Acquisition Spree of New CEOs: A Consequence of Social Comparison with Predecessors

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Abstract

It is commonly observed that several new CEOs engage in an acquisition spree early in their tenure. This is puzzling because on the one hand overwhelming empirical evidence indicates that corporate acquisitions often destruct shareholder value and on the other hand research indicates that any erosion of shareholder value under a new CEO is often attributed to the decision making flaws of the new CEO. To solve this puzzle, we find it useful to consider acquisitions as status signal. With this premise, we build on social comparison theory to offer a status distance based explanation to this puzzle. We argue that a new CEOs ambition to build an empire is driven by their comparison of their status vis-à-vis that of their predecessor. Prior research on social comparison indicates that when status distance between individuals are high in intra-organizational settings, low status actors limit disclosure of status confirming information and increase disclosure of status dis-confirming information about themselves. Similarly, high status individuals are more comfortable disclosing status conforming information especially when they obtain resources by doing so. So when new CEOs are relatively higher in status than their 1 predecessors they engage in an acquisition spree to send out status confirming signals but interestingly, when new CEOs are relatively lower in status than their predecessors they also engage in an acquisition spree to send out status dis-confirming signals. To tease out the divergent mechanisms behind the acquisition motives of low status and high status new CEOs, we consider the moderating roles of market reaction to the new CEOs appointment and the media evaluation of the old CEOs legacy. First, positive market reactions to the appointment of a new CEO will decrease the perceived status distance between the old CEO and a low status new CEO but it will increase the perceived status distance between the old CEO and a high status new CEO. Hence, a positive new CEO announcement effect will increase the motivation of a high status new CEO to use acquisitions as a status confirming signal, but diminish the motivation of the low status new CEO to use acquisitions as a status dis-confirming signal. Second, positive evaluation of the legacy of the old CEO will decrease the perceived status distance between the old CEO and a high status new CEO but increase the perceived status distance between the old CEO and a low status new CEO. So, a positive evaluation of the legacy of the old CEO will diminish the motivation of the new high status CEO to use acquisitions as a status confirming signal, but it will increase the motivation of the new low status CEO to use acquisitions as status a dis-confirming signal. We test these ideas in a sample of 429 new CEOs appointed by SP 500 firms in the US between 1992 and 2001.

Speaker Profile

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