents arguments of scholars for the agency theory assumption of goal conflict not being always applicable and thus the need for it to be relaxed while dealing with specific kind of agents. As explained before, scholars have proved that the goal conflict increases during vertical and horizontal integrations, so that we will assume that the following criticism can be applicable in the relationship between shareholders and CEO. Wight et.al (2001) outlined the need to relax the agency theory assumptions by complementing it with insights from outside literature, especially from the behavioural finance perspective. This paper is assumed as especially valuable due to quality of references used, the scholar's background as well as the fact that the paper has been cited over 200 times. What is more, this paper is especially relevant in our literature analysis part due to its focus on both the goal conflict and risk aversion, which are a part of our developed and value-destroying M&A antecedents described in the thesis.

The next part will focus on psychological factors, which influence managerial decision to undertake M&As, which are not generating value for shareholders. Undertaking those M&As is contrary to the goal of the principle, and therefore will be presented in the lens of the agency theory.

Goal Conflict between Management and Shareholders in M&As

Managers/CEO are known to have two main goals/benefits from undertaking acquisitions: increasing the size of the firm to increase their compensation and increase their own power and prestige. Jensen (1989) argues that CEOs engage in M&As as they want to be remembered as powerful managers who have increased the company's size. They argue that it is very rare for CEOs to present the opposite behaviour, in other words to decrease the company's size and aim to save the shareholder's money. The argument for undertaking M&As to increase the company's size together with the executive compensation has been presented by Reich (1983). He argues that managers, who believe that their salary is tied to the volume of their business, undertake huge debts to be able to acquire unrelated businesses. Jensen (1989) agrees with Reich (1983) in that managers are motivated by the goal of compensation maximization while undertaking M&As, which creates a conflict of interests with shareholders, whose aim is value maximization. Nevertheless, an interesting ***contradiction*** in the literature review about goal conflict in M&As has been found here. Contrary to Reich (1983) and the literature documenting that the size of the company increases compensation, Avery, Chevalier, & Schaefer (1998), found no evidence that the CEO's goal of a compensation increase can be achieved by undertaking value-reducing M&As. In their study, they have examined the reward gained by CEOs, resulting from undertaking value destroying M&As and argue that the goal of CEOs when undertaking M&As ,which do not create value for shareholders, is to gain skills of managing a bigger company, not to increase their compensation. Here, it is worth noting that Avery, Chevalier & Schaefer (1998) agree with the assumption that CEO's undertake M&As to increase their prestige.

Goal Conflict in M&As Through the Psychological Lens – A Portfolio Theory Approach

Mergers and acquisitions have been presented by scholars as a corporate management tool which allows them to diversify into another industry or product line. Diversification by undertaking M&A activities has been presented as an action which leads to goal conflict between the personal interests of management and the goal of maximizing shareholder's wealth. The portfolio theory will be used here to explain the goal conflict assumption of the agency theory.

According to Gordon (1945), the goal conflict between management and shareholder appears due to additional risks that managers take to achieve their personal goals and the psychological benefits that they can gain because of their position within the company. The diversification is seen by managers as a way to improve their managerial positions with respect to the psychological and financial benefits. Diversification can be achieved either by internal expansion or by undertaking M&As of unrelated businesses.

In accordance to the portfolio theory, shareholders have already eliminated firm-specific risk by diversification in financial markets, in other words: buying shares in various lines of businesses. Due to that, they gain nothing from risk-reducing M&As which have been undertaken by corporate management. Shareholders could only benefit from the following acquisitions when they result in synergies. Otherwise, when there are no other benefits from M&As than diversification, it has been proved that shareholders can incur actual damages (Weston, 1959).

The following paragraph will focus on the psychological conflict since the financial one (compensation) has been analysed in-depth in the previous section. Based on that, it can be stated that CEOs gain psychological rewards from leading big companies, due to their leadership and authority (Gordon, 1945). Therefore, there is a positive correlation between the size of the company and psychological benefits. The increased size is supposed to reduce takeover possibilities and adds to the longevity of the company (Gordon, 1945). What is more, the leadership of a big and successful company brings managers prestige and according to Ling (1964) the loss of those benefits may be seen as a traumatic experience for the CEO/management. The fastest way to achieve those financial and psychological goals is the acquisitions of another company and therefore, M&As present the greatest conflict of goals between the principle and agent.

Sub-Conclusion

To sum up, the following section presents interesting findings regarding the assumption of goal conflict in M&As and its criticism. Wright (2001) argues that individuals vary in their goals and therefore present different behaviour under various circumstances. Therefore, the goal conflict can enforce or mitigate the value destruction in M&As, depending on the type of agent and the external circumstances. What is more, an interesting paradox regarding the management's goals while undertaking M&As has been found. The paradox can be seen below:

Paradox: *Jensen (1989):* ***CEO's main goal resulting from engaging in M&As is to increase their compensation together with the size of the firm & increase their prestige and power. Reich (1983): Undertaking M&As is a way to increase CEO compensation together with the company size; they believe it will grow together with the size of the company.***

However: ***Avery, Chevallier & Schaefer (1998) argue that CEO's goals when engaging in M&As is to increase their power of managing a big company (not compensation) and increase their power and prestige. No empirical evidence that CEOs aim to achieve the goal of an increased compensation by undertaking M&As has been presented.***

2.3 The Role of Board of Directors in M&As

The analysis of the information asymmetry as a value-destroying M&A antecedent, points out the importance of the board of directors. Both Adams (2003) and Westphal (1999) argue that the board's advice is important in M&As, especially in big companies. Both scholars argue that the value created as well as the value destroyed by mergers are not only correlated to the CEO's decision, but also to the board's ability to control and advice the main decision-maker in M&As.

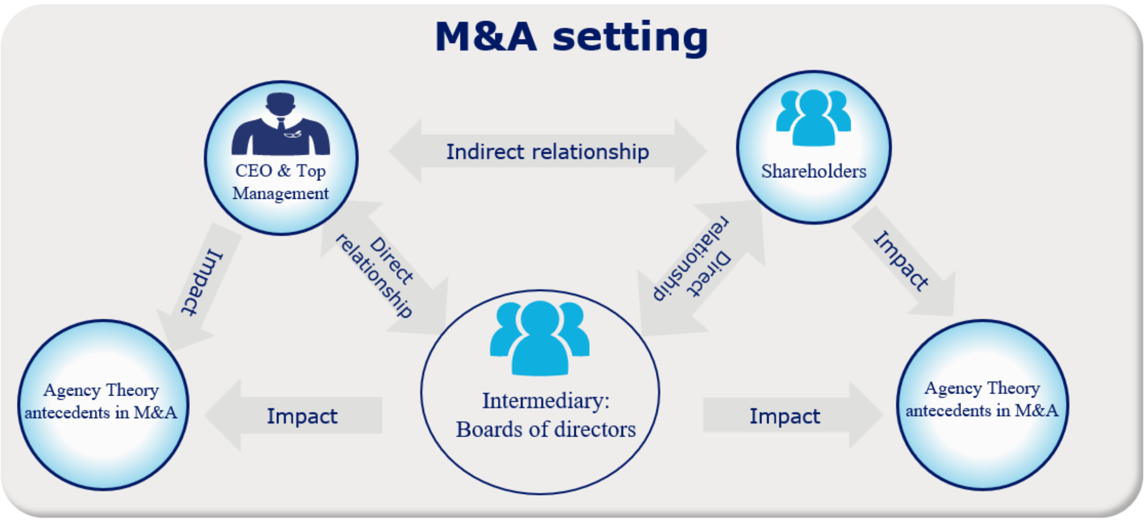
One of the main functions of the board of directors in M&As is to monitor the CEO's decisions on behalf of the shareholders. The theoretical underpinnings of their role are based on the agency theory assumption about the potential conflict of interests which is present due to the separation of ownership and control (Fama & Jensen, 1983). Not only agency theory but also the finance scholars ensure that the role of directors is to warrant that managers are acting in the interest of shareholders (Miller, 1992). The board of directors also plays and important advisory role in mergers & acquisitions, therefore these regulations show the need for directors having financial expertise (Huang, Laing, & Wang, 2004). Based on that, boards in M&As have a dual role: ***the monitory and the advisory***

function. The resource dependence theory provides a complementary finding to agency theory about the provision of resources for CEOs (Hillman & Dalziel, 2003). ***All in all, the board's duty in M&As concerns the monitoring of the CEO, the setting of his compensation, the approval of M&A decisions and afterwards the monitoring of the implemented M&A strategy.***

In recent years, academic research has focused more on how the CEO-board relationship can influence the board's effectiveness when it comes to M&As. Therefore, these relationships, in other words the social ties between both parties and their effect on the value-destroying M&A antecedents, will be further investigated in the normative model.

As seen in the previous analysis of value-destroying M&A antecedents, derived from the agency theory in M&As, the relationship between CEO and shareholders has also received great attention both in the financial and psychological literature. It is worth pointing out, that the board of directors has been excluded in many models and has been assumed to be perfectly aligned with one of the sides, in other words either with shareholders or magement (Warther, 1998). However, shareholders and CEOs do not have a direct interaction with each other. The direct interaction (in other words direct social ties), are defined as a personal relationship between the CEO, who is the main decision maker regarding the M&A engagement, and the board of directors about whom the decision is being made (Larson, 1992). In accordance with the agency theory, it is impossible for shareholders to look after their own interest and therefore they need a board of directors to play in their interest.

Figure 3 - Agency Relationship in M&As



Source: Own creation

Here, an interesting ***contradiction*** will be mentioned, as from an agency perspective the board of directors can also be perceived as an agent for shareholders. For instance, Warther (1998), has focused in his paper on the role of board of directors and critically reflected on the fact that if shareholders are unable to control managers and CEOs, at the same time they should also be unable to control the board of directors. However, the problem can be mitigated due to the shareholder's power to sue individually and the fact that the shareholders, present in the board, can act as monitors for the rest of the shareholders (Warther, 1998). In the following situation, several solutions are possible. One of them is to include more outside block-holders in the board, which will provide additional incentives for extra monitoring. The other external factor is the ***market for directors***, which creates incentives for directors to effectively monitor CEOs due the possible competition and thus a greater selection of 'good' directors (Agrawal & Knoeber, 1996)

Composition of the Board of Directors

Fama & Jensen (1983) argue that boards of directors can be the effective monitoring solution only if the boards' members have incentives to properly monitor CEOs. According to Fama & Jensen (1983), a successful company separates the decision-making process from the decision's control. The following findings suggest ***that having the CEO in the board of directors may have a negative impact for monitoring functions.*** Opposite to that, scholars argue that the presence of outside board members in the boards lead to an increased monitoring of the CEO & management. Therefore, outsiders can be assumed to play in the interest of shareholders, as they value their personal reputation and, according to Fama & Jensen (1983), are independent decision makers.

Due to the limited scope of our thesis, the assumption of the alignment of interests between the board of directors and shareholders will be made and developed in the model. We assume that the board of directors, especially outsiders, are the most effective way of decreasing agency costs and control the strategic decisions such as M&As. Nevertheless, this can be seen critical, as we will do in the discussion section of our master thesis.

2.4 The Role of Top Management Team in M&As

Until now, we have assumed that most of the time the management of the acquiring firm is represented by one person, the CEO. This, however, is not always the case, as normally there is a top management team (in the following: TMT), representing the management of the acquirer. In this section we want to focus on the role of the TMT in M&As, so that differences and similarities between a group representing the management versus the CEO representing the management can be identified.

In fact, from a strategic perspective, it is hard to believe that CEOs decide on acquisitions entirely on their own. It is usually the TMT, including the CEO, that decides whether to proceed with M&As or not, especially when it comes to the most crucial strategic acquisitions (Hayward & Hambrick, 1997). ***TMTs may take part in acquisition decisions ranging from approving targets, assigning due diligence teams and integration managers, setting an accurate price for an acquisition, to choosing how much the company will commit to learning from an acquisition experience, including whether to build a M&A team or not.*** Thus, TMTs have an impact, better or worse, on the acquisition success. In addition, the increased complexity and uncertainty in the competitive landscape have made it difficult for firms to rely solely on the CEO's capabilities. Rather, long term success is influenced by the combined capacity of the members of TMTs.

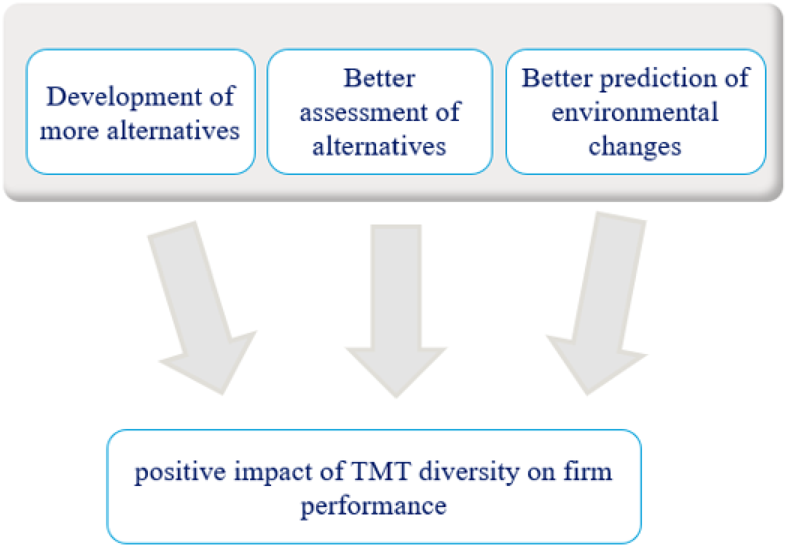
2.4.1 TMT and Firm Performance

Referring to Hambrick & Mason (1984), differences in the TMT's composition result in different strategic choices and ultimately in different performance outcomes, including acquisition outcomes. Since this section focuses mainly on the M&A performance, it is important to mention beforehand that we will not include the information gathered here in the development of our normative model, since our main focus are M&A antecedents, in particular the ones which lead to value destruction.

An often-assessed aspect of the TMT's composition is diversity, including the degree to which TMT members differ regarding their background characteristics such as functional knowledge, age, and tenure (Bunderson, 2003). ***The influence of the TMT diversity on the acquisition process can be defined as a 'two-edged sword' (Milliken & Martins, 1996), in that there are positive impacts as well as negative ones, which we are going to introduce shortly in the following.***

The positive impact of a greater diversity includes the development of more alternatives, a better assessment of alternatives, and a better prediction of environmental changes (Cannella, Park, & Lee, 2008). Linking this to the context of the pursuit of managerial self-interest in M&As, this is of crucial importance, as, for instance, a hubris-infected CEO, who is part of the TMT, can be stopped or stimulated to overthink his or her acquisition decision by other members of the TMT, who may be more rational or humble in their decision making. Thus, a higher diversity of TMTs can decrease groupthink, which is especially important in the context of a CEO being hubris-infected. The positive impact of a greater diversity of TMTs is illustrated in the following:

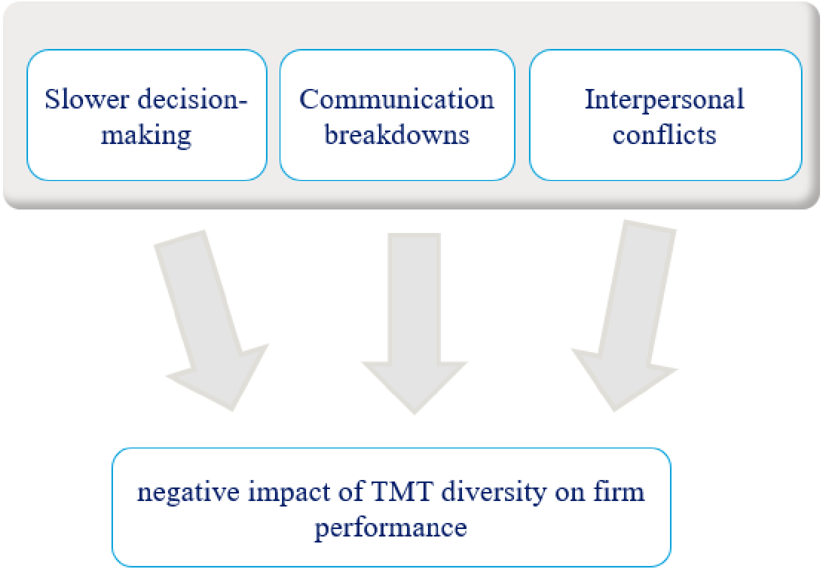
Figure 4 – Positive Impact of Top Management Team Diversity in M&As



Source: own creation

The negative impact of a greater diversity of the TMT includes slower decision making, communication breakdowns, and interpersonal conflict (Cannella et al. 2008). Interpersonal conflicts can be especially severe in a M&A setting, since M&As are high risk- and possibly high return-strategic investment decisions, which bear severe consequences for both of the organizations, the acquirer and target. The negative aspects are illustrated in the following:

Figure 5 - Negative Impact of Top Management Team Diversity in M&As



Source: own creation

Both of these perspectives suggest that the impact of the TMT diversity on firm performance is not unilaterally positive or negative, but rather, that the context in which a team functions moderates the relationship. For instance, it has been shown that environmental uncertainty moderates the relationship between TMT intrapersonal functional diversity and firm performance (Cannella et al., 2008). This underlines the importance and the reason for why we have chosen to analyse all the chosen value-destroying M&A antecedents, mostly based on managerial self-interest, under the light of externalities, like social ties, market complexity and merger waves.

2.4.2 TMT and Acquisition Experience

Generally stated, the values and beliefs of TMT members, as well as the team structure and processes (including the nature of the way the members interact) make learning by TMT different from that by an individual CEO. Assessing these differences is of importance due to its great impact on the success rate and frequency of future acquisitions.

According to Nadolska & Barkema (2013), who have tested their hypotheses on acquisition frequency and success from a TMT perspective on more than 2000 acquisitions by 25 Dutch companies, the composition of the team is crucial to assess how TMTs learn from acquisition experience, and how this influences acquisition frequency and success. They have showed that contrary to homogeneous

TMTs, diverse TMTs are less inclined to incorrectly generalize from past acquisition experiences and thus are less likely to miss-transfer lessons and acquisition processes to new acquisitions. The reason for this is based on the team diversity literature from van Knippenberg, De Dreu, & Homan (2004) and implies that diverse teams are more likely to share their experience with acquisitions, to have comprehensive debates about past acquisitions, and to obtain information from outside the team to solve debates. They, will, thus, spend more time on choosing which insights, skills, and routines are worth transferring from one acquisition to the next and on generating acquisition processes and capabilities. As a result, it is suggested that diverse TMTs can be seen as more successful, but also as slower acquirers than homogeneous ones. Since diverse TMTs are slower acquirers, homogeneous TMTs are likely to acquire more often. Regarding the success of acquisition, it has been found out that TMTs do benefit from their acquisition experience, but that homogeneous teams benefit less per individual acquisition than heterogenous ones. ***Concluding, this suggests that firms with diverse TMTs are expanding more slowly, learn more per acquisition and are less likely to miss-transfer lessons and acquisition processes to later acquisitions, thereby increasing the rate of success.***

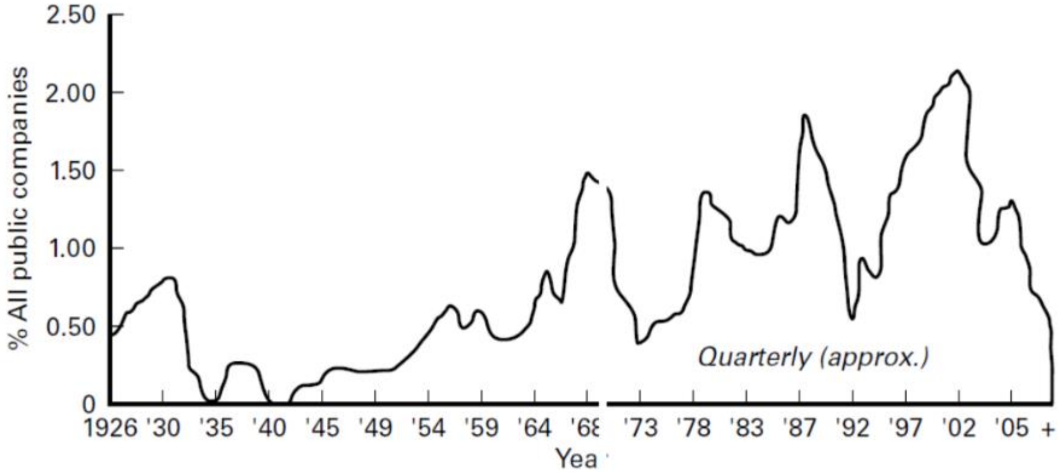
This may be more advantageous when expanding into quite different countries and when the initial success rate of the acquisition is more crucial. On the other hand, homogeneous teams may be more advantageous when the speed of growth through acquisitions is more crucial than the acquisition performance in the beginning and also when the firm is growing into similar countries in which case the risk of mis-transferring lessons and experiences is smaller.

2.5 Merger Waves

In the following section, the concept of merger waves will be introduced and critically analysed. Merger waves will be used as external factor in our normative model, where its impact on the previously described value-destroying M&A antecedents will be further investigated. The four phases of merger waves, based on the model of Clark & Mills (2013), will be assessed to better understand the mechanisms and the CEO-shareholders relationship, which are present during the different stages of merger waves.

The research made by Martynova & Renneboog (2006), confirms that M&As tend to appear in waves. Golbe & White (1993) were among the first to observe empirically the cyclical pattern of M&A activity. This cyclical pattern can be seen in the following illustration:

Figure 6 – US Merger Pattern



Source: Clark and Mills (2013)

The above figure presents the historical M&A pattern over an 80-year period. The US market have been used to illustrate the cyclical tendency of M&As since US mergers have been extensively studied and used as example of wave patterns in recent years (Sudarsanam & Lai, 2001). The US market presents the example and the proof that M&As do appear in waves, however, the fact that M&As cluster in time remains unsolved. The reason for the existence of merger waves is still discussed in the literature and scholars have yet not agreed on one simple reason for why they are present. According to Mitchell & Mulherin (1996), many studies have not been successful in explaining why mergers appear in waves and thus interesting ***contradictions*** in the existing literature will be mentioned here***. One group of scholars argues for the general stock market, which drives waves*** (Harford, 2005; Shleifer & Vishny, 2003). ***The other group believes that technological shocks and new deregulations are the reason*** (Mitchell & Mulherin, 1996). The positive correlation between prices on the stock market and merger activity have been presented by various scholars such as: Shleifer and Vishny (2003), Rhodes-Kropf and Viswanathan (2004), Jensen (1998) as well as Harford (2005). Due to the correlation between the stock market, merger waves and behavioural and agency theory explanations, the prior point of view will be the implemented view of our thesis.

2.5.1 The Behavioural Hypothesis of Merger Waves

The following section will explain how behavioural finance can be used to understand the merger waves pattern. The behavioural approach has been chosen, as it is relaxing the assumptions of the neoclassical theory that managers are always maximizing shareholder value. The behavioural finance approach has been used by Blunck, Bartholdy, & Poulsen (2009) to explain that the irrational investor sentiment could lead to an increase of the market value. The behavioural literature supports the argument that a high market valuation lead to an increased M&A activity, which in other words creates a merger wave pattern. This positive correlation has been described in the recent literature (Golbe & White, 1988; Gort, 1969; Jovanovic & Rousseau, 2002). The high market valuation creates additional incentives for CEOs to engage in acquisitions which have the opposite goal than that of maximizing the shareholder value, thus being value-destroying. ***In other words, CEOs are driven by opportunistic behaviour. During merger waves, it is easier for the management to finance their strategic-decisions due to the higher capital liquidity in the market, which increases the likelihood of the CEO convincing the board of directors that the decision to acquire is a good one. (Sudarsanam, 2003).*** In other words, merger activity has been linked to the increase in stock financing (Andrade, Mitchell, & Stafford, 2001).

What is more, the behavioural finance issues are important to explain merger waves phenomena such as CEO overconfidence, anchoring and information asymmetries. Those antecedents are all behavioural issues which are easier triggered when the market valuation is high. As mentioned before, high market valuations are positively correlated to merger waves. The following let us assume that merger waves are important factors which can further explain the agency conflict between CEO & shareholders when engaging in M&As.

2.5.2 Merger Waves and Agency Costs

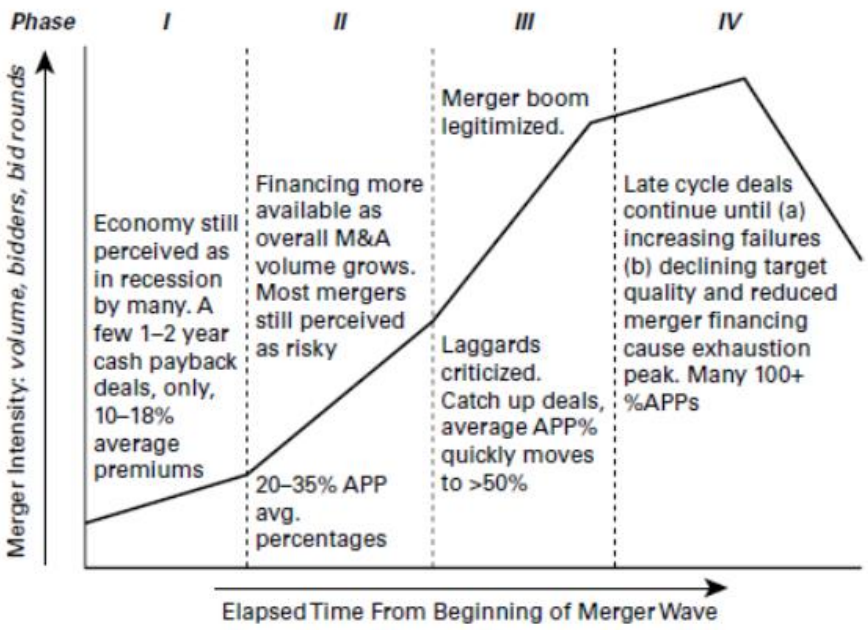
The following section will explain how agency theory can be used to understand the merger waves pattern. As proved in the behavioural finance literature, merger waves are strongly correlated to high market valuations. In the paper of Jensen (2005) it has been outlined how stock market valuations, in other words, merger waves pattern, can enhance the conflict of interests between CEO and shareholders. Stock market valuation has been analysed by Shleifer & Vishny (2003) and Rhodes-Kropf & Viswanathan (2004). However, both papers present important limitations, as scholars argue that the company's management is interested in the maximization of shareholder value. Contrary to that, and in accordance to agency theory, Jensen (2005) argues that the managerial interest is driven by personal motives, such as empire-building and job security. The overvalued market creates the pressure for management to grow the company. Engaging in M&As is the fastest way to solve the problem and grow the company in the short-term. Jensen (2005) assumes that the goal of the management is not consistent with the shareholder's goal of value maximization, so that the management will undertake M&As, even if they could turn out to be value-destroying in the long term. By doing so, the problem is postponed to the future. The CEO is aware that by the time the value-destroying decision will manifest itself, he or she will probably not be a part of the acquiring company anymore. Matching short-term goals and financing them by the overvalued equity instead of trying to get the stock price down to a fair price, can start a circle which can be used as an explanation for the merger wave pattern from an agency theory perspective (Jensen, 2005).

2.5.3 The Phases of Merger Waves

The analysis of different stages of merger waves is essential to be able to better understand the behavioural issues, which have a significant impact on the management's final decision. To do so, it is important to get a deeper understanding of the different phases of merger waves (Kjaer, Ploufmann, Jonas, Meier-Larsen, & Kobborg, 2016).

The merger waves stages will be based on the model presented by Clark and Mills (2013). Their model is based on two measures: ***the merger intensity, which can also be defined as volume, and the acquisition purchase premium***. Higher acquisition premiums lead to a higher pressure for CEO and management to generate additional synergies. According to Goel & Thakor (2010), the following relationship is essential to understand why so many M&A deals turn out to be failures during the later phases of the wave.

Figure 7 - Merger Wave Phases and Acquisition Premium



Source: Clark and Mills, 2013

Phase I begins with a recession, which was present during the last stage of the previous merger wave. After a few years of low merger activity, the management starts to make first bids. That is due to two factors. Firstly, the optimism is coming back to the market. Secondly, the targets are relatively cheap compared to the price during the last merger waves, which creates an extra incentive for CEOs to make a bid.

According to Clark and Mills (2003), *Phase II* is characterized by a rising M&A activity as well as the rise of the purchase premium and an improvement in M&A financing opportunities. These arguments are consistent with the work of Harford (2005) and Shleifer and Vishny (2003), who argue that capital liquidity is essential to initiate merger waves. What is more, the following arguments are also consistent with the previously described behavioural hypothesis. What is more, the financial press has a positive impact on the increase of M&A activity, as they are presenting the positive view on M&As, compared to the time of the previous recession. The M&A activity is growing, as CEO & management want to speed up the deal and finalize it, before the competitors do so.

Phase III is characterized by the most significant growth of merger activities. The managers who have not decided to acquire in the previous phase, enter the bidding competition now. The following behaviour is strongly correlated to behavioural issues, as biased with the successful stories of other companies, the management decides to acquire as well. However, the acquisition premium is much higher compared to the previous phases (Clark and Mills, 2013). The increase in the number of bidders is the reason for that, as the targets are aware that they can extract a higher value (Andrade et al., 2001) due their stronger negotiation power. The position of the target is getting stronger during the movement of merger waves since fewer targets are available and buyers get more desperate to engage into the M&A boom (Bradley, Desai, & Kim, 1988). Moreover, the financial press puts a lot of attention on the bidding competition between companies, which makes it harder to set a reasonable limit for the purchase premium (Clark and Mills, 2013). Therefore, according to Goel and Thakor (2010), a large amount of M&A deals results in overpayment because of managerial irrational behaviour and the inability to correctly measure possible synergies.

The increased merger activity slowly moves the wave to its *final phase*, which is characterized by a poorer quality of targets, as the most attractive ones have already been acquired. According to Rhodes-Kropf & Robinson (2008), the best acquirers and targets already took advantage of the financial opportunities early in the wave phase, which leaves the quality of the remaining targets questionable together with the probability of successful deals in the later phases of the wave. The argument is consistent with Grant (2013), who states that the best resources and capabilities are first to be acquired. The following argument is part of the resource-based view. At the end, the merger activity starts to decrease as the unsatisfying outcomes from the last stage started to occur and the financial liquidity is becoming tighter and tighter.

To sum up, the later stages of merger waves are characterized by an increasing number of failures in the market, since managers perceive the high merger activity as an increased merger performance, which is not necessarily true. What is more, they seek not to notice the switch from the bidder's to the seller's market.

The behavioural finance hypothesis does not state which timing is optimal to engage into M&As during the wave. ***The previously mentioned empirical studies argue that the synergies realized in early stages are significantly higher compared to those realized in later stages***. According to Hagendorff & Vallascas (2011), the deals in earlier stages of the wave experience higher returns. Therefore, it could be easy to state that managers should engage in M&As as quick as possible. However, Persons & Warther (1997), argue that there is a rational explanation behind why managers wait. Managers want to gain additional information about the timing and strategic aspects by waiting for others to acquire before. What is more, the management who is aware about the disadvantages of waiting, can be unable to finance the M&A activity early in the wave due to liquidity issues. ***All in all, studies show that mangers are more likely to destroy shareholder's value by waiting for later phases of wave (Bouwman, Fuller, & Nain, 2003).***

The managerial behaviour will be closer investigated in the normative model, since this part has created a base to analyse how different agency theory antecedents react during different stages of the merger wave, and thus not taking into account other external factors.

2.6 Literature Analysis Sub-Summary

The following section presents a consolidated knowledge about the agency theory and behavioural finance in the relationship CEO-shareholders in M&As. It presents an in-depth literature analysis about the psychological and value-destroying antecedents of M&As through the theoretical lens of the principal-agency theory. The reason for the importance of analyzing the previous M&A literature from this perspective lies in the fact that the emergence of the psychological and human side in the research on mergers and acquisitions becomes more and more apparent. We explicitly focused on the psychological antecedents of M&As which are present in the relation between the CEO and the shareholders.

Secondly, the criticism of agency theory has been presented and the reasons for why the agency theory is too narrow to be fully applied in a CEO-shareholders relationship in M&As have been analyzed. The contradictions have been applied to various antecedents such as: managerial self-interest (hubris, CEO compensation, empire-building, managerial entrenchment), bounded rationality, risk aversion (loss aversion, regret avoidance), goal conflict and information asymmetries. To relax the assumptions of agency theory in M&As, insights from outside of the agency literature have been described, especially those from behavioral finance which were in the scope of our thesis. In the analysis of the literature, regarding the previously mentioned antecedents, we have pointed out a few interesting ***contradictions***, which are present in the current literature. We have presented the agency theory imperfections and how the behavioral finance assumptions could complement on that. These contradictions have created a baseline for a further investigation in the normative model. In other words, how do the value-destroying antecedents react while opposed to internal and external factors?

After doing so, the need to introduce the board of director as an intermediary and shareholder's representative in the relationship with the CEO, in the M&A setting, seemed to be essential. The following section pointed out interesting ***contradictions,*** as some scholars see boards of directors as agents to shareholders. However, several existing solutions to mitigate the following agency problem have been presented which let us assume an alignment of interests between boards and shareholders. Further research regarding the relationship between boards and CEOs is suggested here. Besides that, the role of the top management team has been mentioned and the alignment of interests between CEO and top management team has been made.

The concept of merger waves through the lens of agency theory and behavioural finance has been introduced and a solid literature analysis regarding the correlation between the stages of merger waves and management behaviour has been conducted. The following gave us a foundation to use it as an external factor in the development of our normative model.

III. Normative Model Development

According to Haleblian et al. (2007), moderators, such as internal and external factors, play a crucial role in the acquisition's performance, as they can have a significant effect on the final performance of M&As. After moving from the research of articles and creating a solid literature analysis about the agency relationship between CEOs & shareholders, we will now proceed to the development of our normative model. ***Moderators, such as external factors, will be analysed and critically reflected upon.*** Their influence on the previously described value-destroying agency theory antecedents will be our contribution to the existing literature about M&As, behavioural finance and agency theory. ***Firstly, it will create an interesting source of knowledge about how behavioural finance can complement on the fact that agency theory has been defined as being too narrow when it comes to M&As. Secondly, the model will explain the impact of externalities on the level of the value destruction in M&As. In other words, the model will investigate whether the presence of external factors in M&As has an enforcing or mitigating effect on value destruction in M&As, by investigating each of the antecedents separately.***

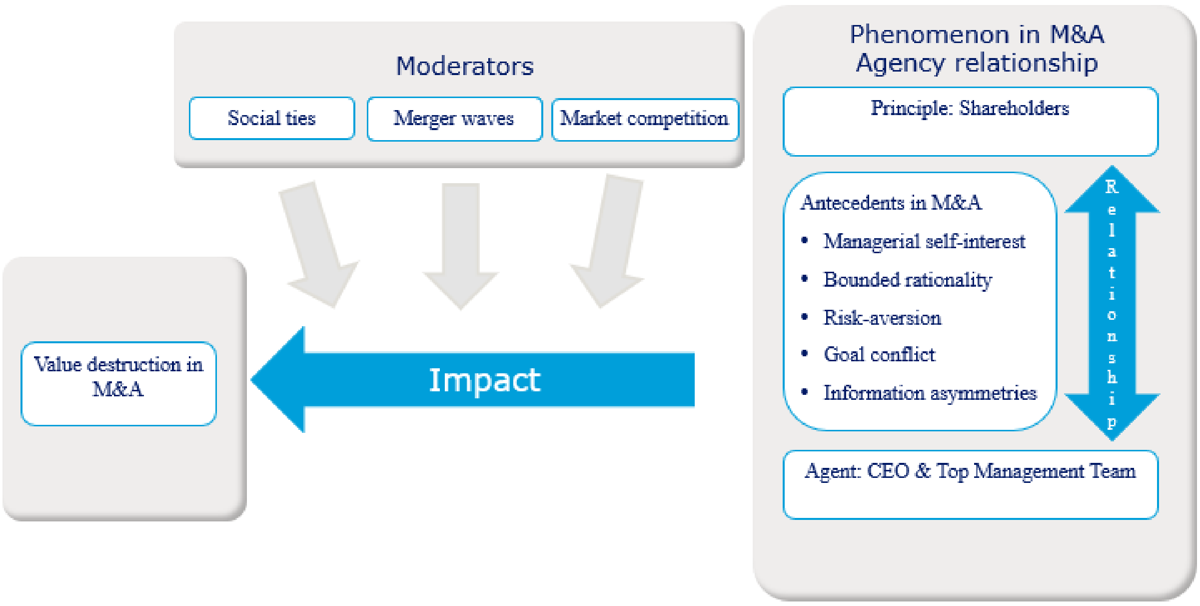
Until now, little research exists on how ***social relationships between CEOs and the boards of directors*** influence corporate investment decisions like M&As. What is more, there is no combined research on how social ties can affect the value-destroying antecedents in M&As such as information asymmetries, hubris, risk-aversion and goal conflict. Therefore, social ties between CEO & top management and the board of directors, who are representing shareholders, have been chosen as a

first factor to analyse. The aspect of bounded rationality has been taken out of the scope of our analysis since we agree with the fact that humans are bounded rational and the following have been stated in the previous analysis. Thus, we will put the focus on managerial self-interest, information asymmetries, risk-aversion and goal conflict.

Market complexity and uncertainty is another interesting factor to apply in the model. The same as above, no combined research on how market complexity and uncertainty can affect the previously described value-destroying agency theory antecedents in M&As has been found. Thus, market complexity and uncertainty will be the ***second*** factor in our situational analysis.

After an in-depth analysis of social ties, market complexity and uncertainty, the analysis of the impact of merger waves on the CEO and board of director's relationship will be conducted. The reason for this is that there is, normally, an increased engagement of companies in M&As during a certain period of time, which is defined as a merger wave. Resulting, ***mergers waves*** will be regarded as our ***third*** external factor in the development of our normative model.

Figure 8 - Normative Model Development



Source: Own creation

Lastly, to reflect the reality of M&As as accurately as possible, merger waves will be used as a setting to present an even more in-depth situational analysis and its impact on value destruction in M&As.

3.1 Social Ties Between CEO and Board of Directors in M&As

In accordance with psychological and sociological studies, social ties between the board of directors and CEO, play a significant role in M&As. Firstly, M&As are initiated by the CEO. Secondly, the CEO's decision must be approved by the board of directors before the transaction can take place. Thirdly, the board of directors acts as an intermediary and thus represents shareholders. The following relation let us assume that social ties between both parties are especially relevant when it comes to M&As, as they are defined as an uncertain transactions for both parties, in that value-destructive M&As could lead not only to the CEO being fired but also to the company becoming a future target (Lehn and Zhao, 2006). Direct social ties are defined as personal relationships between the CEO, who is the decision maker in M&As, and the board of directors, about whom the decision is being made (Larson, 1992). Those direct social ties strongly influence the indirect relationship between the CEO and shareholders, as the board of directors is assumed to play in the interest of the shareholders.

Based on this, the impact of this external factor, namely social ties, on the agency theory antecedents, present in the relationship between the CEO and board of directors and afterwards, its impact on the value destruction in M&As, will be analysed.

Definition of Social Ties

Social ties between management and independent directors can originate from different circumstances (Hoitash, 2011). For instance, management and board members could develop them while participating in the same social & networking events. However, more visible ties can be developed when the management and board members sit together in the boards of other companies (Guedj & Barnea, 2009). In other words, social ties refer to the resources which CEOs can use to take advantage of their position (de Graaf & Flap, 1988), which will be further applied to a M&A setting, being the topic of our thesis.

The theory about network ties is known to be developed by Granovetter (1973). Numerous scholars, in their sociological, psychological and management papers underline the importance of social ties as a driver of acquisitive behaviour (Haleblian et al., 2009). Results of those findings moderate the CEO-board of director's relationship in M&As and influence the level of information asymmetries between both of the parties. According to Boyd, Haynes, & Zona (2011), research regarding these relationships has benefited from the application of the social network theory.

After defining what social ties between management and the board of directors are, their influence on the level of value destruction in M&As will be presented.

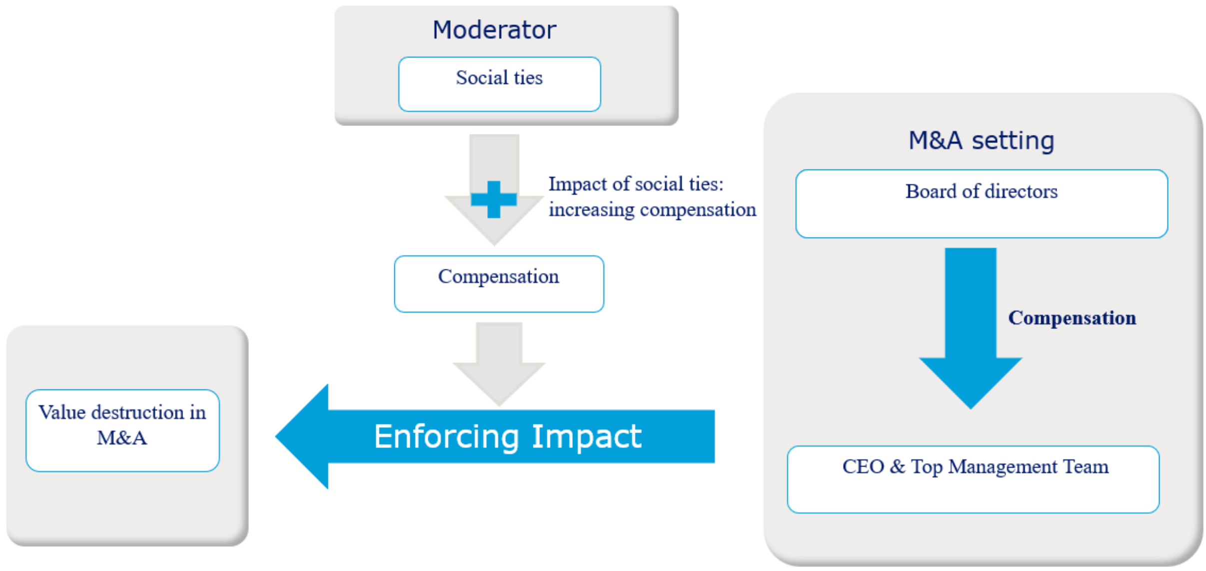
3.1.1 Influence of Social Ties on CEO Compensation in M&As

In this section we will analyse how social ties between CEO and board of directors influence the compensation level in a M&A setting. In our literature analysis, it has been shown that the acquiring CEO's post-acquisition compensation generally increases, irrespective of the resulting performance of the acquisition. This may trigger the management to induce M&As just for pecuniary benefits and thus most likely leading to value destruction for the shareholders. The factor of social ties will be applied to further investigate how its presence can influence the CEO's compensation level and whether a mitigating or enforcing effect on the value destruction in M&As can be observed.

Harford & Li (2007) have stated that acquisitions provide a natural opportunity for the CEO and the board to restructure the executive compensation, in that the CEO may argue for a higher compensation and for a pay that is less sensitive to performance, due to the increase in size and complexity of integrating two companies. Thereby, the board of directors is the one whose responsibility is to set the CEO's compensation in line with the shareholder's interest.

In the empirircal study of Hoitash (2011), a compensation model of 3525 observations has been built. Thereby, the data concerning CEO compensation, financial information and mergers and acquisitions has been collected. ***Based on his model and findings, it has been stated that social ties between the CEO and board of directors lead to a positive relationship with regards to CEO compensation.*** What is more, the study argue that excessive CEO compensation is strongly correlated to social ties between both parties. The results of the study are consistent with the empirical test presented by Larcker, Richardson, Seary, & Tuna (2005). They suggest that connections between CEOs and board members lead to a higher compensation level. These findings have been confirmed by Hoitash (2011) and Hwang & Kim (2009). Due to the high quality of the presented studies based on the scholars' backgrounds and the number of times the papers have been cited, we assume that the following findings are relevant and can be applied to M&As. Firstly, as mentioned before, M&As are associated with a general increase of the CEO's salary. Secondly, the presence of social ties has been tested by scholars and it has been proved that social ties improve the compensation level. By connecting the following findings we assume that ***social ties increase the upper echelon compensation***, especially in M&As, so that management might engage in M&As just to increase their compensation while doing so.

Figure 9 - Influence of Social Ties on Compensation



Source: Own creation

The assumption is consistent with the managerial power theory. According to Bebchuk & Fried (2004), the outcome of the board's decision regarding the upper-echelon compensation is more beneficial for management, even though boards are representing shareholders. The reason behind it lies in the psychological and social connection between CEOs and boards. When it comes to M&As, we assume that the close relationship between boards and CEOs could lead to excessive payments due to the characteristics of M&As itself as well as a higher managerial control over the boards.

Consistent with the following assumption, Fich & White (2005) have found out that the CEO compensation is higher when social ties are stronger. These findings have been based on the situation when the board's composition included more than one pair of board members who serve together on more than one board. In other words, when the management sits in the board of the other company and vice versa. The limitation, presented in the work of Fich and White (2003), is that scholars do not distinguish between the types of social types and between individuals involved. However, the following limitation has been filled by the previously mentioned study of Larcker et al. (2006), who have distinguished between different types of ties and focused on the relationship between CEO & shareholders. According to their finding, the CEO compensation is higher when social ties are present.

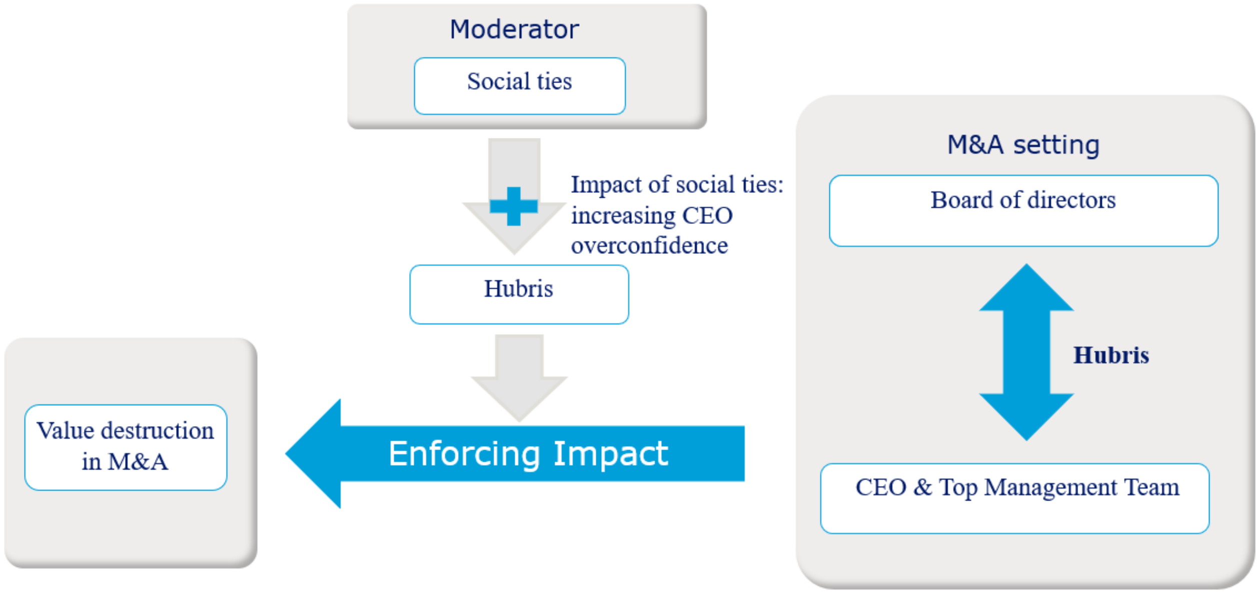
However, the limitation of Larcker et al.'s study (2006), in turn, is the assumption that social ties are only identified when the CEO and independent board members sit together at least in one board of another company. The fact that management and board members could develop them while participating in the same social & networking events is out of the scope of Lacker's paper. The off-board relationships can be seen as out of the scope of our thesis . Based on our previously described definition of social ties, when applied to a M&A setting, a similar impact can be observed.

Therefore, the fact that the upper-echelon compensation increase in a M&A setting together with the fact that social ties between the CEO and board members increase CEO compensation, create a solid basis for us to argue that ***there is a positive relationship between social ties and CEO compensation in M&As***. This excess compensation is not in the best interest of shareholders and therefore the effect, which social ties have on the executive compensation in M&As, might enforce the present agency conflict and thus lead to a higher level of value destruction in M&As.

3.1.2 Influence of Social Ties on CEO Hubris in M&As

In this section, the findings, which create a baseline for the argument that ***strong ties*** between CEO and the board of directors ***increase the managerial overconfidence*** in M&As, will be presented. Referring to Malmendier & Tate (2002) and according to the psychology literature, the illusion of control makes individuals more overconfident about outcomes that they believe are under their control. In the previous section the empirical studies of Johanson et al. (1993) and Tosi & Gomez-Mejia (1997), which have proved that personal ties between the CEO and board of directors decrease the board's capacity to monitor the CEO and decrease the involvement of outside directors in the decision-making process, have been mentioned. The less the board monitors the CEO, the more control the CEO gets. ***According to Malmendier & Tate, (2002), while the board's monitoring activity decreases, the CEO believes that the outcomes are more under his or her control, which increase his or her level of confidence in strategic decisions, like M&As. The following arguments let us assume that managerial overconfidence increases while social ties are present between both of the parties.***

Figure 10 - Influence of Social ties on Hubris



Source: Own creation

The board's vigilance is a way to limit this enforcing impact of social ties on the managerial overconfidence, which, in turn, is assumed to enforce the value destruction level in M&As. The arguments behind this will be investigated in the following part.

Influence of Board's Vigilance on CEO Hubris

According to Finkelstein et al. (2009), the board's vigilance can be seen as the center of corporate governance and describes the degree to which boards effectively monitor and discipline top managers, especially CEOs. ***With regards to the board's vigilance, we will focus on two aspects of it, i.e. non-duality (i.e. the separation of the CEO from a chairperson position in the board) and the outside director representation (i.e. a relative ratio of outside directors in the board).***

Referring to (Hayward & Hambrick, 1997), it is proposed that a weak board's vigilance, due to CEO duality, promotes managerial entrenchment, since chair-CEOs can dominate the agendas and contents of the board's meetings, control most valuable information emerging from the board's meetings as well as enforce their power by selecting directors who are loyal to them (Finkelstein & D'Aveni, 1994). As a result, CEO-duality allows chair-CEOs to base their decision-making on hubris in a relatively unconstrained manner. ***Contrary to that, CEOs may be less powerful of enabling their***

hubristic mindset to drive the firm in their attempts when the board's chair and CEO position are separated.

Focusing on the M&A setting, ***outside directors*** assess the management's acquisition proposal as well as monitor the whole acquisition process. Thus, ***they ensure that the CEOs do not take actions, which are harming to the firm's stockholders by pursuing their own hubris-infected goals (Byrd & Hickman, 1992). What is more, they can estimate the benefits and cots of an acquisition more objectively and in some cases, they have a better knowledge of the target firm and the industry it is operating in. The better estimation of the acquisition's benefits and costs is especially important when it comes to hubris-infected CEOs, as, as already stated in our literature review, hubris manifests itself by the underestimation of risks and the overestimation of possible synergies in M&As.*** Particularly, it has been found out that the average abnormal announcement-day return follows a less negative trend for companies with a board including more than 50 % of outside directors (Byrd & Hickman, 1992). In addition, ***an independent board is also more likely to replace CEOs that are enacting value-destroying M&As through their hubris-infected decision making.***

The conclusions, which have been made above, have been mostly based on the research of J.-H. Park et al. (2015). It is important to mention here that the research setting of this work is based on large Korean business groups. However, regarding the influence of the board's vigilance on CEO hubris, this work is valuable, in that in the late 1990s most large Korean business groups had been criticized for their lack of transparency in corporate decision making, lower accountability of top management and higher debt-equity ratios compared to their principal international competition. Nevertheless, in the wake of the economic crisis, the Korean government has mostly adopted the Anglo-American governance system, including the chair-CEO separation and introducing independent boards of directors, so that the study of J.-H. Park et al. (2015), even though the sample is restricted to Korea, can be seenn as informative, in that it shows the effectiveness of Western-based corporate governance reforms for post-crisis Korean firms (J.-H. Park et al., 2015).

Concluding, we can stress that, to get significantly positive results from M&A transactions, companies must thoroughly take care of their governance corporate structure, so that it can evaluate and deliberate M&A transactions able to generate value and eliminate those, that do not give rise to any benefit for the firm. With this regard, the results of the study of Teti et al. (2017) have showed that the presence of independent profiles in the boards of directors and the separation

of the role of CEO from the one of the president are both elements to contribute to the development of benefits for the decisional efficacy when enacting M&A transactions.

3.1.3 Influence of Social Ties on Information Asymmetries in M&As

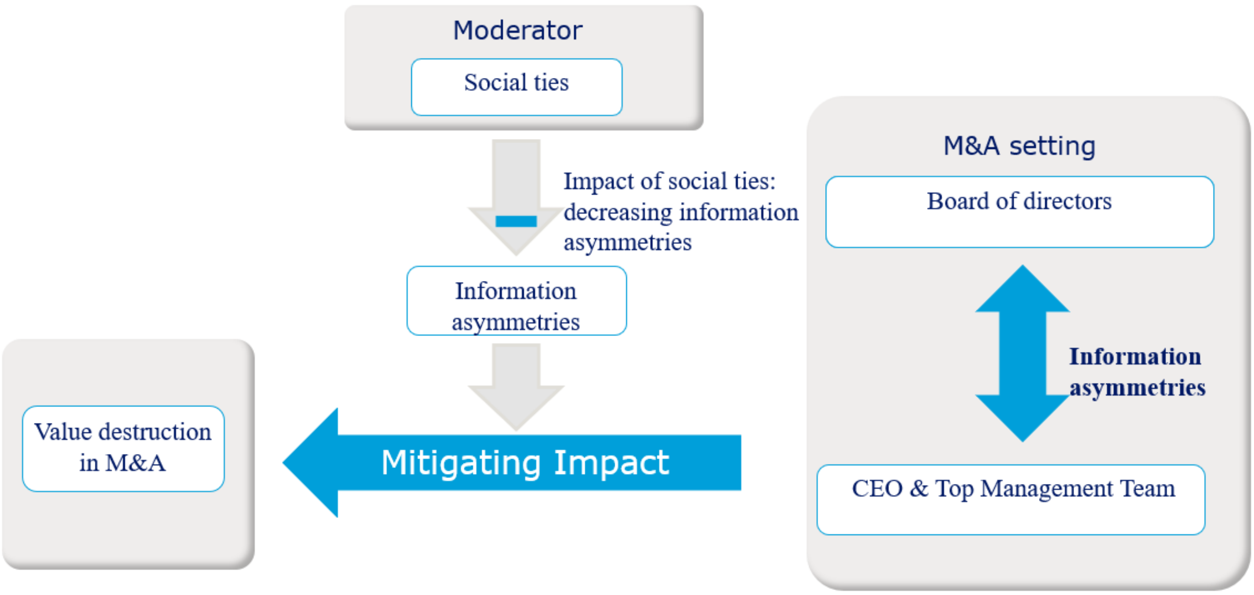
In the section we will present arguments, which create a solid base to argue that ***strong ties*** between the CEO and board of directors ***decrease information asymmetries*** in M&As between CEO and shareholders and thus counteract the value-destructive nature of information asymmetries as M&A antecedents. To explain the following assumptions, the critical reflection will be presented and developed.

Johanson et al. (1993) and Tosi & Gomez-Mejia (1997) have proved in their empirical research that personal ties between the CEO and board of directors decrease the board's capacity to monitor the CEO and decrease the involvement of outside directors in the decision-making process. However, scholars argue that the board's role is not only to monitor, but also to advice the CEO on strategic issues (Gomez-Mejia & Wiseman, 1997; Zahra & Pearce, 1989). Contrary to the negative correlation between social ties and the board's monitoring activity, scholars argue that social ties can increase the board's involvement as well as advisory function in the strategic decision-making process.

According to Westphal (1999), CEOs who need quality advice from boards, must disclose the existing problem and their own limitations together with extra information, which they possess. In that case, CEOs needs to forget about the power they can get from ***information asymmetries,*** one of the value-destructive antecedents derived from agency theory (Jensen & Meckling, 1976). As mentioned before, facing the decision whether to acquire or not, CEOs possess a lot of secret information and face the dilemma weather to reveal it to get a better advice from the board of directors, but at the same time to get more control and monitoring, or keep the information secret.

Based on the following findings, existing or strong social ties between the CEO & board of directors have a significant influence on the CEO's need for advice and therefore social ties seem to have significant effect on the reducement of information asymmetries, which has a mitigating impact on the value destruction in M&As. The following assumption will be presented in the sub-model overview below:

Figure 11 - Influence of Social ties on Information Asymmetries



Source: Own creation

However, in the study of Westphal (1999) a ***paradox*** regarding the influence of social ties on the board's monitoring activity has been presented. Even though Westphal's (1999) findings are contrary to the findings of the previously mentioned scholars, in that social ties between the CEO and board are negatively correlated to the monitoring level, the assumption regarding social ties and information asymmetries still holds. Westphal (1999) has found out that social ties do not reduce the monitoring activity of the board of directors. Contrary to that, he argues that such ties may result in an increased board's involvement, as the collaboration between both parties is encouraged during strategic decision-making processes, such as M&As. In his empirical work, he agrees with the statement that ***social ties*** between both parties increase the advice level. The following findings are also aligned with the developed assumption, that social ties could lead to reduction of information asymmetries and therefore result in decreasing agency costs.

We argue that the assumption that social ties reduce information asymmetries is consistent with the results of behavioral finance. Westphal (1999) has combined the findings presented by the behavioural finance scholars and described that ***personal relationships between individuals in a work place increase the advice-seeking need***. What is more, friendships in organizations lead to higher communication and assistance by enhancing mutual trust (Westphal, 1999).

Therefore, we argue that such finding can be applied to bigger organizations and especially to more complex settings, like M&As. We interpret that strong personal relationships between the CEO and the board lead to a higher probability that the CEO will ask the board of directors for advice due to advice-seeking needs. ***To receive a valuable advice, the CEO will have to reveal some extra information, which deceases the information asymmetry between the agent (CEO) and principal (shareholders).*** What is more, already developed social ties are more prone to increase the trust level between the CEO and the board.

Therefore, contrary to the developed and existing ties, weak ties or the lack of them could reduce the willingness to share extra information, which increases the level of information asymmetries. The CEO will not be willing to share extra information regarding M&As with independent directors, to whom they do not have or have only weak social ties.

Social ties provide a mechanism by which investors (shareholders) obtain information. The more information investors obtain, the lower the information asymmetries between both parties. Social ties facilitate the exchange of information and therefore improve the quality of advice on high-importance decisions like M&As. Social ties increase the trust and information sharing between management and directors, which improves the effectiveness (Westphal, 1999).

3.1.4 Influence of Social Ties on Managerial Risk Aversion in M&As

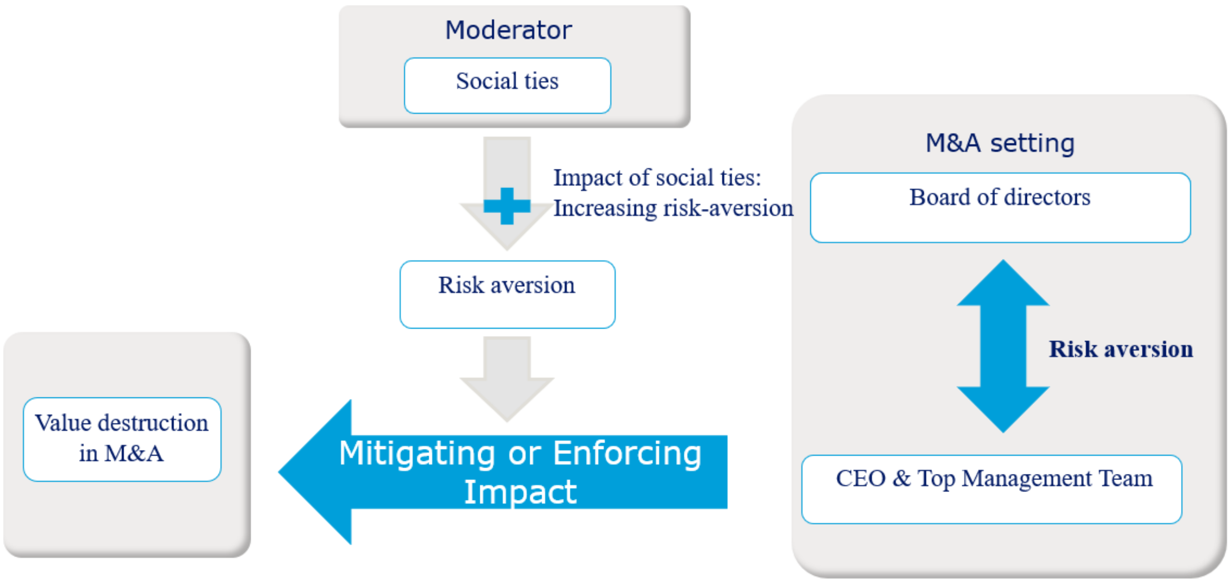
The aim of the following section is to analyse how the level of the CEO's risk aversion change when social ties are present. Evidence from our findings let us assume that existing social ties between the CEO and board of directors can relate to a ***lower level of managerial risk taking*** in M&A activities. CEOs, who have a connection with the board of directors, seem to prefer lower risk-level in their strategic decisions and appear to undertake M&As less likely. According to the assumptions of the principal-agency this is not of interest for the shareholders and thus may be argued as another reason behind the value destruction of M&As.

In the study of Bertrand & Mullainathan (2003), the importance of the 'quiet life' hypothesis has been outlined. In accordance with the 'quiet life' hypothesis, manager's main goal is not to increase the firm size, but to avoid creating new risky-investments and avoid destroying the already existing empire, as they prefer a safe and quiet life. As mentioned before, M&As are a way to increase firm size without the need to internally develop resources and capabilities. Therefore and in accordance to the ‘quiet life’ hypothesis, CEOs will be more likely to avoid risky projects like M&As. However, the connection between the ‘quiet life’ hypothesis in M&As and social ties needs to be further evaluated.

In line with the work of Hicks (1935), Bertrand & Mullainathan (2003) have presented the hypothesis that a poorer governance of managers will lead to a managerial avoidance of costly decisions. Betrand and Mullinathan (2003) have stated that managers, who are not closely monitored, will chose the activities which are not necessarily in line with the shareholder's value. In other words, they will choose less risky projects, which might build their empire. The effect of social ties on the monitoring activity seems to be correlated to the risk-aversion level.

As mentioned in the previous section, social ties between CEOs and boards have been negatively correlated with the board’s monitoring activity. Johanson et al. (1993) and Tosi & Gomez-Mejia, (1997) suggest in their empiricial research, that personal ties between CEOs and boards of directors decrease the board’s capacity to monitor the CEO and decrease the involvement of outside directors to monitor the CEO. What is more, Hermalin & Weisbach (1998) have found evidence in their empirical study that social ties between the board of directors and the CEO reduce the monitoring activity. Hwang & Kim (2009) argue that social ties between both parties matter and that social ties with the board of directors makes the CEO feel safer about his or her job, which decrease his or her pressure to take risks, such as M&As, which could lead to an enhancement of firm value in the long run. However, the lower risk-level does not need to be necessarily bad for the shareholders. The risk impact is strongly dependent on whether the M&As will turn out to be value-enhancing or value - destroying since value-destroying M&As create additional manageiral risks of becoming fired.

Figure 12 - Influence of Social Ties on Risk Aversion



Source: Own creation

In accordance to the presented findings, we argue that the presence of social ties between boards of directors and CEOs support the 'quiet life' theory. CEOs who are less closely monitored seem to prefer to take ***less risk*** to activate their empire-building and 'live a quiet life' at the expense of the shareholders. ***Therefore, risk-shirking activates dominate the risk-taking ones when social ties are present. Whether this mitigates or enforces value destruction in M&As is strongly correlated to the post-merger outcome.***

3.1.5 Influence of Social Ties on Goal Conflict in M&As

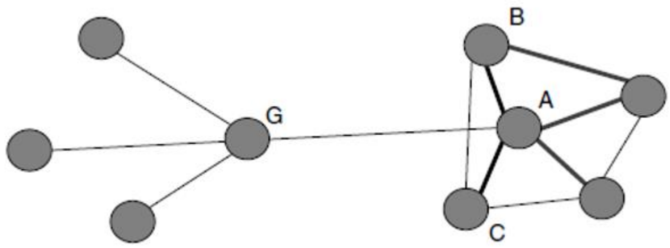
The aim of the following section is to critically reflect on how social ties can influence the level of goal conflict between the CEO and shareholders. As mentioned before, the goal of shareholders is to get the financial benefits and maximize the company's value by activities, which supports the growth strategy, like M&As. Contrary to that, the CEO & TMT have additional, non-financial goals, like prestige, empire-building and compensation maximization (Jensen & Meckling, 1976). We agree, that social ties can have both: a positive and/or negative effect on the value destruction level caused by agency conflicts. ***We argue that there is a certain level of social ties, called the break-even point, in the relationship between the CEO and board of directors in a M&A setting, where the negative impact of them outweights the positive one*** . Thus, social ties between the CEO and the board of directors have a positive effect on the reduction of the goal conflict between CEO & shareholders before reaching this break-even point. After reaching the break-even point, social ties have a negative effect on the goal conflict between CEOs and shareholders in M&As.

However, the break-even point is out of the scope of our thesis and therefore presents an interesting gap for future research. In other words, it is suggested to analyse how ‘strong’ and ‘weak’ ties should be defined and at which level the switch is visible.

According to the ***contact hypothesis***, the contact between personal units reduce the conflict level within organization (Nelson, 1989). The concept of the contact hypothesis has been developed by scholars such as Allport (1954) and Amir (1969). The various explanations why social ties reduce the goal conflict have been presented. According to Amir (1987), the interaction between individuals leads to a positive sentiment, which reduces the goal conflict. However, the contact theory has been opposed by the fact that a too high level of group interaction leads to distortions of groups and conflicts and has been described by Janis (1972) in his psychological study: ‘Victims of groupthink’. In accordance with the contact hypothesis, Nelson (1989) has presented in his scientific paper the theory about the ***‘Strength of strong ties’.*** Nelson (1989) argues that social ties are generally associated with the absence of conflicts between individuals and that organizations with developed social ties generally represent the low-conflict ones. What is more, based on the ‘Strength of strong ties’ theory, strong ties lead to important advantages. The ties act as active components which lead to trust and mutual understanding. Based on the following theory, strong ties might reduce the goal conflict between the CEO and shareholders in M&As, as the mutual trust makes the CEO willing to share extra information, which is in the shareholder's interest. As mentioned before, decreased information asymmetries decrease the goal conflict described by the agency theory. However, the study presents various limitations, such as the fact that the network structure is not the only antecedent of conflicts in organizations. The following limitation is especially relevant in a complex and unique setting like M&As. Therefore, the hypothesis about the Strength of strong ties’ is not sufficient to state that social ties reduce the goal conflict. It cannot be fully applied to M&As, in which the network structure is especially complex.

Opposed to the ‘Strength of strong ties’ theory, ‘The Strength of weak ties’ has been developed by the American sociologist Mark Granovetter. According to his theory, similar people tend to bond as they share common alerts. According to Mark Granovetter (1973), those ***strong ties*** lead to a higher information redundancy of information in the network. The theory has been applied to dense networks, therefore we argue it is relevant in M&A activities. The ***'Strength of weak ties'*** theory states that people with ***weak ties*** tend to link disconnected individuals and those people with weak ties can be considered as proxies of bridges. The following relation will be illustrated in the picture below:

Figure 13 - Structural Holes, the Strength of Weak Ties



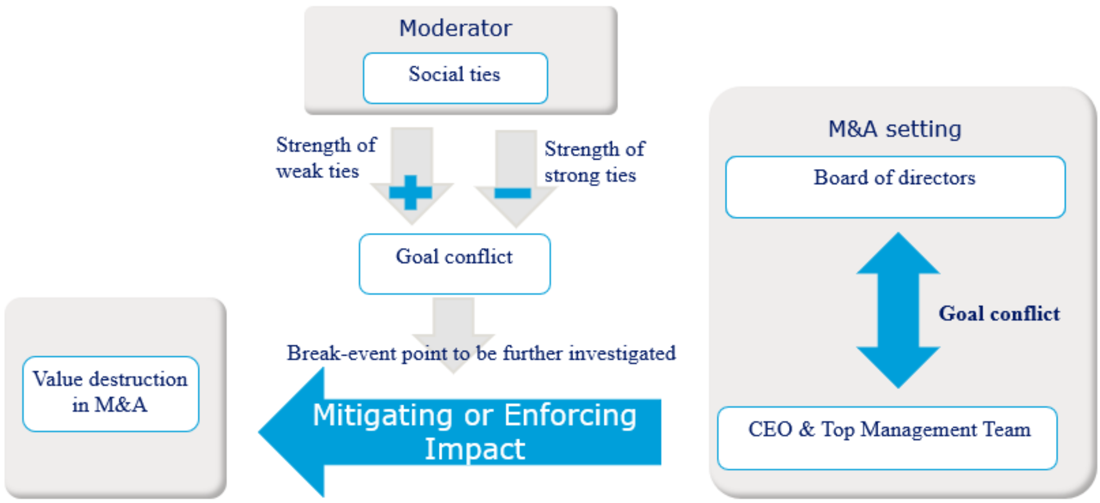
Source: Burt (1992)

According to Granovetter (1983), strong ties cannot be a source of novel information (G-A on the illustration). Here, the following theory will be connected to the relationship between CEO (A) - shareholders (G). As assumed in the model, the board of directors is used as an intermediary during M&As. When the relationship between the CEO and board of directors is too 'strong', a structural hole between G (shareholders) - A (CEO) exists, which proves that the board's monitoring role decreases and therefore the goal conflict between the CEO and shareholders increases. The following theory presents interesting findings that need to be further investigated, as the board of directors (who is presented as a 'bridge'), has more social capital than the shareholders. Social capital, as a metaphor, is defined as the advantage individuals gain from being in a certain type of social network (Burt, 2004). The board of directors, who connect two unconnected individuals, i.e. CEO and shareholders, has additional information and therefore additional benefits of control. ***According to Burt (1992), the individuals who are perceived as bridges of structural holes can decide whose interest they want to serve and with whom they want to share the extra information they possess***. This can be perfectly applied to the board of director's intermediary role in M&As. The following presents another interesting gap to be further investigated, in that it would be crucial to analyse whether the board of directors can take advantage of this 'bridging' position, which they have in M&As. However, the following is outside of the scope of our thesis, as in our thesis the board of directors is assumed to play as an intermediary which is in line with the shareholder's interest.

Therefore, the existing literature presents two interesting, theoretical directions: ***The strength of weak ties vs the strength of strong ties***. We agree, that none of the theories described can be completely applied to argue for either a positive or negative impact of social ties on the CEO-board of director's relationship in M&As. The goal conflict between both parties is more complex. It is assumed to be the main problem stated by the agency theory and the reason for agency problems to arise. Therefore, based on the presented overview of the impact of social ties on different antecedents, the goal conflict will be further investigated.

Based on the analysis of the described theories as well as the previously analysed antecedents, we cannot directly state weather social ties increase or decrease the goal conflict between the CEO and boards of directors. We argue that from an agency theory perspective in complex, strategic decisions such as M&As, the impact on the goal conflict is more complicated. Based on both theories about the 'strength of strong ties' and the 'strength of weak ties', we argue that a certain break-even point of the impact of social ties between the CEO and board of directors exists**.** ***Social ties have a positive influence and decrease the agency conflict between CEO and shareholders until a certain level. When this level is reached, too strong social ties can lead to the CEO and the board of directors not acting in the best interest of shareholders.*** In the latter situation weak ties could have lowerd the lever of value destruction in M&As.

Figure 14 - Influence of Social ties on Goal Conflict



Source: Own creation

However, the assessment of this break-even within the relationship of the CEO and board of directors in M&As is out of our scope and therefore presents an interesting aspect to be further investigated.

3.1.6 Sub-Summary

The social network theory seeks to explain how company behavior and performance can be explained via a pattern of social ties (Boyd et al., 2011). Social networks are used to shape firm behavior and interconnect entities by various ties in relationships between suppliers, individual employees and management. In the following section, the social network theory has been applied to the relationship between management and board of directors in a M&A setting. Social ties between the CEO and board of directors have been used as an external factor and their effect on the value-destroying and from agency theory derived antecedents of M&As have been investigated. According to Boyd et. al (2011), research on the relationship between management and the board of directors significantly benefits from applying the social network theory, which explains the consequences of interlocking directorates. According to Gulati & Westphal (1999), boards of directors are perceived as a unique mechanism, which links top management with shareholders in larger corporations and provides an opportunity to exchange information between parties.

Through the lens of the agency theory, the conflict of interests between both parties is assumed. The aim of this section has been to critically reflect upon weather the presence of social ties between the CEO and board of directors can lead to a mitigating or enforcing level of value destruction in a M&A setting. In order to get the right results, the effect of social ties on the value-destroying M&A antecedents, being present in the relationship between CEO and shareholders, has been analyzed separately to allow us to formulate the following findings:

1. Influence of Social Ties on CEO Compensation

- ***Social ties*** between the CEO and board of directors ***increase the CEO's compensation level*** in M&As.
- Too high or excessive CEO compensation ***increases the conflict of interests*** between CEO and shareholders as the management's goal of private benefits maximization is achieved, which is not in the interest of shareholders and therefore enforces the value destruction in M&As.

***To be further investigated*:** The break-even level of the upper-echelon compensation (above which the CEO compensation could be qualified as excessive) should be further investigated through the lens of agency theory in a M&A setting.

2. Influence of Social Ties on CEO Hubris

- Social ties between the CEO and board of directors increase the level of CEO hubris. Since social ties decrease board's monitoring activity, the CEO believes that the outcomes are more under his control, which increases the managerial overconfidence level.
- The board of director's vigilance is a way to mitigate the increasing impact of social ties on hubris and decreases the conflict of interests between the CEO and shareholders and thus the value destruction level of M&As.

3. Influence of Social Ties of Information Asymmetries

- ***Social ties*** between the CEO and board of directors ***decrease*** information asymmetries.
- Lower information asymmetries ***decrease the moral hazard problem*** between the CEO and shareholders and therefore decrease the value destruction level of M&A

4. Influence of Social Ties on CEO Risk Aversion

- ***Social ties*** between CEO and board of directors ***increase the CEO's risk aversion level***. In other words, the CEO prefers taking less risk in accordance to the so called 'quiet life' hypothesis.
- According to the agency theory, a higher level of the CEO's ***risk-aversion increases the conflict of interests*** between CEO and shareholders in a M&A setting
- However, due to the complexity of M&As, the higher risk-aversion level does not necessarily have to be bad for shareholders and result in a higher value destruction. If M&As, which have not been undertaken due to a high managerial risk-aversion, were value-destroying, then the increased risk-aversion level would have decreased the value destruction level of the M&A engagement, as 'wrong' M&As are avoided.

***To be further investigated*:** A further investigation between the real intentions of the CEO and the level of luck (such as favorable external factors, which lead to M&As being of value) creates an interesting gap to be further investigated.

5. Influence of Social Ties on Goal Conflict

- ***Social ties between the CEO and board of directors in M&As have a positive effect on the reduction of goal conflict between CEO & shareholders upon a certain break-even point.*** The strength of strong ties theory can be applied to explain this. After reaching the break-even point, social ties have a negative effect on the goal conflict between CEO and shareholders. The strength of weak ties theory can be applied to explain this.

To be further investigated: The break-even point at which the switch between the positive and negative effect of social ties between the CEO and board of directors on the goal conflict between the CEO & shareholders in a M&A setting can be observed.

As presented in the overview, it has been proved that social ties between the CEO and board of directors in M&As can have either a positive or negative effect on the agency conflict between the CEO & shareholders. Some of the antecedents react positively (in other words: they lead to a mitigating impact of value destruction in M&As), while others react negatively (agency conflict of interests between managemnt and sharheolders increases).

To sum up, we argue that the presence of social ties in M&As is important, as CEOs are more willing to seek for the board's advice, which is strongly correlated with decreased information asymmetries. We assume that such advice can be especially useful in complex strategic decisions, like M&As, where a wrong decision may result in a huge value-destruction of the shareholder's empire. However, at a certain level, when social ties become too strong, a negative effect can be observed, as the board seems to act more in the interest of the management than in the interest of shareholders, which increases the agency conflict between CEO and shareholders.

After an in-depth analysis of the first external factor, we will now investigate how market complexity and uncertainty can influence the value destruction level of M&As.

3.2 Market Complexity and Uncertainty in M&As

As a crucial factor in the company's environment, we will now focus on the moderating impact of market complexity on the assessed value-destroying M&A antecedents. This must be done in order to create a more realistic perspective of our normative model, which aims to describe and structure the M&A setting. Hereby, it is important to mention that, regarding the moderating impact of the next external factor on CEO hubris, we will focus on both the market's complexity and uncertainty due to the importance of CEO hubris in our literature analysis as well as interesting findings considering both of these factors. All other antecedents are going to be analysed under the moderating impact of the market's complexity, mostly capturing the competitiveness of the industry, faced by the acquirer.

According to Aldrich (2008) and Dess & Beard (1984), market complexity includes the market's heterogeneity as well as competitiveness, where the competitiveness increases the market's heterogeneity due to a lower industry concentration. The widely used measure for market competition is the Herfindahl-Hirschman Index (HHI). It is calculated as the sum of squares of market shares in the industry. A high value of it proposes a low market competition or high industry concentration (Laksmana & Yang, 2015).

3.2.1 Influence of Market Complexity on CEO Compensation in M&As

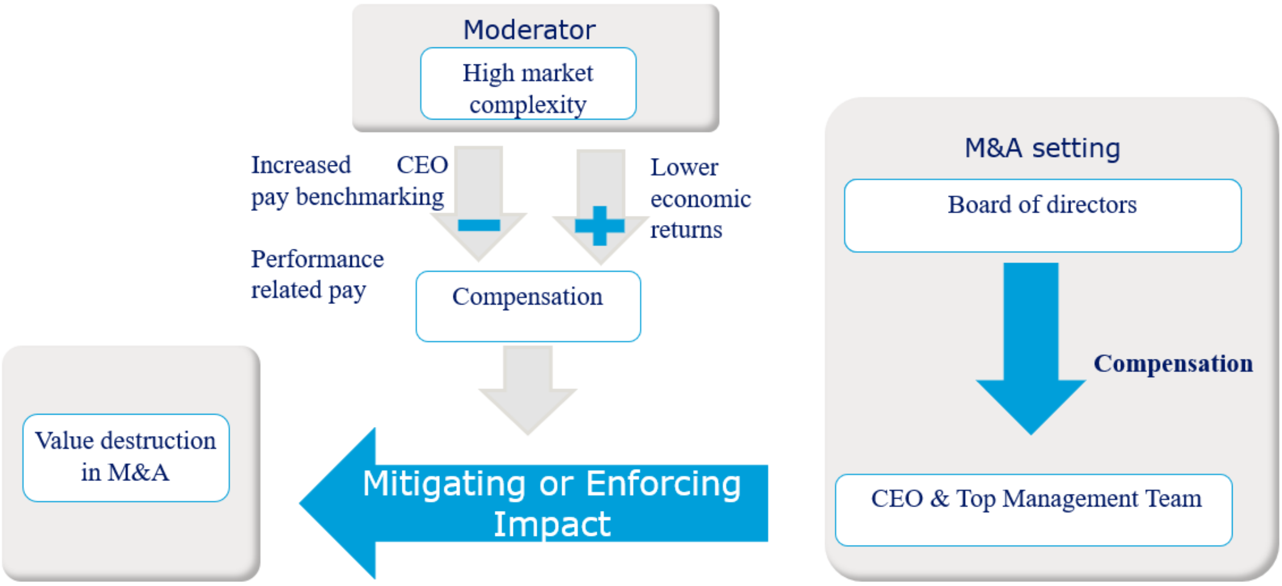
According to Cuñat & Guadalupe (2009), market competition has an impact on managerial compensation through different channels. Firstly, competition changes the elasticity of profits of the firm to increase in productivity. Thus, it alters the returns to the effort of the executives of the firm (Schmidt & Tyrell, 2002). As a result, firms may choose to reoptimize their compensation packages following a change in the competitive environment. Secondly, competition alters the risk and implicit incentives that the economic environment provides to managers and accordingly, it may alter the optimal explicit incentive package that firms offer to them (Schmidt, 2002). Lastly, and possibly deviating from the classic principal-agent approach, changes in competition may change the profit levels of the firm, the relative bargaining power and the incentives for managers to extract rents from the firm (Bebchuk, Fried, & Walker, 2002).

The view, that market complexity may mitigate the strong link of upper echelon compensation and ownership to acquisition frequency, and thus decrease the possible value destruction of M&As, may be argued by the significantly greater impact of CEO pay benchmarking in more-competitive industries than in less-competitive ones (Brick & Palia, 2016). By implementing 'compensation benchmarking', corporations use peer companies to assist in setting the pay to their CEOs. ***Thus, CEOs may restrain from undertaking M&As just for the sake of personal benefits, like increasing their compensation, as their compensation will be measured relatively to peer companies, thus decreasing liberal post-acquisition equity-based pay grants. What is more, Cunat & Guadalupe (2009) have found out that competition increases the steepness of performance pay contracts*** (if there is already a performance related pay in place). This is also in line with the research of Burgess & Metcalfe (2000), who have found out that the likelihood of a performance related pay increases with competition. This is especially important with regards to the described findings in the compensation section of our literature analysis, where it has been shown that post-acquisition compensation generally increases, irrespective of the resulting performance of the acquisition. Focusing on the link to agency theory, Baggs & de Bettignies (2007) have identified a direct pressure effect, as well as a significant agency effect of market competition, which both increase the importance firms place on contractual incentives***. Besides increasing the slope of performance contracts, firms have also reduced the fix component of directors pay (Cunat & Guadalupe, 2005).*** The results of the work of Cunat & Guadalupe (2005) are insofar viable, as in their research a quasi-natural experiment has been exploited, i.e. the sharp appreciation of the Pound Sterling in 1996, which can be interpreted as an exogeneous shock in competition, due to the resulting increase in competitive pressure***. Concluding, both the greater impact of CEO pays benchmarking in more-competitive industries as well as the increased likelihood of performance related pay in competitive industries contribute to the assumption that market complexity may mitigate the strong link of upper echelon compensation to acquisition frequency, so that the value destruction level of M&As, triggered by the pursuit of M&As due to an increased managerial post-compensation, might be reduced.***

On the other hand, the residual demand that firm face may shrink in a competitive environment, which may trigger management to pursue even more M&As, if a company has adopted a CEO's post-acquisition compensation which increases irrespective of the resulting performance of the acquisition.

Both of these perspectives are illustrated in the following:

Figure 15 - Impact of Market Complexity on Compensation



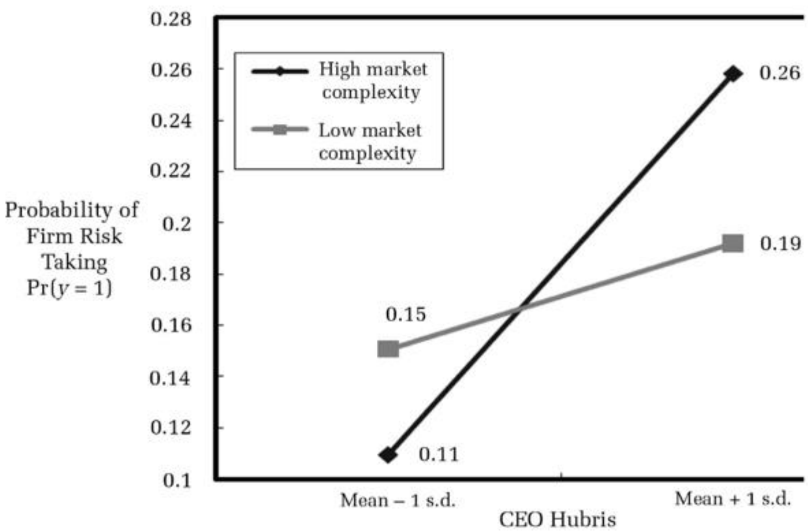
Source: Own creation

Whereas we have only underlined one factor of a high market complexity positively contributing to a higher pursuit of M&As to increase managerial compensation, there are two factors of a high market complexity, i.e. increased CEO – pay benchmarking and a higher probability of performance related pay, contributing to a decreased pursuit of M&As to increase managerial compensation. Nevertheless, the arguments suggesting that competition increases the steepness of performance pay contracts assumes indirectly that a performance-related compensation is already in place. This is not always the case, as mentioned earlier, where it has been shown that some companies have adopted liberal post-acquisition equity-based pay grants.

3.2.2 Influence of Market Complexity and Uncertainty on CEO Hubris in M&As

Contrary to highly competitive markets, markets with fewer competitors tend to be simpler, as they have highly developed rules of interaction, which may limit the CEO's strategic degree of freedom (Hambrick & Finkelstein, 1987). At the same time, when competitors are numerous, the degree of maneuvering without detection is enforced, since firms operating in more complex markets face fewer restrictions, which increases the CEO's strategic degree of freedom. Referring to Li & Tang (2010), this higher degree of CEO's discretion acts as a moderator of the relationship between CEO hubris and firm risk taking and may enable the CEO to enact firm decisions which may be based on managerial overconfidence. ***When testing the hypothesis that market complecxity, i.e. heterogeneity and competitiveness of the market, strengthens the positive relationship between CEO hubris and firm risk taking through an increased managerial strategic degree of freedom***, Li & Tang (2010) have found the following positive result:

Figure 16 - Moderating Effect of Market Complexity



Source: Li & Tang (2010)

The hypothesis that a higher strategic degree of freedom, through an increased means-ends ambiguity in competitive and uncertain industries, enforces the tendency of CEOs expressing their hubris in their decision making is in line with the positive relation between CEO power and CEO hubris, which has been proven by Cormier, Lapointe-Antunes, & Magnan (2016) and is based on the framework of Petit & Bollaert (2012). Accordig to their framework, CEOs need to be in a context in which they have power for hubris to emerge. If used wisely, power can serve some useful purposes but its exercise can also result in abuse. The potential for such abuse increases dramatically in the case of top decision makers developing hubris as their power increases.

Another argument for the suggestion that a higher market competition increases CEO hubris is the so called 'difficulty hypothesis', which claims that people tend to be more overconfident of their ability on hard than easy tasks (Griffin & Tversky, 1992). Thus, it is expected that the overinvestment and value-destroying merger decisions of overconfident CEOs would be stronger in competitive industries, since higher industry competition increases the difficulty of firms outperforming their peers.

Nevertheless, the data of the study of Li & Tang (2010) only concerns Chinese CEOs of firms mainly being in the manufacturing industry. Thus, the generalizability of these results may be questioned. What is more, the moderating effect of the market complexity is tested through the CEO's discretion as a mediator and on the probability of risk taking, so that a direct link to the influence of the market complexity on CEO hubris and its relation to M&A activity is lacking. However, the three main operative mechanisms that link CEO hubris to firm risk taking, i.e. overestimation of a CEO's own problem-solving capabilities, underestimation of the resource required and underestimation of the uncertainties the firm is facing, may be indeed identified in M&As undertaken by hubris-infected CEOs. Another aspect worth noting here is that even though an increased CEO discretion leads to a higher probability of the CEO expressing his or her hubris, it does not tell us anything about how hubris-infected behavior evolves, in that, for instance, a humble CEO becomes overconfident. Testing the expression of hubris through a CEO's higher strategic degree of freedom, triggered by a higher market complexity, assumes that the CEO is already hubris-infected by nature.

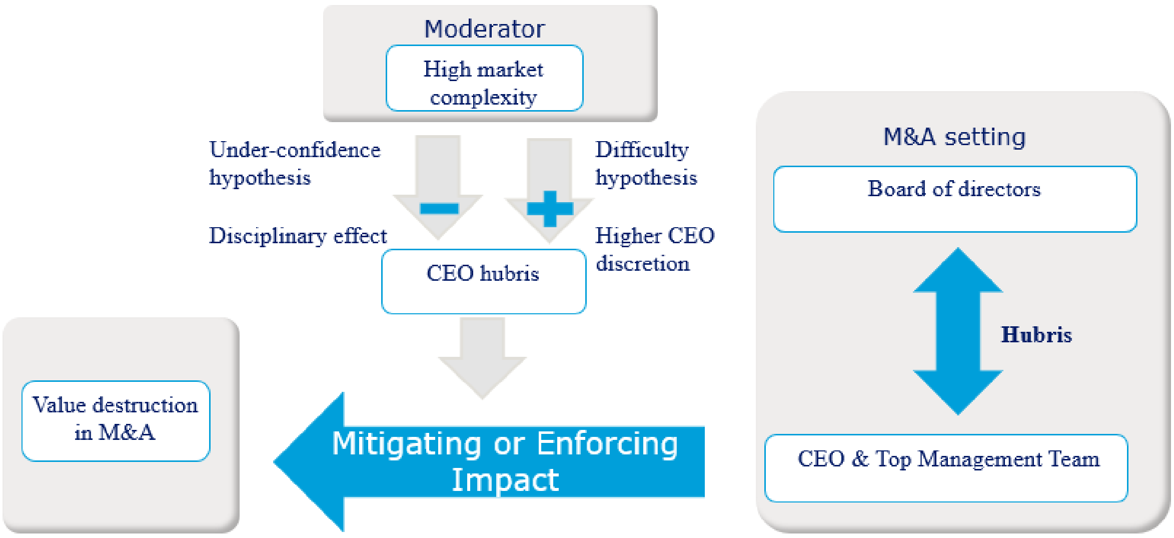
A contradictive view of the 'difficulty hypothesis' is the 'under confidence hypothesis', which postulates that people perceive themselves as 'better-than-average' on easy tasks, but worse than others on difficult tasks (Moore & Cain, 2007), like mergers and acquisitions are. In fact, the study of Ho, Huang, Lin, & Yen (2016), has concluded that the overinvestment of overconfident CEOs is mitigated by a higher market competition environment, because CEOs are more inclined to be overconfident when the task or working environment is easy and higher market competition pushes CEOs to work harder and reduces their overconfidence. ***Moreover, it has been also found out that the merger tendency of overconfident CEOs falls in a competitive market environment. Concluding the work of Ho et al. (2006), it can be said that market competition is a vital mechanism that can reduce CEO hubris.***

Proceeding with the influence of market factors on CEO hubris, we will now focus on the uncertainty of the market. The uncertainty of the market defines the degree to which a CEO faces an unpredictable and unstable environment (Hambrick & Abrahamson, 1995). It mainly includes the extent to which a market is competitively unstable (Grimm et al., 2006) or competitor's actions are unpredictable

(Ferrier, 2001). ***Like a competitive market, market uncertainty creates an increased means-ends ambiguity since market information is unstable and unreliable. Thus, the range of options CEOs face is not significantly constrained, as it is the case with markets which have a lower uncertainty (Hambrick & Finkelstein, 1987). This enhanced discretion allows CEO's to more strongly influence firm decisions and outcomes which may be hubris-infected. The suggestion that high market uncertainty enforces hubristic acquisitive behavior is also in line with the 'difficulty' hypothesis***, which has been described further above, as a market which is competitively unstable and where competitor's actions are unpredictable can be seen as being difficult to operate in. ***Contrary to that stands the 'under confidence hypothesis', where it is assumed that the market uncertainty, in fact, mitigates the overconfidence of the CEO when it comes the assessment of possible synergies which can be realized through M&As.***

The findings presented above can be summarized by the following illustration:

Figure 17 - Impact of Market Complexity on Hubris



Source: Own creation

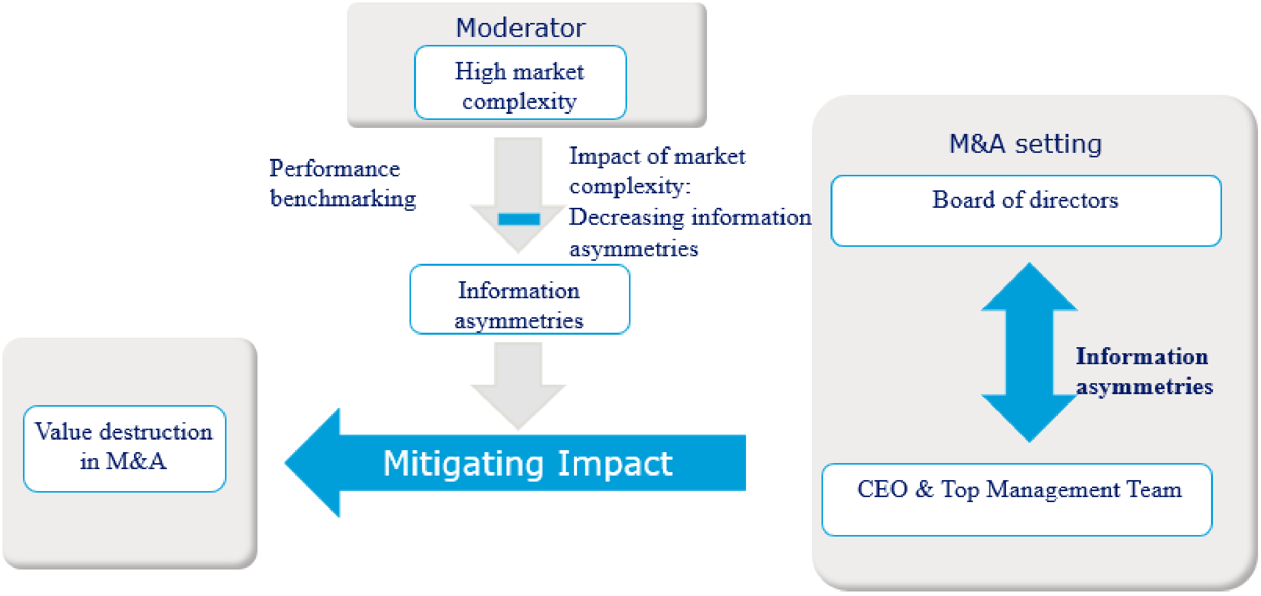
Here it becomes clear that the enforcing impact of a high environmental complexity and uncertainty on CEO hubris is due to an increased discretion of CEOs in these kind of environments. However, as already stated above following this line of argument, one has to directly assume that the CEO is already hubris-infected and by a higher competiton and uncertainty of the industry he or she gets the chance to enact decisions like mergers and acquisitions based on his or her hubris. Thus, this line of arguments does not consider the development of hubris-infected behavior, in that, for instance, a humble CEO may become overconfident when facing a highly competitive, heterogeneous and uncertain environment. ***On the other hand, a high environmental complexity and uncertainty may indeed result in a CEO becoming less overconfident since the impact of market competition on managerial overconfidence has been directly investigated by Ho et al. (2016) with the result that market competition is a vital mechanism that can restrain overconfident CEOs.***

3.2.3 Influence of Market Complexity on Information Asymmetry in M&As

In line with the point, that an increased market competition may lead to an increased means-end ambiguity, one can argue that market complexity is positively related to information asymmetry, so that, due to this ambiguity, shareholders cannot assess whether, for instance, the failure of the merger or acquisition is due to the pursuit of managerial self-interest or other external factors. However, to our knowledge, there is no empirical evidence regarding this argumentation.

Contrary to the point above and referring to Holmstrom (1982) and Nalebuff & Stiglitz (1983), an increase in competition can act as a moderator of agency problems by increasing the information available to principals for a more accurate monitoring and assessment of the manager's relative performance. When competition exists, shareholders can observe performance in other firms and use this information as a benchmark to assess managers. ***Thus, the moral hazard problem decreases, as managers cannot claim that the negative announcement returns of the enacted M&As are due to negative exogeneous shocks. This negative impact of a high market complexity on information asymmetry between the CEO and the shareholders, represented by the board of directors, is illustrated in the following:***

Figure 18 - Impact of High Market Complexity on Information Asymmetries



Source: Own creation

Concluding, during the development of our normative model, we have decided to take on the perspective that a high market complexity decreases the information asymmetry in a principal-agency relation.

3.2.4 Influence of Market Complexity on Managerial Risk Aversion in M&As

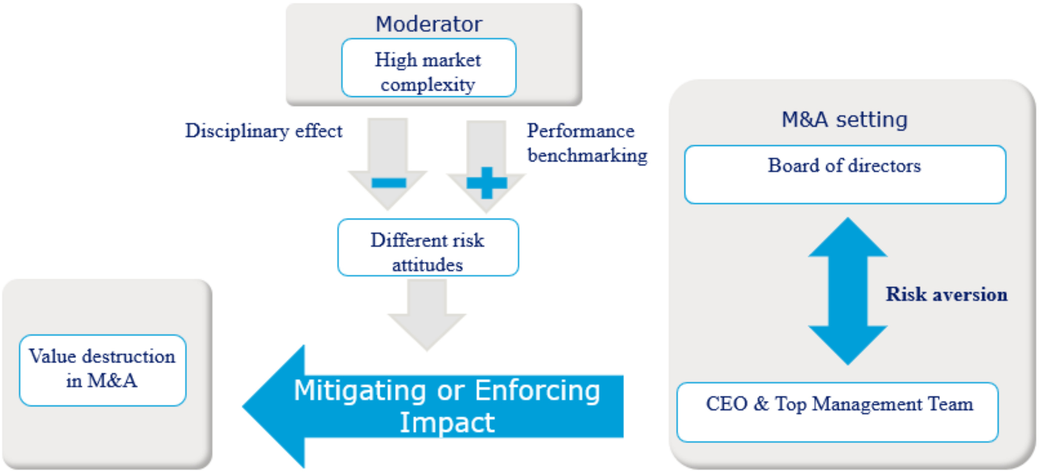
Generally, it can be said that previous research on the association between product market competition and risk-taking is ambiguous, in that there are indications for a positive association as well as a negative one. The reason for a negative association between market competition and managerial risk-taking is because competition allows to assess the manager's performance relative to his or her competitors (Meyer & Vickers, 1997) and, as already stated above, enforces the manager's career concerns due to an increased CEO turnover in highly competitive industries than in less competitive ones. The peer comparisons in highly competitive industries make it more difficult for CEOs to blame bad results for exogeneous shocks when investing in high-risk and possibly high-return projects like M&As.

Nevertheless, during the development of our normative model, we will also present the perspective of a positive association between product market competition and risk taking, so that a high competitive industry leads to an increased corporate risk-taking and thus mitigates agency costs resulting from different risk attitudes of the CEO and shareholders. The reasons for our suggestion will be presented in the following.

First, even though a highly competitive industry allows for more assessment of a manager's performance relative to his or her competitor and thus may result in a higher managerial risk aversion, the increased information available to principals may offset this impact. Thus, even if managers are inclined to forgo an acquisition, which is value maximizing but risky, the principals are aware of that due to the increased information available in highly competitive markets. What is more, using firm-year observations from 1990 to 2010, Laksamana & Yang (2015) have found out that market competition is positively correlated to managerial risk-taking. These results are robust even after controlling for corporate governance mechanism and executive compensation. ***A possible explanation for this could be that competition reduces opportunities for resource diversion for the sake of managerial self-interest and, in turn, decreases managerial risk aversion***. ***In addition, competition makes managers more inclined to take more risk for the long-term survival of the company.*** Moreover, market competition has been identified as an investor protection mechanism since the quality of investor protection is positively related to corporate risk-taking (John et al., 2008). Contrary to a weak investor protection, management of firms with better investor protection are more inclined to make risky value-enhancing mergers and acquisitions since the investor protection mechanism decreases the opportunity for managers to expropriate corporate resources.

The described findings are summarized in the following:

Figure 19 - Impact of Market Complexity on Risk Aversion



Source: Own creation

Summarizing, the performance benchmarking in a competitive industry increases the managerial risk aversion in a M&A setting, whereas the disciplinary impact decreases it. However, it is important to mention here that an increased level of risk-aversion might not be as detrimental as predicted by the general principal-agency theory, due to long-term consequences of such big investment decisions, like M&As are.

3.2.5 Influence of Market Complexity on Goal Conflict in M&As

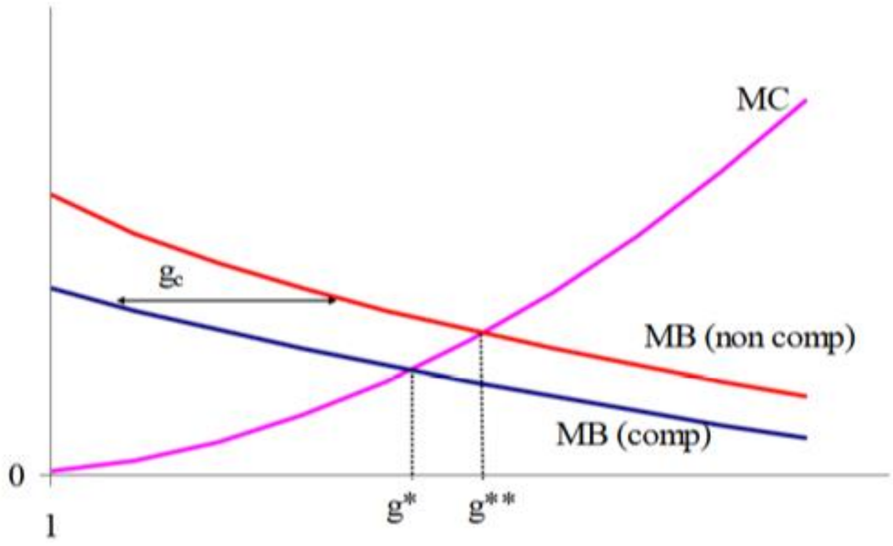
As already described in our literature analysis, the goal conflict between the CEO and the board of directors in a M&A setting arises due to the CEO's propensity to enact M&As to increase his or her compensation as well as his or her own prestige and power. This often happens at the expense of the stockholders, whose aim is the firm's value maximization.

Research in corporate governance has shown that the board's monitoring function (Fama, 1980) and the market for corporate control (Shleifer & Vishny, 1986) are viable mechanism to mitigate the agency conflicts between managers and shareholders. Nevertheless, despite the relevance of these mechanisms to align the managers' goals with the ones of shareholders, there are still some examples where managers do not expropriate the shareholder's welfare when the above mentioned governance mechanisms are lacking (Chhaochharia, Kumar, & Niessen-Ruenzi, 2012). According to Chhaochharia et al. (2012), the reason for that may be the intensity of the market competition.

Regarding the disciplinary impact of market competition, we will suggest that competition may act as a substitute for corporate governance and thus decrease the goal conflict between the CEO and shareholders in a M&A setting. The reason for this suggestion can be explained by the fact that tough ***market competition may force management to improve the acquirer's financial performance and to enact decisions which are value-increasing in the future, since failure to do so would possibly result in bankruptcy (Chou, Ng, Sibilkov, & Wang, 2011).*** As a result, managers will not expand their firms beyond the optimal size to indulge their aspiration for pecuniary and non-pecuniary (power and prestige) benefits. Referring to the work of Laksamana & Yang (2015), this has been measured by making use of the FCF hypothesis (Jensen, 1986) and thus testing the moderating effect of a high product market competition on the association between the positive FCFs and overinvestment.

Moreover, in the theoretical model of Allen & Gale (2000), it is argued that market competition is used to select the best management team and to eliminate firms with bad management. In fact, it has been proved that managers of acquiring firms, exposed to greater increase in competitive pressure, experience higher announcement returns due to choosing targets with higher synergies and are more likely to be fired after the execution of value-destroying mergers compared to all other managers. In fact, the positive impact of an increased competition is stronger in acquirers with relatively higher agency costs (Alimov, 2013). ***This can be seen in the following illustration, where the marginal benefit of market competition is higher for non-competitive industries, due to its disciplinary effect, than for firms in competitive industries, where the disciplinary impact is already incorporated. The marginal cost is identical for both industries:***

Figure 20 - Marginal Cost and Benefit of Market Competition

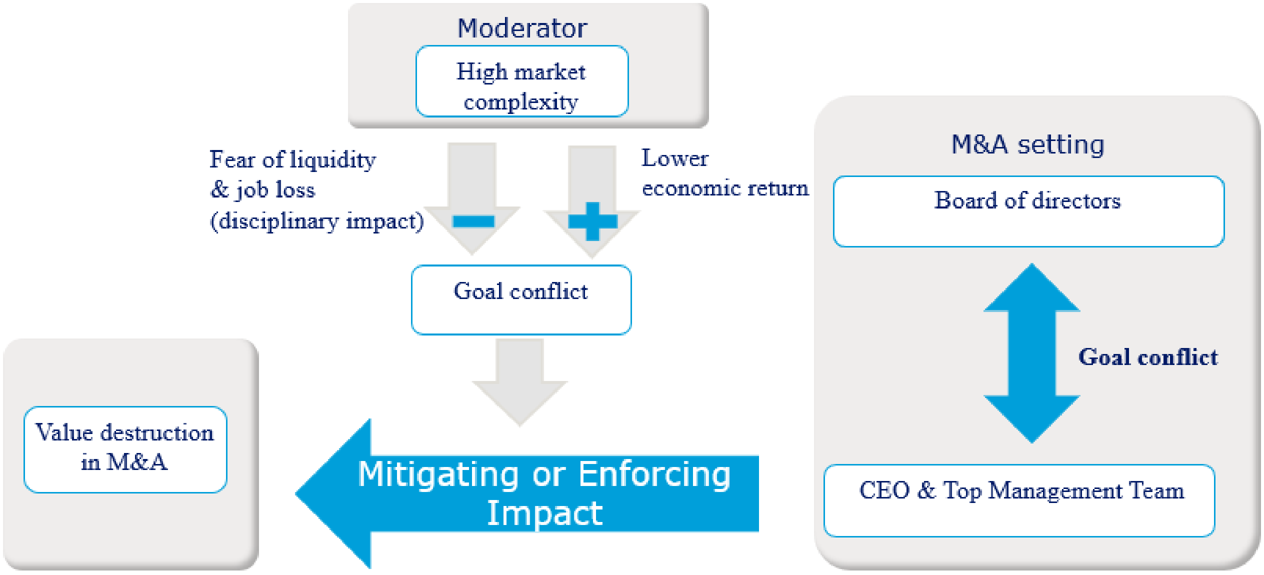


Source: Alimov (2013)

Nevertheless, there are researchers who have documented that firm performance and industry competition are negatively related (Peress, 2010). For instance, Schmidt (2002) argues that an increasing competition decreases each firm's profits and as a result the owner of the company may lower the manager's compensation, which, in turn, decreases the manager's incentives to exert effort. ***According to Wang & Chui (2014), a convex relation between product market competition and managerial incentive can be suggested.*** They have found out that the negative impact of lower economic rents seems to outweigh the positive impact of reducing managerial slack resulting from additional monitoring and the threat of liquidation over a certain level of competition intensity in product market. ***Finding this certain level of competition intensity may be an alley for future research, which could be investigated, for instance, by a meta-analysis of M&A's performance analysis.***

The above described findings are illustrated in the following and can be interpreted as a sub-model of the whole overview of our normative model, concering the psychology of value destruction in M&As:

Figure 21 - Impact of Market Complexity on Goal Conflict



Source: Own creation

During the development of our normative model and in order to be obejctive, we have presented both the arguments for a mitigating as well as an enforcing impact of a high market complexity of the goal conflict between both parties, leading to a higher value destruction level of M&As. ***Nevertheless, we would like to stress here, that we rather agree with a mitigating impact of a high market complexity on the goal conflict between management and shareholders in a M&A setting.*** The reason for this is due to the recent work of Laksmana & Yang (2015), where the two opposite effects of market competition on corporate investment decisions have been introduced as well as tested by a regression analysis, to examine the association between corporate risk-taking and overinvestment of free cash flow (here: through M&As) and market competition. ***The study has provided support for the disciplining role of product market competition in managerial investment decisions and enforces us in our assumption that the disciplinary impact outweights the negative one, in that the results are recent (from 2015) as well as derived from a direct test of both of the opposite effects (enforcing and mitigating one) and thus ensuring objectivity.***

3.2.6 Sub-Summary

In general terms, product market competition in an industry affects managerial decisions and thus is a crucial determinant of firm profitability (Porter, 1990). The influence of market complexity and uncertainty on different antecedents will be summarized in the following:

1. Influence of Market Complexity on CEO Compensation as an Incentive to Engage in M&As

The influence of market complexity on CEO compensation as an incentive to engage in M&As is ambiguous and thus creates an alley for future research. The findings are:

- An ***enforcing*** impact of market complexity on ***CEOs pursuing M&As to increase their compensation*** can be justified by the ***lower economic returns*** typically arising in a competitive industry. Thus, the manager will ***seek to increase his or her compensation through enacting M&As***, especially when granted with liberal post-acquisition equity-based pay grants, bonuses and other compensation (Harford & Li, 2007). ***The following can be identified as enforcing the value destruction level in M&As.***
- A ***mitigating*** impact of market complexity on CEOs pursuing M&As to increase their compensations can be justified by an enforced effect of ***CEO pay benchmarking*** as well as a higher probability of the ***steepness of performance pay contracts in highly competitive industries. The following can be identified as mitigating the value destruction level in M&As.***

To be further investigated: The argument that an increased CEO pay benchmarking has a mitigating impact in the M&A setting should be tested empirically, as research until now has only provided the argument that an increased CEO pay benchmarking is used for rewarding upper echelon management. Moreover, the argument that a higher market complexity increases the steepness of performance pay contracts and thus mitigates the propensity of CEOs pursuing M&As for compensation-based benefits, assumes that there is already a performance-based pay in place. It would be of interest to test whether a higher market complexity leads to an increased incentive alignment of the CEO and shareholders within companies, which do have a fixed compensation scheme. This could be done, for instance, through a quantitative study.

2. Influence of Market Complexity and Uncertainty on CEO Hubris in M&As

- According to the ***difficulty hypothesis*** as well as the ***increase of the managerial strategic degree of freedom*** through an increased means-end ambiguity, triggered by a higher market complexity, an ***increased market complexity as well as uncertainty may enforce the CEO to base his or her decision-making on hubris***. This enforces the value destruction level in M&As.

- According to the ***under-confidence hypothesis*** as well as the ***research of Ho et al.* (2006)**, where it was found out that the merger tendency of overconfident CEOs falls in a competitive market environment, ***an increased market complexity and uncertainty may weaken the CEO's hubris, which has a mitigating effect on the value destruction in M&As.***

To be further investigated: The argument that hubris-infected managerial behavior is enforced through an increased managerial discretion, triggered by an increased means-end ambiguity in a complex and uncertain environment, should be tested on an universal sample and not only on the Chinese one in a manufacturing industry. Otherwise, these findings cannot be generalized. What is more, the argument does not show how hubris evolves, which would be an interesting aspect to investigate. Regarding the widely quantitatively researched view that CEO hubris decreases with a higher market competition and uncertainty, due to its disciplinary impact, there could be a qualitative study implemented, in that one could exactly identify when in the M&A setting the disciplinary force of market competition decreases the manager's tendency to pursue his or her self-interest.

3. Influence of Market Complexity on Information Asymmetry in M&As

- In an agency context, several theoretical papers suggest that ***competition improves incentives*** by providing ***performance evaluation information*** not available in a monopolistic industry.
- Specifically, if exogeneous shocks affecting each firm's profitability are correlated, then an increase in competition generates additional information which the firms' owners can use to ***mitigate moral hazard problems***.
- ***Thus, by an increased market complexity, controlling and monitoring costs typically induced by principals in a principal agency relation can be reduced together with the value destruction level of M&As.***

To be further investigated: The argument that by an increased means-end ambiguity, triggered through a high market complexity, the information asymmetry between the CEO and the shareholders increases, should be further investigated, as there is, to our knowledge, a lack of research. This can be done by implementing a case study, where it can be identified where exactly the means-end ambiguity has emerged and how it has contributed to the information asymmetry between the CEO and shareholders.

4. Influence of Market Complexity on Managerial Risk Aversion in M&As

As already stated above, the influence of market complexity on managerial risk aversion in M&As is ambiguous, in that:

- An ***enforcing*** impact on the ***managerial risk aversion*** can be justified by an increased possibility of the principals to ***assess the relative performance of the agent***, which may result in the propensity of CEOs to restrain from M&As, as it more difficult for CEOs to blame bad results due to exogeneous shocks, when investing in high-risk and possibly high-return projects like M&As. This enforcing impact is even more supported by a ***higher CEO turnover*** in highly competitive markets.
- The ***mitigating impact on managerial risk aversion*** can be explained by the research of Laksamana & Yang (2015), where ***competition has reduced opportunities for resource diversion for the purpose of managerial self-interest*** and, in turn, ***has decreased managerial risk aversion***. In addition, competition makes managers ***inclined to take more risk for the long-term survival of the company.***

To be further investigated: Here, it would be of high importance to assess which of the impact (enforcing or mitigating) is more severe in the M&A setting, or to which degree of the market complexity the enforcing impact is superior to the mitigating impact or the other way around. The reason for that is that differences in risk attitude is, besides the assumption of goal conflict, one of the main assumptions of the principal agency theory, which we have used in order to analyze the value destruction of M&As. Moreover, even though a highly competitive industry allows for more assessment of a manager's performance relative to his or her competitor and thus may result in a higher managerial risk aversion, the increased information available to principals in a highly complex market may offset this impact.

5. Influence of Market Complexity on Goal Conflict in M&As

Regarding the assessment of the impact of a high market complexity on the goal conflict between management and shareholders in a M&A setting, it can be said that all of the above-mentioned factors (CEO hubris, information asymmetry and managerial risk aversion) are of importance. Concluding, it can be said that:

- The majority of research has proven that ***market complexity*** (competitive and heterogeneous) may be seen as a ***substitute for corporate governance***. One reason for this is ***the fear of***

liquidation when acting in a highly competitive and heterogeneous market. Moreover, in the theoretical model of Allen & Gale (2000), it is argued that market competition is used ***to select the best management team and to eliminate firms with bad management***.

- However, there are still scholars arguing for an increase of the goal conflict between shareholders and management.

To be further investigated: As a matter of fact, it would be interesting to investigate the certain level of competition, where the negative impact of lower economic rents of a highly competitive environment outweighs the positive disciplinary effect of it. What is more, the research supporting the enforcing impact on the goal conflict between the management and shareholders is mostly based on the impact on managerial slack, which is not exactly captured by the pursuit managerial self-interest, which we have analyzed, and which has resulted in overinvestment (i.e. undertaking more M&As, irrespective of the value generated) rather than lower effort.

3.3. Merger Waves

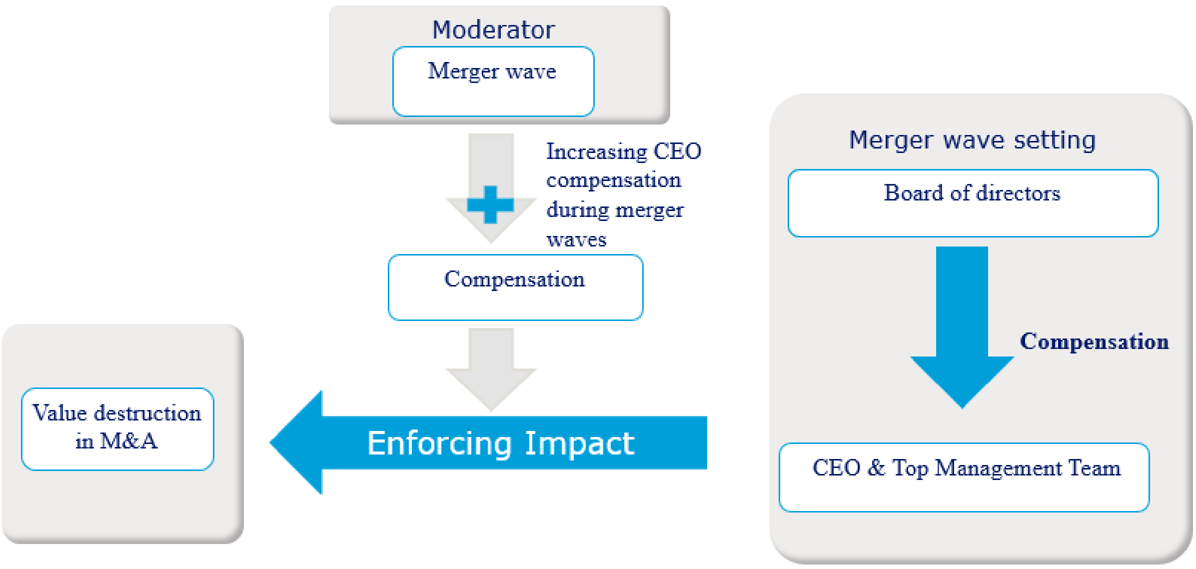
In the analysis of our literature, the concept of merger waves has been introduced. In contrast to the prior section, which focuses on understanding what drives merger waves, this section will investigate their consequences for managerial incentives and agency theory antecedents such as CEO hubris, CEO compensation, information asymmetries, risk-aversion and goal conflict. The influence of the different stages of the merger wave on the value-destructive level of M&As will be assessed.

According to Duchin & Schmidt (2013), wave or late-wave acquirers have weaker governance than out-wave ones and are therefore more prone to agency problems. The increasing agency problems during waves let us assume that including merger waves in the model will create a valuable contribution to a better understanding of the relationship between top management & shareholders in a M&A setting.

3.3.1 Influence of Merger Waves on CEO Compensation

The impact of merger waves on the pursuit of an increased compensation is the highest during the earlier stages of merger waves. According to Goel & Thakor (2010), the increase in the total compensation of CEO and top management team in the acquiring company is higher in earlier stages of acquisitions than in later stages. What is more, the bidder gains in the later acquisitions in a merger wave are smaller than those for earlier acquisitions in the wave (Goel & Thakor, 2010***). Thus, a rather positive relation of merger waves and the pursuit of an increased compensation by management through the engagement in M&As can be identified.*** This relation is illustrated in the following:

Figure 22 - Impact of Merger Waves on Compensation



Source: Own creation

This positive effect of merger waves on compensation can be even enforced by real-world executive compensation which is based on benchmarking. When a CEO, who has been previously in a specific benchmarking group, moves out of it, due to an increase in the firm's size as well as his or her compensation after an acquisition, the lower-paid CEO may become envious. Concluding, real-word executive compensation practices enforce the compensation-based motivation to grow firm size through acquisitions, by shining the spotlight on envy-based behavior, typically arising during merger waves (Goel & Thakor, 2010).

3.3.2 Influence of Merger Waves on Hubris

During merger waves the impact of hubris on the decision making of corporate management will be, most likely, further strengthened. Clark & Mills (2013) have focused on the impact of a 'rising tide lifts all ships' due to the correlation between the trend in equity prices and merger activity. Linking this to the behavioural finance perspective, the share price of the corporation will increase during merger booms, coinciding with improved investor sentiment. This results in a misinterpretation from the view of corporate management of the acquiring company with regards to them being the reason for the superior corporate performance, which will trigger a biased view regarding their competence to run the company. Consequently, this factor supports the creation of more optimism in the M&A market. Looking at the different stages of merger waves, which have been presented above, it is also important to mention that, additionally, in Phase III of the merger wave, the financial press normally starts to pay attention to M&A success stories, which enforces the confidence of the CEO even more.

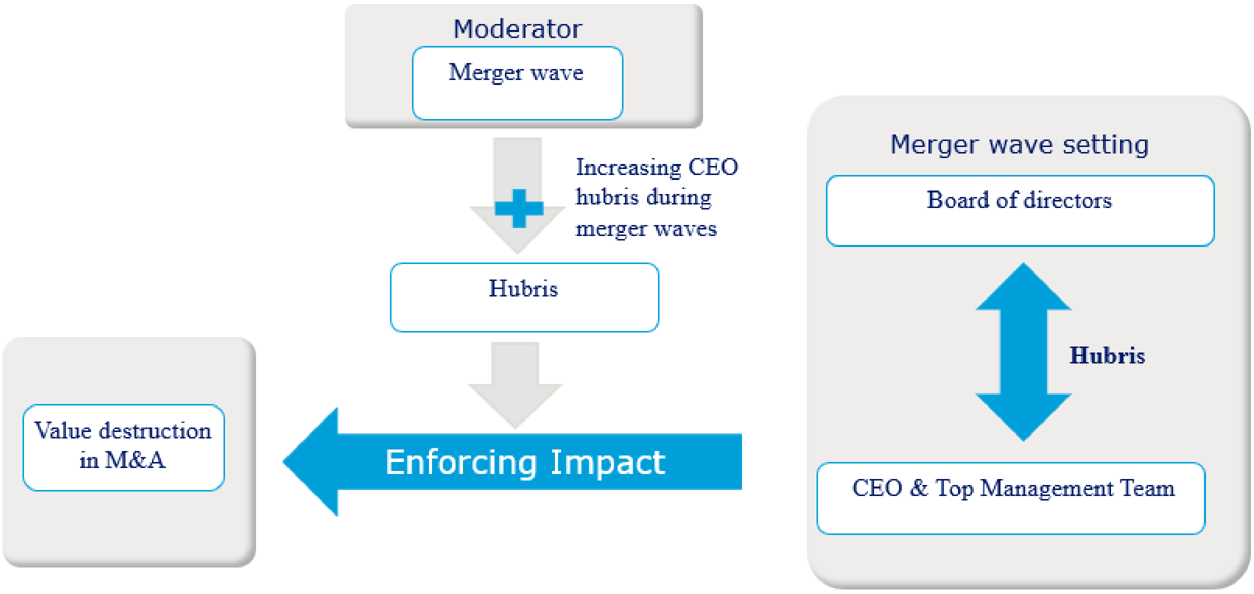
Another argument supporting the enforcing impact of merger waves on CEO hubris is mostly based on the envy-argument, which suggests that envy triggers a correlation in merger activities by inducing other CEOs in this cohort envious of the larger firm size and compensation (when firm size correlated) now associated with the management of the firm that acquired first. Resulting, even if their own synergies do not guarantee acquisitions, these CEOs acquire to get rid of the utility-sapping effect of their envy (Goel & Thakor, 2010). The impact of envy gets even stronger in the later stages of the merger wave, especially for the ones who have not yet joined the fray. Thus, it takes smaller synergies to trigger the later acquirers in the merger wave to seek acquisitions. This is similar to the hubris hypothesis, where management overestimates potential synergies of an acquisitions, so that with hubris-infected management it also takes, in fact, smaller synergies (due to the overestimation of them) to trigger CEOs and TMTs to engage in M&As. Here, we will assume that the managerial envy, typically arising in the early stages of merger waves, may even increases CEO hubris, as this phenomenon may encourage the CEOs to be even more overconfident in their decision making regarding M&As.

In addition, the CEO turnover after a bad acquisition performance is lower during merger waves than outside of them. ***Thus, contrary to a high market complexity, mergers waves have a smaller disciplinary impact on management, so that managers can enact hubris-based M&As without the fear of immediately losing their position. Therefore, the enforcing impact on value destruction inside waves is visible.***

All of the arguments mentioned above, may be the reason for the third merger wave from 1955 to 1975, to have given rise to the concept of diversification (Pikulina, Renneboog, & Tobler, 2014), which is often a manifestation of managerial hubris, in that managers are too overconfident in the creation of synergies between two companies which engage in businesses not necessarily related.

The positive impact of merger waves on the enaction of hubris-based M&As, thus being value-destructive, can be seen in the following:

Figure 23 - Impact of Merger Waves on Hubris



Source: Own creation

Nevertheless, a direct causality between CEO envy and hubris in the context of merger waves is still lacking, which could be a possible alley for future research.

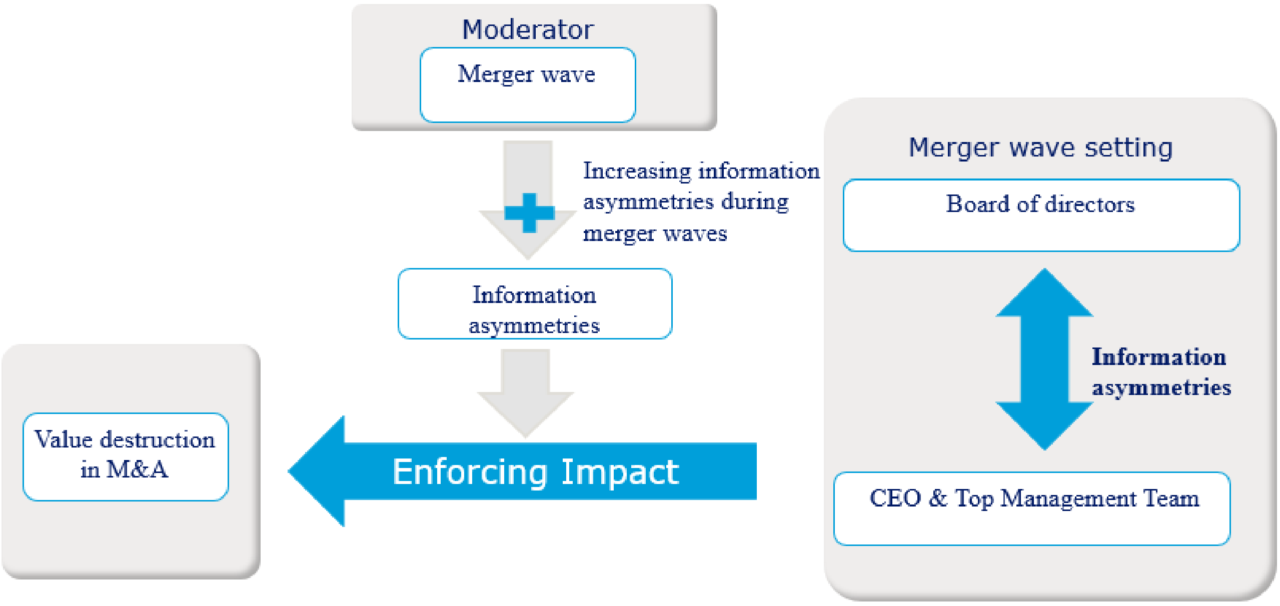
3.3.3 Influence of Merger Waves on Information Asymmetries

Various scholars such as DellaVigna & Pollet (2009), state that agency driven management could avoid negative consequences of implementing bad M&As due to the constrained information processing of both investor and analysts during merger waves. ***According to Duchin & Schmidt (2013), the costs of monitoring CEO & management increase after the initiation of a wave, when the M&A boom have already started. Therefore, the following let us assume that the higher the cost of monitoring, the more difficult it is for boards to follow managerial actions.*** While facing lower level of control, the CEO has more opportunity to play in his or her own interest. Due to the reduced monitoring activity, getting to know the inside information, which management possess, starts to be a challenge for the board of directors. As mentioned in the earlier stages of thesis, Renee B. Adams (2003) describes the dual role of the boards of directors, which creates a ***trade-off for the CEO***: weather to disclose the superior information to the boards or hide it and keep it secret. ***The environment of waves creates incentives for the CEO to keep the information secret due to personal interests, which are more visible in the latter stages. The following behaviour is strongly correlated to behavioural issues, as biased with the successful stories of other companies, management decides to acquire as well, even though those M&As result in overpayment due to irrational behaviour (Goel & Thakor, 2010).*** In the following situation, the management has lower incentives to share the information they possess as they want to speed up the M&A process. According to Bikhchandani, Hirshleifer, & Welch (1998), in strategic decisions acquirers do not have any intention to give valuable information away. ***Therefore, the information asymmetries between both parties significantly increase, which has a negative impact for the shareholder's well-being.*** In the following situation, value-destructive M&As may increase. According to Huang et al., (2004), the probability that managers will be fired due to engaging in value destroying M&As decreases, due to the limited enforcement resources and monitoring activity, which is another argument for the increased information asymmetries between the parties during merger waves.

Secondly, merger waves are known for a higher level of uncertainty. The finance literature has documented the extent to which the uncertainty and information asymmetries affect M&As (Fishman, 1989; Officer, Poulsen, & Stegemoller, 2009). Information asymmetries reflect the amount of information available for management and the amount of information available for shareholders, while uncertainty reflects the risks of undertaking M&As in the period of waves.

In the following section the correlation between uncertainty, the quality of shareholder's analysis and information asymmetries will be investigated through the lens of merger waves. ***Clement (1999) and Clement & Tse (2016) have proved that the quality of forecasts during waves decline, due to the higher number of companies and industries to analyse. According to Duchin (2013), the alternative hypothesis states that the value of analysis increases during merger waves, which can improve the quality of analysis due to the higher number of companies in the market, which can be used as a benchmark.*** The following creates an interesting ***contradiction*** regarding how the waves can influence the accuracy of analysis and the information flow, which has been further investigated by Duchin et. al, (2013) in their empirical study. Their study states that higher level of uncertainty leads to a poorer quality of analysis for shareholders. They argue that the workload of analysts increases during wave. What is more, a specialized experienced is needed to correctly analyse market behaviour. ***As mentioned before, merger waves are driven by behavioural issues, which can be hard to analyse***. We agree with the argument that the higher the uncertainty, the lower the quality of the analysis for shareholders, as the information can be biased and affected by behavioural and agency issues. The following is the second argument explaining the assumption that information asymmetries between management and shareholders increase during merger waves, as the forecast quality, which shareholders get from their analysts, declines.

Figure 24 - Impact of Merger Waves on Information Asymmetries



Source: Own creation

The poorer quality of analysis and the uncertainty lead to a reduced monitoring activity (Duchin et. al, (2013). The impact of the monitoring activity on information asymmetries has been analysed previously and has been proved to lead to agency driven M&As and to higher information asymmetries.

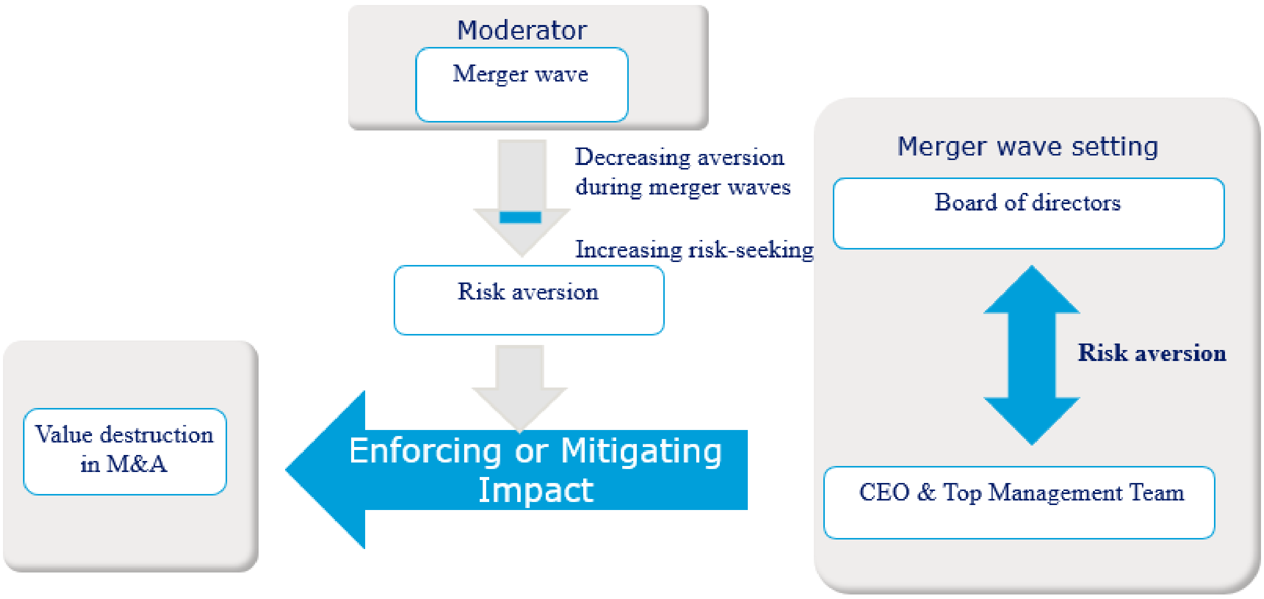
3.3.4 Influence of Merger Waves on Risk Aversion

The aim of the section is to analyse how merger waves impact the CEO’s risk-aversion. Evidence from our findings let us assume that the CEO's risk-aversion decreases during merger waves, especially during latter stages, as managerial loss aversion leads to risk-seeking behaviour, which is not necessarily in the best interest of the shareholders and can lead to a significant destruction of value.

According to Garfinkel & Hankins (2011), M&A activities, especially during waves, are correlated to risky management strategies. The paper indicates that merger activity starts when companies, which are facing cash-flows uncertainty, decide to vertically integrate to improve their liquidity and hedge the cash flow uncertainty. The following finding is consistent with the previously conducted literature analysis, in that M&As are used by CEOs, as a tool to reduce 'other risks'. ***Inside waves, the management's aim is to decrease the risk of cash-flow uncertainty and M&As are used as a tool to do so. However, due to the higher level of uncertainty during M&As, the overall level of risk is not necessairly lower and can lead to a significant decrease in the company's value.***

According to that, loss aversion and escalation of commitment should be further investigated in the merger waves setting. As previously described, loss aversion can lead either to ***risk aversion*** or to ***risk-seeking behaviour***. In order to avoid a potential loss a manager could potentially take an irrational risk and thereby demonstrate risk-seeking behaviour. ***The correlation between risk-seeking behaviour and merger waves is significant***. ***According to Shleifer and Vishny (2003), acquiring companies believe that the synergies will be obtained during M&As, especially during latter stages, when management compares itself with the management who has already successfully acquired***. The explanation has been described by Persons & Warther (1997), who argue that managers learn about the M&A's quality based on the outcomes of earlier movers. The model predicts that CEOs will continue to follow their predecessors, until their experiences will be poor enough, to assume that the later movers will perform poorly as well. The following let us assume that during the later stages of merger wave, the presence of regret avoidance is significant as management wants to avoid regretting not repeating the success of predecessors. Regret avoidance can easily lead to escalation of commitment, which can be visible during the 3rd and 4th stage of the wave. Due to a higher acquisition premium, compared to those in previous phases, managers slowly realize they have overpaid for what they have acquired. However, they persist with the failing course of action and they avoid admitting that the allocation of the recourses was vain (Brockner, 1992).

Figure 25 - Impact of Merger Waves on Risk Aversion



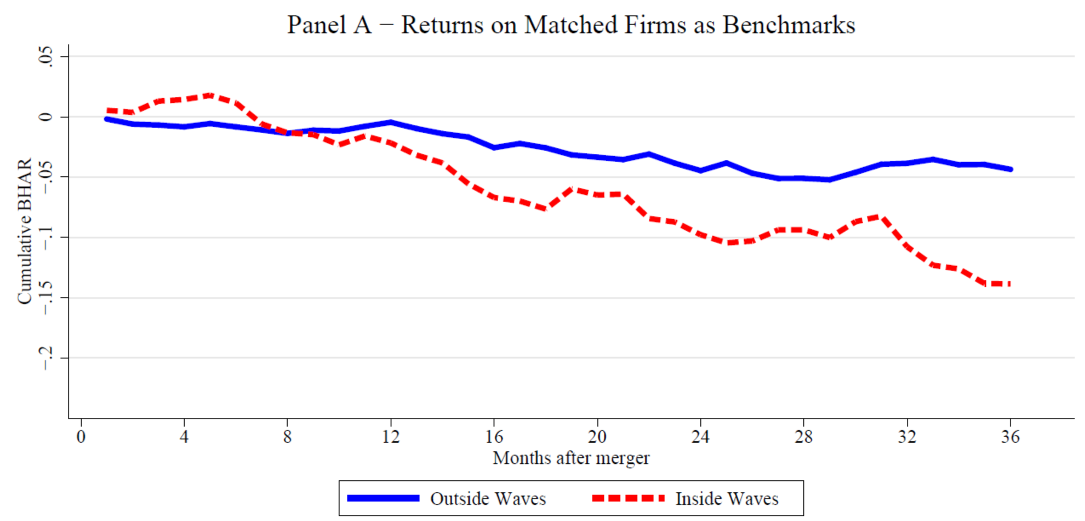
Source: Own creation

The following proves, that the level of risk-aversion during merger waves significantly decreases, especially in latter stages, as management is highly motivated to take extra risks to repeat the success of predecessors. Therefore, risk-seeking behaviour is present. However, as mentioned before, the lower risk-level does not need to necessarily be bad for shareholders. ***The risk impact is strongly dependent on whether the M&A will turn out to be a value-enhancing or a value destroying activity.*** As proved by Berger & Bouwman (2009), mangers are more likely to destroy shareholder's value by waiting and acquiring in the latter phases of the wave (Berger et al., 2009). ***Therefore, the excessive risk-taking during merger waves increases the agency conflict between management and shareholders and enforce the level of value destruction in a M&A setting.***

3.4.5 Influence of Merger Waves on Goal Conflict

There are a couple of arguments which support the hypothesis that merger waves enforce the goal conflict between shareholders and management, which leads to inefficient mergers. Firstly, connecting theoretical works such as Scharfstein & Stein (1990), with merger waves theory, it can be implied that ***merger waves offer the possibility of 'sharing the blame' of an unsuccessful merger with other managers.*** For instance, 'good' managers may also be presented as 'bad' since, if unlucky, their decisions may have systematic, unpredictable components (Duchin & Schmidt, 2013). To test this, Schmidt & Duchin (2013) have assessed how likely managers are to be eliminated from their jobs following bad merger outcomes during a merger wave***. As a result, it has been found out that the turnover of managers is less sensitive to bad post-merger performance, when the merger is initiated during merger waves than outside of it.*** For instance, during waves, a decrease of one standard deviation in post-merger returns corresponds to an increase of only 11 % in the predicted probability of a turnover, whereas outside waves it corresponds to an increase of 35 %, an increase of 68 %. ***This suggest, that during merger waves, management may be more inclined to follow their self-interest through the engagement in M&As (whether good or bad) and thus decreasing the value- maximization goal of shareholders, since less incentives for the interest alignment between the principals and agents are provided***. The following figure illustrates these findings by showing post-merger, long term performance of acquirers relative to different benchmarks:

Figure 26 - Acquires Performance Outside vs Inside Waves



Source: Schmidt & Duchin (2013)

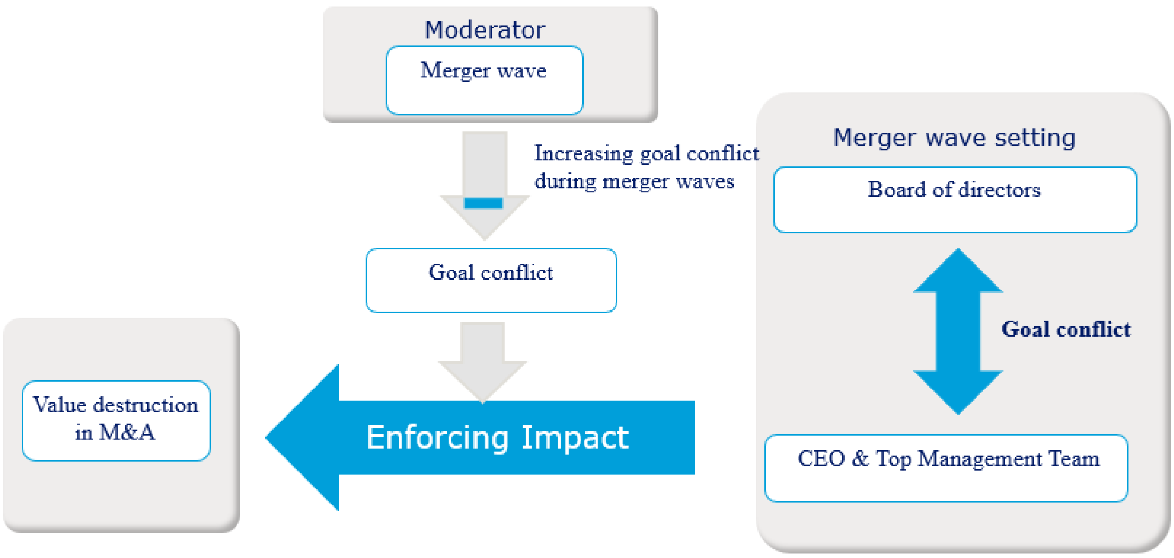
Even though this illustration may be interpreted as out of the scope of our master thesis, as it looks at the post-merger, long term performance of acquirers and we are focusing on value-destructive M&A antecedents, it is still of importance for us, as antecedents of M&As have indeed an influence on the post-performance of M&As.

To further assess the agency channel, it has also been proved that the governance of in-wave acquirers is weaker than the governance of out-wave acquirers. The following supports the hypothesis, that if managers are indeed on purpose initiating bad mergers during merger waves, one should identify poorer governance for in-wave acquirers relative to out-wave acquirers (Schmidt & Duchin, 2013).

What is more, since merger waves are triggered by an increased market valuation, it has been found out that that bidders with non-overconfident managers, rather than confident ones, gain the most in high valuation periods. Contrary to depressing markets, in high valuation markets, overconfident bidders may be able to hide the quality of the deal and the possible overpayment. This may be again interpreted as another argument for merger waves increasing the goal conflict between management and boards of directors.

These above-mentioned findings, which generally support a positive link between merger waves and goal conflict, are mostly based on the research of Schmidt & Duchin (2013) and are illustrated in the following:

Figure 27 - Influence of Merger Waves on Goal Conflict



Source: Own creation

The findings of Schmidt & Duchin (2013) are insofar viable, in that a large sample of 9854 mergers from 1980 to 2009 has been implemented as well as the differences between mergers initiated inside and outside mergers waves are directly addressed, so that no implicit conclusions have had to be made. What is more, their results are robust to different measures of long-term performance and also persist after controlling for stock market overvaluation, differences in the method of payment, acquirers' size, and the ownership status of the target company. Thus, we have decided to agree on this perspective.

3.4.6 Sub-Summary

Contrary to prior work, focusing on what drives merger waves, our normative model tries to investigate the moderating impact of merger waves on managerial incentives. This is insofar interesting, in that we assess an external impact on the antecedents of M&As, which is defined by an increased activity of M&As during a certain period of time. Following, we will summarize the moderating impact merger waves may have on hubris, compensation, information asymmetries, risk aversion and last but not least goal conflict.

1. Influence of Merger Waves on Executive Compensation in M&As

According to Chen et al. (2017), ***merger waves and the managerial pursuit of an increased executive compensation through the engagement in M&As is positively related***, in that:

- The increase in total compensation of the acquiring firm's CEO and TMT is higher in earlier acquisitions than in later ones, leading to the inclination of management to be the first in engaging in M&As during a high valuation period.
- The positive effect of merger waves on seeking monetary benefits through the engagement in M&As is even more supported by real-word executive compensation, which is set on the basis of benchmarking, since the lower-paid CEO may become envious when looking at the increased compensation of others after an acquisition or merger. This might enforce the level of value destruction in M&As.

2. Influence of Merger Waves on Hubris in M&As

During the assessment of merger waves on managerial hubris in a M&A setting, ***we find a rather enforcing impact***, in that:

- Merger waves support the creation of managerial optimism in the M&A market by the fact that the increase ***in the share price of the corporation, typically arising in merger booms, coincides with an improved investor sentiment, so that managers are more prone to interpret the superior corporate performance as a result of their competence*** to run the company.

- ***Furthermore, the managerial envy typically arising in the early stages of merger waves, may constitute another factor increasing managerial hubris during merger waves.***
- Lastly, the decreased CEO turnover during merger waves, may lead to a ***decreased disciplinary impact on management during merger waves, so that managers can enact hubris-based M&As without the fear of job loss.***
- As a result, the typical deviation of interests in a principal agency relationship increases during merger waves leading to an increased level of value destruction in M&As.

To be further investigated: As a direct causality between managerial envy and hubris during merger waves is lacking, it would be of great importance to assess this relation. This could be done by a case study, where it can be explicitly shown how managerial envy in mergers has led to the development and/or to the enforcement of hubris-infected behaviour.

3. Influence of Merger Waves on Information Asymmetries in M&As

The impact of merger waves on information asymmetries is an enforcing one, in that:

- The costs of monitoring CEO and management increases after the initiation of waves, so that it becomes more difficult for the boards of directors to follow managerial actions. What is more, ***besides the increase of information asymmetries due to a lower level of control, management is also more inclined to hide information from the boards of directors during merger waves***, as it may become clear that the engagement in M&As might have been only due to envy and not rational benefits like the creation of synergies.
- Secondly, the increased uncertainty during merger waves may be another argument for an increase in the information asymmetry, since referring to the study of ***Duchin et al. (2013) a higher level of uncertainty results in a poorer quality of analysis for shareholders due to a higher workload.***
- Concluding, the higher costs of monitoring as well as the poorer quality of analysis for shareholders during merger waves lead to an increase of information asymmetries between management and shareholders in the M&A setting, so that agency costs increase during merger waves which present an enforcing effect on value destruction in M&As.

4. Influence of Merger Waves on Managerial Risk Aversion in M&As

During the development of our normative model, we have identified a mitigating effect of mergers waves on managerial risk aversion, thus decreasing the difference in risk attitude between management and shareholders, in that:

- Management ***wants to decrease the risk of cash-flow uncertainty***, which typically triggers merger waves, ***by taking some extra risks connected to M&As***.
- Moreover, especially during later stages of merger waves, ***management is driven by regret avoidance when considering the success of early movers due to the selection of good targets.***
- Concluding, risk-seeking behaviour is present during merger waves, which can mitigate the differences in risk attitudes between management and shareholders. From an agency perspective, the decrease in risk aversion should mitigate the level value destruction in M&As. However, at a certain point the excessive managerial risk seeking can be detrimental for shareholders and significanly enfore the value destruction level in a M&A setting.

5. Influence of Merger Waves on Goal Conflict in M&As

In the process of developing our normative model, we ***have identified an enforcing impact of the occurrence of merger waves on the goal conflict between the management and boards of directors in a M&A setting, in that:***

- There is a ***smaller disciplinary impact on management*** since there is ***a decreased turnover of managers during merger waves*** due to the possibility of '***sharing the blame***' of unsuccessful mergers with other managers (difference of 68 % in the predicted probability of a turnover)
- Moreover, it has been proved ***that the governance of in-wave acquirers is weaker than the governance of out-wave acquirers.***
- In addition, in high valuation markets, often triggering merger waves, overconfident bidders may be able to hide the quality of the deal and the possible overpayment. It has been proved that non-overconfident managers rather than confident ones gain the most in high valuation periods.

To be further investigated: To our knowledge, the research paper of Duchin & Schmidt (2012) is the first one to directly link the well-documented phenomena that mergers tend to happen in waves to the common view, shared by many practitioners and researchers, that some mergers are agency-driven.

Thus, it would be of major importance to further quantitatively as well as qualitatively investigate the possible link and on the basis of this create a meta-analysis.

3.4 Social Ties and Market Complexity and Uncertainty in a Merger Wave Context

The aim of our normative model is to analyse how different external factors can affect the psychological and value-destructive antecedents of M&As, which are present in the relation between the CEO and the shareholders, which has supplemented the existing gap in current literature and presented a valuable contribution on how the M&A antecedents react while exposed to different factors. Based on our previous analysis, we state that external factors have a significant impact on the relationship between CEO-shareholders in the M&A setting, as some of them decrease the conflict between both parties, which mitigates the value destructive level of M&As, while other factors increase it, which enforces the value destruction level of M&As.

Firstly, the presence of social ties seems to decrease agency problems until a certain point, as information asymmetries between the CEO & the board of directors decrease. However, after reaching a certain level, the negative effect between strong social ties and agency problems can be observed and agency problems seems to increase.

Secondly, the presence of market complexity seems to decrease the level of the agency conflict between CEO & shareholders, due to the high competition which leads to a higher CEO turnover and an increased risk of liquidation or bankruptcy, thus constituting a disciplinary impact on management.

Lastly, the specific case of merger waves has been applied, which has created an additional and more complex setting to apply in M&As, as mergers tend to appear in waves. Due to the significant presence of agency problems and behavioral finance in the wave context, together with their complexity, agency problems seem to increase the conflict between CEO-shareholders in a M&A setting.

The aim of the following section is to combine the previously described factors and further investigate how social ties and market complexity and uncertainty react in a merger wave setting, which will create a more in-depth analysis and a more detailed contribution to the previously analysed factors. The following explains why social ties and market complexity have been connected to a merger wave setting, and not the other way around.

3.4.1 Market Complexity and Uncertainty in a Merger Wave Context

Based on the previous literature analysis and the development of our normative model, we want to further assess how the presence of a complex market (high market competition and thus high market heterogeneity) together with the presence of a merger wave can influence the management-shareholders relationship in a M&A setting. The reason for this assessment is due to the aim of our normative model to represent the reality of M&As, often resulting in value destruction, as accurately as possible. The occurrence of merger waves in a complex market (high market competition and thus high market heterogeneity) is quite likely, in that M&As are often a tool for gaining a competitive advantage as well as counteracting high competitiveness by creating a higher industry homogeneity.

With regards to the managerial overconfidence, often occurring when engaging in M&As, a high market complexity being still present during the merger wave and not only leading to it, may lose its disciplinary impact on the management of the acquiring firm. The reason for this is that when regarding the fact that the management turnover is weaker, in fact about 68% weaker than in outside waves, the ***argument that management will restrain from basing their investment decisions on hubris will no longer hold, as there is a smaller fear of job loss***. This, however, has constituted the most important factor when arguing that a high market competitiveness may decrease the management's tendency to be overconfident when choosing a target company.

Regarding the incentive alignment between shareholders and the management of the acquiring company through executive compensation, it can be said ***that a high market competition may indeed enforce the incentive alignment based on executive compensation in a merger wave, thus mitigating agency costs.*** The reason for this suggestion is the ***increased performance benchmarking*** (and not compensation benchmarking) as well a higher probability of ***a performance-related pay in a competitive environment***. This may offset the fact that in a merger wave managers may become envious of the compensation of other acquiring managers (compensation benchmarking), as they will perceive that there will be a higher probability of a performance-related pay.

When it comes to information asymmetries between management and shareholders during a merger wave, ***a high market complexity can even further spur the information asymmetry, as more successful stories of more companies (due to a higher market heterogeneity in a complex market), may make the management even more inclined to behave irrational and acquire as well and thus hide certain information due to personal interest, so that the boards of directors will accept the acquisition even though the shareholder's value will not increase. The mitigating impact of a high***

market complexity on the information asymmetry will probably not hold in a merger wave context, as the performance benchmarking effect of a high market complexity only holds after the acquisition has been performed and may not be penalized due to the fact that there is a ***lower probability of a CEO being fired after an unsuccessful M&A transaction***, as management can ‘share the blame’ during merger waves.

Combing the occurrence of a merger wave with a highly complex market, it may be suggested that a ***high market competition during a merger wave will even further enforce the positive impact of merger waves on the risk-seeking behaviour of managers.*** The reason for this suggestion is, again, that the main argument that market complexity may have a mitigating impact on managerial risk aversion through an increased CEO turnover no longer holds in the case of a merger wave. ***As a result, management may actually be inclined to seek risks, supported by an increased envy and the fear of missing out in a merger wave. At first, this may lead to a decrease in agency costs. However, shareholders must pay attention that the increased propensity of managers taking risks during a merger wave may not result in a excessive pattern of managerial risk-taking, which is often the consequence of managerial overconfidence.***

Summarizing, ***the combined impact of market complexity with a merger wave*** may have a detrimental impact on the shareholder’s value and thus ***increase the goal conflict between management and shareholders.*** The main reason for that is that in this specific setting, i.e. merger waves, ***industry competition may no longer act as a substitute for corporate governance.*** Moreover, the theoretical model of Allen & Gale (2000), stating that market competition is used to select the best management and to eliminate firms with bad management, seems also not applicable during a merger wave. As a result, managers might still expand their firms beyond the optimal size to indulge their aspiration for pecuniary and non-pecuniary benefits even if market competition prevails during a merger wave. Moreover, the accurate monitoring and evaluation of manager’s relative performance, through an increased competition, does also not lead to a decrease of information asymmetries in a merger wave context, as it is offset by the fact that having more players engaging in M&As may make the management even more inclined to engage in M&As out of irrational reasons, which, in turn, they want to hide from shareholders and thus increase the information asymmetry. However, it may be argued that the combined and enforcing impact of the market complexity and merger waves on the value destrution level of M&As might depend on the level of the market uncertainty and competition, which may create an alley for future research.

3.4.2 Social Ties in a Merger Wave Context

The aim of the following section is to further investigate how the presence of social ties together with the presence of a merger wave can affect the CEO-shareholders relationship. The statement whether social ties enforce the value destrcution level caused by merger waves or slightly mitigate the following problem will be further investigated based on the previous literature analysis and our normative model, which can present an interesting research gap for scholars to further reflect upon.

Social ties seem to strengthen the CEO's overconfidence in a merger wave setting. Based on our normative model, managerial overconfidence seems to increase during merger waves due to CEO's envy, often identified in the latter stages of merger waves, and the lower managerial turnover during merger waves. The presence of social ties presents the same tendency, as CEO overconfidence increase when social ties are present due to the lower board's monitoring activity and the higher level of CEO freedom and control in M&A setting. The board's vigilance has been presented as a way to decrease the negative effect of social ties on hubris. However, the question how social ties act in a merger wave content remains unanswered. When it comes to a merger wave setting, Schmidt (2015) has presented an interesting analysis of the costs and benefits of friendly boards in the setting of merger waves. Based on those empirical findings, the board's independence seems to be harmful for shareholders when the advisory needs surpass the monitoring need, which is present in the content of waves, as due to the lower quality of forecasts, the monitoring role of boards seems to decrease even more. Schmidt (2015), used the social ties between both parties a proxy to test the prediction, which is especially relevant in the following section. The most important contribution of the research is that the situations in which socially connected boards have a positive or negative effect on the firm's performance should be identified. ***Therefore and based on our in-depth literature analysis, the argument that social ties in the special situation of merger waves, lead to a higher level of CEO hubris since the monitoring activity decrease even more in the wave setting, which together with the managerial envy in later stages of the merger wave increase the level of managerial overconfidence.***

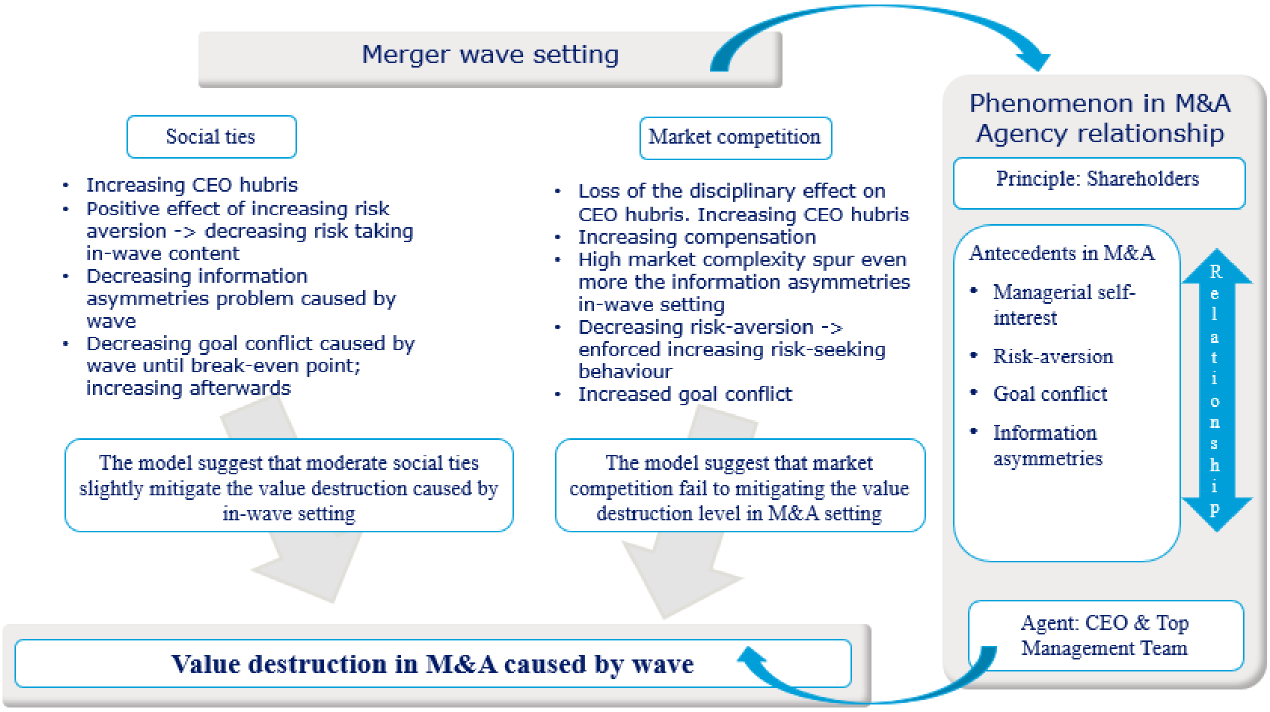
When it comes to the risk-aversion antecedent of M&As, social ties seem to have a positive effect on the reduction of agency problems between CEO and shareholders from the risk aversion perspective. Due to the presence of excessive risk-taking in the later stages of the wave, the literature proves that may M&A decisions can lead to a significant overpayment for the target and thus to value destruction. We argue that the presence of social ties in the following setting can mitigate the problem, as the managerial risk-aversion level increases when social ties are present in an out-wave content. In the in-wave context, the quiet life hypothesis can create a trade-off for the CEO, weather taking an excessive risk and acquire in the later stages of the wave is worth it or whether it is better to enjoy a quiet life, as, according to Hwang and Kim (2009), social ties between both parties make the CEO feel safer about his or her job, which decreases the pressure to take risks during merger waves.

What is more, social ties seem to slightly mitigate the information asymmetries problem, which significantly increases during waves, as it is both harder for the boards to monitor management as well as for analysts to deliver a proper forecast analysis for shareholders. As previously proved, personal relationships between both parties increase the advice-seeking need and the ability to reveal extra information. Therefore, we argue that in the setting of merger waves CEOs can be more willing to reveal information.

The conducted analysis clearly suggest that merger waves enforce the goal conflict between shareholders and management, which results in inefficient mergers and an increased level of value destruction. We argue that in the special setting of waves, the problem can be slightly mitigated by the presence of moderate social ties between CEO and boards of directors. Under a certain level, the social ties will mitigate the negative effect of excessive risk-taking and the decreased willingness of CEOs to share extra information in the latter stages of waves. ***However, too strong social ties can lead to excessive compensation and overconfidence and at some point will not mitigate the increasing agency conflict and the impact of value destruction, caused by the presence of merger wave.***

In the following, both the impact of social ties as well as a high market competition on the value destruction of M&As in a merger wave setting is illustrated.

Figure 28 – Merger Wave Overview



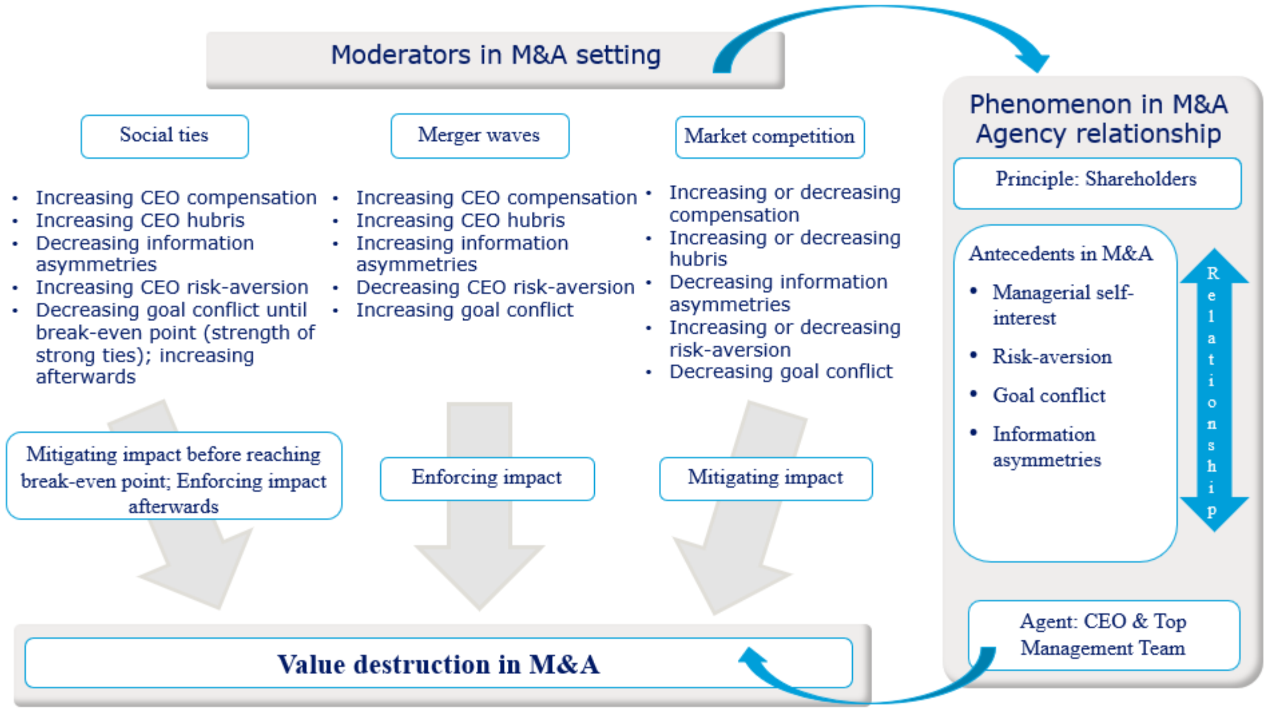
Source: Own creation

Whereas social ties can mitigate (to a certain extent) the value destruction caused in an in-wave setting, market competition fails to impose its disciplinary impact during a merger wave. Summarizing, it can be said that the occurrence of a merger wave is a very special event, where certain impacts of the previously described moderators do not longer hold.

3.5 Normative Model Overview

The created normative model adds value to the existing literature by examining the influence of external factors on the phenomenon of the relationship between CEOs and shareholders in M&As, through the lens of agency theory. The results of our work have revealed multiple conditions which moderate the relationship by affecting the value-destroying M&A antecedents. Therefore, the moderators can either increase or decrease the value destruction of M&As by having a significant influence on the acquisitive behaviour. The model doees not only fulfil the existing gap but also points out valuable directions for future research. The overview of the model is presented in the illustration below.

Figure 29 - Normative Model Overview



Source: Own creation

Besides the main overview, the sub-models, presenting the impact of different external factors on each of the antecedents, have been included in the different sections of our normative model development. In other words, we have developed the overview of our normative model by summarizing all of the findings generated in the sub-models. ***Thus, this is our description of the reality of the phenomenon of the relationship between CEO and shareholders and its impact on value destruction in M&As, derived from the existing theories and empirical studies and focusing on the pre-phase of M&As, namely antecedents.*** The model underlines the imperfections of theoretical assumptions and outlines the importance of behavioural issues which vary while opposed to different externalities.

IV. Discussion & Recommendation

This chapter of our master thesis aims to discuss the outcomes in a complete and clear way. Besides the discussion, the chapter provides valuable recommendations which have been derived from our developed normative model. The recommendations section will include general recommendations for academic researchers, recommendations for future research as well as practical recommendations.

4.1 Discussion

The developed normative model tries to broaden the principal agency theory, in that we have clustered different value-destructive M&A antecedents and exposed them to different situational factors. By this, we have wanted to create a more realistic view of the relationship between management and shareholders in the M&A setting, as well as the value destruction level of M&As. In fact, the relationship between management and shareholders in M&As can be seen as a phenomenon, since there is a lot of contradictive findings regarding this relation. By the development of the normative model we have generated a deeper and more profound understanding of the application of agency theory in the setting of value-destroying M&As.

The finding that the disciplinary impact of market competition on managerial self-interest no longer holds in a merger wave, might seem surprising at first and not in line with the argumentation when looking at the individual impact of market competition on value-destroying M&A antecedents. However, considering that merger waves offer the possibility of 'sharing the blame' of unsuccessful mergers with other managers, this seems viable**. *A merger wave can be interpreted as an extraordinary phenomenon, where certain conditions no longer hold*.** Nevertheless, taking into perspective that some companies might be financially distressed (due to a high market complexity) before the merger wave, they will probably not engage in M&As even if the merger wave offers the possibility of 'sharing the blame'.

However, the finding that social ties, to a certain level, have a positive impact on the agency problems during merger waves is in line with our expectations. The reason for this is that while analyzing the individual impact of social ties on the principal-agency relation between management and shareholders, we have already identified a mitigating impact of social ties (up to a certain level) on agency costs and thus value destruction. As previously proved, personal relationships between both parties increase the advice-seeking need and the ability to reveal extra information, which is especially beneficial in a merger wave context, where there is the tendency of management to hide valuable information, so that the M&A engagement will not face resistance from shareholders. ***Thus, the occurrence of a merger wave is expected to not hinder the positive impact of social ties on agency costs and thus the value destruction level of M&As.***

Another point worth discussing concerns the role of outside directors in the principal agent relation in a M&A setting. The independence of directors is often argued to be the main solution for mitigating agency costs, due to their objectivity through which they can better estimate the benefits and costs of M&As. In fact, it has been shown that the average abnormal announcement-day return follows a less negative trend for companies with a board of directors having more than 50 % of outside directors. However, when implementing the social ties theory on M&As, outside directors may not be as beneficial as they seem to be at first, since CEOs are less likely to share information with independent directors. ***Thus, the better estimation of benefits and costs of M&As through independent directors might be offset when considering the social ties theory. As a result, it can be argued that the independency of boards directors is not always the most suitable solution to mitigate agency conflicts.***

Furthermore, we have indirectly argued that in a M&A setting the threshold for the negative impact of managerial risk-aversion on shareholder-value might be higher. The reason for this is that value-destroying M&As may have negative and long-lasting effects on the financial performance of the combined firm, so that a more cautious approach might be appropriate for shareholders. This only fosters our assumption that the principal agency problem may not be implemented on a M&A setting without any adaptation. In a different setting, like investments in R&D, the application of the principal agency theory might prove to be easier.

Proceeding with the discussion part of our master thesis, it can be said that we have chosen to take a different approach to find out how to mitigate agency problems derived from managerial self-interest motives. ***Rather than taking a typical approach, in that the use of debt, due to the constrain of managerial discretion, as well as the alignment of executive compensation may lead to a decrease of agency problems, we have looked at outside factors. Thus, we have undermined the role of monitory incentives towards the role of non-monetary ones of effective mechanisms for the reduction of value-destroying M&As.***

With regards to the discussion of our choice to develop a normative model to describe the M&A phenomenon with a special focus on the relationship between management and shareholders, as well as on the value-destruction level of M&As, we have enhanced the work of Haleblian et al. (2009), where a framework was developed to organize and review recent empirical findings regarding M&A literature. Like their work, we have focused on M&A antecedents. However, we have generated an even deeper insight of M&A antecedents, by particularly focusing on the ones which can be value-destructive. What is more, we have exposed them to a situational analysis, to generate information on how the chosen managerial M&A antecedents respond to different situations. Thus, contrary to the research of Haleblian et al. (2009), we have not assessed the moderating impact of external outcomes on acquisition performance, but on the degree of the manifestation of specific value-destructive M&A antecedents. We have done so since we focus on the psychological aspects of the M&A setting, which mostly can be seen in the initial phase of M&As, where the initial thought on synergy potential as well as price level of the acquiring management starts to form. An alternative approach could be the application of case studies, which potentially could provide a better understanding of the individual company. However, doing so would make it more difficult to reflect a M&A setting as a phenomenon, as well to draw a general conclusion from the case study of one company, due to the fact that neither M&A transaction is completely identical. As a result, by the development of a normative model, the thesis is more concerned with the presence of behavioral finance and the impact from the related issues on M&A antecedents on an industry level, relatively to a firm level. Moreover, this discussion reflects the point of one approach not ultimately being superior to another one. However, the implemented approach must be able to show great consistency towards the question it aims to assess and answer.

Another point which can be made in this chapter, is that M&As highly influence the intensity of market competition. In fact, M&As may be a tool to influence the competitive landscape. Thus, it is important to keep in mind that even though market competition may be argued to have a disciplinary impact on management, other companies may still engage in M&As and thus shape the competitive landscape. As a result, market complexity decreases (higher market concentration), so that the disciplinary impact of it no longer holds, when considering the actions of other companies. However, it is hard to predict the decisions of other players in the market as well as the impact of their decisions of a particular company at hand.

Regarding the application of the principal agency theory it may be argued that due to its flawed practicability in a M&A setting another theoretical lens, as our base line and complemented with the behavioral finance theory, might have been introduced. However, the failure of M&As is often due to information asymmetry as well as opposed interests of the acting partners, which is mainly captured by the principal agency theory (Marsch, 2015). There is hardly any other theory which captures this topic as a central assumption, as the principal agency theory does. As a result, the principal-agency theory has a huge impact on the assessment of the success of M&A transactions and thus might be seen as the first choice when describing the relation between management and shareholder in M&As as well as the value destruction which might come with it.

Lastly, we would like to mention that the following recommendations are all based on the development of our normative model and thus the categorization of findings of our literature analysis. However, in order for these recommendations to ultimately be of relevance for shareholders on the verge of pursing value-maximizing M&A strategies, one must first be certain about the validity of the obtained findings. Thus, the proposition is to test the whole developed normative model empirically.

4.2 Recommendations

By introducing the influence of external factors on the impact of M&A antecedents in our normative model, our ***general recommendation*** is to take into account different situational circumstances when assessing the motives of management for engaging in M&As. Thus, it is important to take an 'outside view' when monitoring the actions of the acquiring firm. For instance, knowing that managerial overconfidence during a merger wave increases even more within firms which have social ties with the boards of directors (than within firms which do not have them), can result in the occurrence of a more cautious approach when it comes to the assessment of whether a specific target has been chosen due to managerial self-interest or the goal of value maximization. Thus, monitoring costs may be reduced. When an acquirer decides to acquirer another company outside of a merger wave but within an industry, which is characterized by high market complexity as well as uncertainty, monitoring activities may also be reduced, in that the high competitiveness will most likely discipline the management due to an increased fear of job loss as well as bankruptcy. As a result, it can be said that the generated information through the situational analysis of managerial self-interest motives in a M&A setting is most likely more of value for shareholders than CEO and TMTs. This is especially important with regards to the fact that biases and heuristics are often unconsciously experienced by management and thus almost impossible to completely eliminate for the decision-making process of humans. Thus, it is in the hand of the shareholders to deal with these issues and be aware of their magnitude in different situations. The gathering of more information on external factors will force shareholders to see the managerial investment decisions from another point of view and as a result potentially ensure the value creating motives of acquiring a particular target.

Moreover, we suggest the appreciation of motivations for M&As for the current assessment of this phenomenon. In fact, the 'myopia' of performance studies, with oversimplification of motives and outcomes by finance, strategy and economics scholars, may in part explain some of the paradoxes identified during our literature analysis. Otherwise, the oversimplification of the application of the principal agency theory in a M&A setting can result in crude categorisations which will have confounded data. ***A more sensitive picture is closer to actual M&A practice 'on the ground' and raises new questions over the way in which M&A performance may be analysed***. A more sophisticated view of motivations may help to solve the performance paradox of M&As, in that their popularity is still rising even though most of them tend to be value destroying.

Furthermore, we suggest that it is crucial to assess M&A activity according to their cyclical tendency, especially when they happen to be during a merger wave, as during a merger wave different stages can be identified which might have a different intensity regarding their impact on M&A antecedents. In fact, the presence of merger waves fuels the increased concerns in terms of mergers being primarily triggered by irrational managerial behaviour.

Also, we would like to stress the importance of internal power dynamics (boards vigilance, social ties and so on) when assessing the value destruction of M&As, as well as boundary conditions which may change such dynamism. For instance, we suggest that the effect of hubristic CEOs would depend upon power balancing forces, and thus the notion of power dynamics should be considered in a broader context.

With regards to ***recommendations for future research***, we want to present the a few points. First, when we have assessed the impact of social ties on CEO compensation, we have found out that it would be of interest to investigate the break-even level of executive compensation above which the compensation could be qualified as excessive. The reason for that is that a too high or excessive CEO compensation enforces the conflict of interests between management and shareholders and this is even more enforced when social ties are present within a M&A setting. The break-even level might be investigated, for instance, by implementing quantitative studies, where the effects of different compensation levels on the firm's performance might be analysed. Second, a further investigation of the real managerial intentions and the level of management luck (such as favorable external factors, which lead to M&As being value creating) is proposed as an alley for future research when assessing the impact of social ties on managerial risk aversion. Summarizing the impact of social ties on the goal conflict between management and shareholders in a M&A setting, we have suggested that it might be interesting for future researchers to assess the break-even point at which the switch between the positive (decreased information asymmetry) and negative effect (interest alignment between board of directors and management) of social ties on goal conflict in a M&A setting might be observed. This might also be done by a quantitative study, where different levels of social ties (depending for example on how often two people are in contact) as well as their respective impact on the firm's performance is investigated. Taking into account the impact of market complexity on the value-destructive M&A antecedents in our 'recommendations for future research' section, we would like to propose to further investigate the mitigating impact of an increased management pay benchmarking on M&A engagement based on the benefit of a higher managerial compensation. The reason for this is that researchers, until now, have only provided support for the argument that an increased CEO pay benchmarking is used for rewarding upper echelon management and not making them to restrain from M&A engagement. Proceeding, the argument that hubris-infected managerial behavior is enforced through an increased managerial discretion, triggered by an increased means-end ambiguity in a complex and uncertain environment, should be tested on an universal sample and not only a Chinese one in a manufacturing industry. Otherwise, it will be difficult to generalize these findings. What is more the argument does not show how hubris evolves, which would be an interesting aspect to further investigate by, for instance, a case study. What is more, to exactly identify when in the M&A setting the often claimed disciplinary effect of market competition decreases the manager's tendency to pursue his or her self-interest, a qualitative study might be implemented. Furthermore, when looking at the assumption of an enforcing impact of market complexity on agency problems the arguments for it are often based on an increased means-end ambiguity in a complex market. However, to increase the viability of these arguments, it is crucial to investigate what exactly is meant by the increased means-end ambiguity and how this ambiguity evolves and contributes to the increased value destruction in a M&A setting. This, for instance, might be done by a qualitative study. When looking at the impact of market complexity on managerial risk aversion, we suggest to further assess to which degree of market complexity the enforcing impact (relative performance assessment and higher CEO turnover) on managerial risk aversion is superior to the mitigating impact (reduction of opportunities for resource diversion and more risk for the long-term survival of the company) or the other way around. In addition, when regarding the effect of a high market complexity on the goal conflict between management and shareholders in a M&A setting, it would be of importance to investigate the certain level of competition, where the negative impact of lower economic rents of a highly competitive environment outweighs the positive disciplinary effect of it. When considering our last external factor, i.e. merger waves, we have found some more interesting alleys for future research. For instance, as a direct causality between managerial envy and hubris during merger waves is lacking, it would be of great importance to assess this relation empirically or with a case study, where it can be explicitly shown how managerial envy during a merger wave has led to the development and/or the enforcement of hubris-infected behavior. Closing the section of recommendations for future research, it can be said that the research paper of Duchin & Schmidt (2013) is the first one to directly link the well-documented phenomena that mergers tend to happen in waves to the common view that some mergers are agency-driven. Thus, it would be crucial to further quantitatively as well as qualitatively investigate the possible link and on that basis implement a meta-analysis, to ensure the validity of this link.

With regards to the ***practical implications*** of our developed normative model, it can be said that decision makers can greatly improve their chances of success by mitigating the studied behavioural issues and ultimately obtain a more clear and balanced view in terms of the true chances of success. By implementing a strong focus on the existence as well as relevance of these specific tendencies during different external circumstances a good starting point to minimize their significance and effect can be created. The tendency of corporate managers being overconfident, especially when social ties as well as a merger wave are present, might be counteracted by obtaining, similar to the general recommendations, an 'outside view', in that rather than focusing on the project itself, management should obtain information about similar cases (Lovallo & Kahneman, 2003). Doing so, might provide the management of the acquiring firm with a better perspective in the terms of the chances of success. However, it is worth noting here that, especially during a merger wave, it is not about information regarding present similar cases but past cases, as similar cases during a merger wave might increase the herding effect. Thus, it is important for the management to have in mind that the analysed biases are intensified during a merger wave. When the number of bidders increases, the winner's curse is at the same time more likely of becoming apparent resulting in generous increases in the acquisition purchase premiums (Roll, 1986). Nevertheless, as an approach to ensure that bid premiums stay within appropriate limits, we recommend applying certain methods. Firstly, and in line with the idea of the 'outside perspective', the acquirer can assign a dedicated M&A function, which main aim is to propose alternatives to the deal when merger activity increases (Lovallo et al., 2007). As a result, the possibility of overpayment might be significantly decreased since the deal is assessed in a broader context, and the alternatives might become relatively more beneficial in the light of the increase in bidding prices of the initial target. What is more, the acquiring manager might set a limit price prior the start of the bidding. Nevertheless, if the limit prices changes during the bidding or the price is insufficient to outbid the other potential acquirers, the acquirer should reassess the potential M&A transaction (Lovallo et al., 2007). Last but not least, the acquiring manager must be aware of the fact that the firm which ends up buying the target might not be the true winner, since simple avoiding the M&A market might yield a better outcome. This is also in line with our assumption of a higher threshold of the managerial risk aversion having a negative impact on the acquirer's performance in a M&A setting. What is more, management can deal with the biases by making decisions in group. This is also why we have introduced the role of the top management team in a M&A setting. Hereby, it is important to state, that great attention should be paid to the diversity of the TMT in order for the TMT to be of advantage for handling the different biases, with which the CEO might be infected with.

V. Conclusion

The main objective of the thesis was to describe if, and how, the application of the theoretical lens of agency theory can describe the value destruction in M&As and to present how it could be improved. The reason for that is to add findings to the existing literature on the value destruction in M&As. When focusing on improvements, which can complement the agency theory assumptions with regards to the value destruction level of M&As, different scenarios have been developed. In the scope of our thesis, scenarios are perceived as the presence of different externalities affecting the managerial behaviour in M&As, which, in turn, creates a significant impact on the shareholder's well-being. Derived from the existing theories and empirical studies, a normative model has been presented as the approach to explain reality. Due to the complexity of the presented problem, we have formed sub-questions. The aim of such an approach has been to guide the progress of the thesis from the beginning towards a desired conclusion. Before moving to the results of our problem statememt, these sub-questions will be answered chronologically.

Firstly, the agency theory lens has been introduced and applied to ensure that the literature is relevant and is viewed from the same perspective. Agency theory is built upon the underlying assumption that the agent's actions end up being value destroying for the principle. Therefore, from the corporate perspective, the phenomenon of the relationship between CEO and shareholders has been put in the centre of our thesis. The relevant literature indicates that a relatively big sample of M&A transactions fail to create shareholder's value due to the CEO's attempt to maximize his or her own self-interest (Haleblian, 2011). Consequently, the application of the theoretical lens of the agency theory seems to be an appropriate approach to further investigate the value-destroying motives in a M&A setting.

The described antecedents have been chosen based on an in-depth analysis of the literature to present how the agency relationship can describe the value destruction in M&As. The following has paved a need to further investigate managerial self-interest, risk-aversion, goal conflict and information asymmetries in the normative model. In accordance to agency theory, they provide the best explanation for the question why so many M&As fail. However, the thesis points out that for complex and strategic decisions, such as M&As, agency theory seems to be too narrow to explain the reality. Taking risk-aversion as an example, Gomez-Mejia (1998) argues that the assumption remains undeveloped within agency theory and according to Tushman & O'Reilly (1997) external factors significantly affect the risk-aversion level of agents. We argue that the statement can be applied to managerial-self-interest, as upper-echelon compensation and the overconfidence in M&As are much more complex than agency theory would assume. When it comes to goal conflict, Wright (2001**)** argues that individuals have various goals and behave differently under different circumstances. The findings, based on the analysis of literature, have suggested that a more in-depth investigation of the chosen antecedent would be a valuable contribution for the existing literature, as externalities have a significant impact on the theoretical assumptions.

The agency theory imperfections have paved a way for alternative theories to be introduced. One of the approaches to complement on the agency theory's simplicity, is the behavioural finance literature, which focus on cognitive psychology to understand human behaviour patterns. As a result, the application of behavioural finance undermines the agency assumptions regarding agents, which leads to interesting contradictions. It challenges different assumptions, such as the fact that human behaviour in M&As cannot be generalized. The combination of the agency theory with the behavioural finance findings, let us assume that the agency theory assumptions are especially relevant in M&As, however, the presence of externalities and behavioural biases can make them dubious in particular settings. Therefore, the agency theory and behavioural finance will play a central role to further explain the phenomenon of M&As. Upon having concluded the in-depth analysis of psychological antecedents, present in the relationship between CEO-shareholders in M&As, the introduction of the top management team and board of directors has seemed to be essential. The reason for that was to present a realistic picture of M&As and thus complement on theoretical simplicity.

Turning towards the normative model, its aim is to present the solution about how the agency explanation of value destruction in M&As can be improved, in that it becomes as realistic as possible. The normative model contributes to the existing research on the phenomenon of the relationship between CEO and shareholders in the M&A setting, by explaining deviations from the theoretical assumptions. To do so, external factors have been applied in order to fil the existing gap in the literature and present an alternative approach. The reason for that is to test how the agency theory antecedents react while exposed to various externalities and how they can impact the level of value destruction caused by M&As. The introduction of externalities creates a valuable contribution to the literature, and together with behavioural finance, complements on the agency theory, as it decreases the theoretical simplicity of it. The chosen factors include social ties, market complexity (competition & uncertainty) and merger waves. The reason for the choice of the first two, is that little research exists on how they impact corporate investment decisions like M&As. What is more, social ties reflect quite accurately the social aspect of M&As and are a useful tool to explain the board's behaviour. Market complexity is often a major reason for engaging in M&As and thus might have a crucial impact on the antecedents. Merger waves are insofar interesting, in that they pick up our major topic, i.e. mergers and acquisitions, in that they describe a period of time where there is a high engagement of companies in M&As. Thus, the analysis of how the phenomenon of the relationship between CEO and shareholders reacts during a merger wave has been conducted. To sum up, the chosen factors can be interpeted as the most relevant ones, as all of them are connected to either the agency or behavioural issues in M&As, which is the focus point of our thesis.

The outcome of the analysis of our first moderator let us state that under a certain level, the social ties between CEOs and boards of directors have a positive effect on the shareholder's well-being. However, after reaching a break-event point, the strength of social ties has a negative effect on the shareholder's wealth and thus the value destruction in M&As becomes more visible. This statement is based on our analysis, which proves that the presence of social ties decrease the information asymmetry level between both of the parties since CEOs are more willing to seek for advice, which has a positive effect on the value creation through M&A engagement. However, the level of risk-aversion increases. Even if agency theory states that risk aversion is not in the shareholder's interest, it cannot be fully applied to M&As, as risk-aversion may prevent from engaging in value-destroying

M&As. What is more, social ties have been found to increase both CEO compensation and the level of overconfidence, which can be destructive for the shareholder's value.

The outcome of the analysis of market complexity and uncertainty let us state that the increased competition can be assumed to mitigate the value-destructive assumptions of agency theory in M&As as the market competition can be perceived as a substitute for corporate governance. The reason for this assumption can be derived from the fact that the management turnover as well as the probability of a firm's liquidation is higher in competitive environments, which motivates management to not waste the firm's resources. In fact, it has been shown that corporate governance quality (the usual disciplinary mechanism for management) has a significant effect on a firm's performance only when market competition is weak. The model of Allen & Gale (2000) supports the disciplinary impact of a high market competition by showing that competition plays the role of takeovers. Well-managed firms take over the market from poorly managed firms. Thus, competition helps identifying the best management team and disciplines management. What is more, the increased competition has led to a lower level of information asymmetries between the parties. As a result, Guadalupe & Pérez-González (2010) have found out that strong competition decreases private benefits of control. They attribute the impact of competition to both the enhancement of information transparency for firms in the same industry and the fear of bankruptcy. The findings regarding the impact of market competition on each of the antecedents have been gathered together in the sub-conclusion of the impact of market complexity & uncertainty on M&As.

Based on the analysis of the last moderator, the presence of merger waves seems to increase the agency conflict and the value destruction level of M&As due to an enforced level of CEO hubris, which is strongly correlated to managerial optimism and managerial envy, combined with a lower CEO turnover in the latter stages of the merger wave. Information asymmetries are enforced during waves due to higher costs of monitoring the CEOs, lower quality of forecasts and an increased uncertainty. Waves present a mitigating effect on managerial risk-aversion, which mitigates the differences in risk attitudes between CEOs and shareholders. However, only to a certain point, as excessive risk-seeking can be detrimental for shareholders. What is more, the level of regret avoidance and escalation of commitment significantly increases during in-wave acquisitions. The normative model assumes an enforcing effect of merger waves on goal conflict, due to weaker governance and a smaller disciplinary impact on management behaviour.

Upon having analysed the impact of social ties, market complexity & uncertainty and merger waves on the level of agency problems, present between CEO and shareholders, the merger waves have been applied as a setting. The aim of the following approach was to combine previously described factors and further investigate how social ties and market complexity and uncertainty react in a merger wave setting, which creates a more in-depth analysis and more detailed contribution to the previously analyzed factors and, in general, to the M&A setting.

Market complexity fails to mitigate the negative effect of merger waves on the shareholder's well-being. Merger waves are assumed to have a detrimental impact on the shareholder value due to the fact that market competition does not longer act as substitute for corporate governance. What is more, contrary to an out-wave setting, during merger waves the increased competition does no longer lead to decreasing information asymmetries. Nevertheless, it is worth to point out that the enforcing level of market complexity on agency problems during waves depends on the competition level.

Contrary to market complexity, we argue that the presence of social ties between CEO and board of directors during waves can slightly mitigate the agency problems, and therefore lead to a lower level of value destruction in M&As, caused by the presence of waves.

The following findings suggest that the research regarding the combined presence of social ties and market complexity in a merger wave setting could be further explored.

When taking into account the entire outcome of the thesis, the principle-agent relationship offers a valuable baseline to explain the reason for the value destruction in M&As. However, the agency perspective has been found out to be too narrow to be fully applied to complex and strategic decisions, such as M&As. Our findings confirm the importance of behavioural theories to complement on agency theory imperfections and the normative model has been presented as the improvement of the agency relationship between management and shareholders in a M&A setting, while exposed to different situational factors. The model aims to reflect the reality of value destruction as precisely as possible by presenting the situational analysis, which proves that the agency conflict between CEO and shareholders significantly changes while opposed to different externalities.

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