Journal of Financial Economics 000 (2016) 1–24

Contents lists available at ScienceDirect

Journal of Financial Economics

journal homepage: www.elsevier.com/locate/jfec

The effect of director experience on acquisition performance[☆]

Laura Casares Field[a,*], Anahit Mkrtchyan[b]

[a] Alfred Lerner College of Business & Economics, University of Delaware, 316B Purnell Hall, Newark, DE 19716, USA
[b] D'Amore-McKim School of Business, Northeastern University, 360 Huntington Avenue, Boston, MA 02115, USA

ARTICLE INFO

Article history:
Received 3 March 2014
Revised 12 April 2016
Accepted 6 May 2016
Available online xxx

JEL classification:
G30
G34
J24

Keywords:
Corporate governance
Board of directors
Mergers and acquisitions

ABSTRACT

Prior research finds that firms hire directors for their acquisition experience, regardless of acquisition quality (whether their prior acquisitions earned positive or negative announcement returns). Using several short- and long-run measures, we examine the effects of directors' acquisition experience on the acquisition performance of firms hiring them. We find that board acquisition experience is positively related to subsequent acquisition performance, demonstrating that firms appropriately value experience. Beyond experience itself, however, the quality of directors' prior acquisitions is also important. Our results suggest that firms may be better served to select directors based upon both past acquisition experience and acquisition performance.

1. Introduction

On December 16, 2009, the U.S. Securities and Exchange Commission (SEC) approved new rules requiring firms to disclose in their proxy statements the experience, qualifications, attributes, and skills of each director nominee that had led the board to conclude that he or she should serve as a director. Along with industry, executive, finance, and other types of expertise, firms often highlight the acquisition experience of directors. For example, Western Digital Corp.'s 2010 proxy states, "[Mr. Kimsey] has extensive experience negotiating, overseeing and integrating merger and acquisition transactions at both the executive and board level, which is experience highly valued by our Board of Directors." GT Advanced Technologies Inc.'s 2013 proxy states, "Ms. Petrovich brings a wealth of experience in mergers, acquisitions and the integration of acquired businesses in the automotive, off-highway and transportation industries." Although firms must now specify director experience in proxy statements, providing shareholders with better information upon which to base their votes, there is scant evidence about the effects of director experience on firm value. In this paper, we examine whether director acquisition experience contributes to firm value by improving the quality of firms' acquisitions.

Harford and Schonlau (2013) provide evidence that acquisition experience is valued in the director marketplace. Specifically, they demonstrate that directors who participate in acquisitions are significantly more likely to obtain higher numbers of board seats in subsequent years, regardless of whether their past acquisitions generated positive or negative announcement returns. Additionally, they find

[☆] We thank an anonymous referee, Bob Bowen, James Conklin, Moussa Diop, Matthew Gustafson, Peter Iliev, Tunde Kovacs, Yelena Larkin, Michelle Lowry, Donald Margotta, Karl Muller, Zhan Shi, Jess Smith, Jianing Zhang, and the participants of workshops at Baruch College, Clemson University, Florida State University, HEC Montréal, Miami University, Northeastern University, Penn State University, UC Riverside, University of Connecticut, University of Delaware, University of Missouri, and University of San Diego, as well as participants at the 2016 Eastern Finance Association and the 2012 FMA Doctoral Student Consortium for helpful comments.

[*] Corresponding author.
E-mail addresses: lfield@udel.edu (L.C. Field), a.mkrtchyan@neu.edu (A. Mkrtchyan).

http://dx.doi.org/10.1016/j.jfineco.2016.12.001
0304-405X/© 2016 Published by Elsevier B.V.

that firms hiring directors with acquisition experience are more likely themselves to make acquisitions in the near future, suggesting that firms hire such directors for their expertise. Because firms seem to recruit directors for their acquisition experience regardless of the quality of directors' prior acquisitions (i.e., whether they earned positive or negative announcement returns), Harford and Schonlau contend that, in the case of acquisitions, experience is more important than ability.

Although Harford and Schonlau demonstrate that firms recruit directors for their acquisition experience, they do not examine whether such experience actually affects acquisition outcomes. In this paper we seek to fill this void. Specifically, we address the following questions: Does prior director acquisition experience lead to better acquisition announcement returns for the firms that hire them? Are firms' acquisition announcement returns affected by the performance of directors' past acquisitions?

Given Harford and Schonlau's results, we may expect prior acquisition experience to result in better acquisition outcomes for firms with experienced directors on their boards, but Harford and Schonlau's results provide no evidence to suggest a relation between the *quality* of directors' prior acquisitions and future acquisition outcomes. To examine these issues, we propose the following two hypotheses. The Experience Hypothesis conjectures that acquisition experience alone affects future acquisition outcomes: firms with higher levels of board acquisition experience will engage in better-performing acquisitions. The Performance Hypothesis conjectures that, beyond experience, ability affects future acquisition outcomes: firms in which directors' prior acquisitions earned higher announcement returns will engage in better-performing acquisitions.

Using a broad sample of firms conducting acquisitions from 1998 to 2014, we examine the relation between the bidder's board acquisition experience and its acquisition outcomes. We use two measures of board acquisition experience: (i) the total number of acquisitions in which independent directors were involved outside the principal firm during the prior ten years, and (ii) the percentage of independent directors that have had acquisition experience outside the principal firm during the prior ten years. We find that acquisition experience among independent directors of acquirers is common: 80% of acquirers have at least one independent director with acquisition experience. For acquirers with experienced boards, on average 36% of independent directors have acquisition experience, and independent directors, on average, have participated in almost seven acquisitions with other firms.

Consistent with the Experience Hypothesis, we find that board acquisition experience is valuable for bidders: firms with higher levels of board acquisition experience earn significantly higher acquisition announcement returns. This effect is statistically and economically significant: increasing board acquisition experience by one standard deviation raises the three-day average cumulative announcement return (CAR) by 0.53%. By comparison, the sample average CAR is 0.49%.

Next, we test the Performance Hypothesis by investigating the extent to which past acquisition performance, rather than just acquisition experience, affects the value of future acquisitions. We measure the quality of the board's prior acquisitions by summing announcement returns for all prior acquisitions in which directors have participated outside the principal firm. Summing across all past acquisitions, we find that only 54% of acquiring firms' boards have earned net positive returns on their past acquisitions; 46% of boards' prior acquisitions were, in sum, value-decreasing for shareholders. This provides further evidence that, consistent with Harford and Schonlau (2013), firms hire directors based on past acquisition experience but not past acquisition performance.

It is possible that directors learn equally from good and bad acquisition outcomes. If so, it would be rational for firms to disregard past acquisition performance in favor of experience when searching for directors. However, we do not find that this is the case. In fact, the quality of directors' past acquisitions does affect future acquisition performance. Consistent with the Performance Hypothesis, we find that the quality of the board's past acquisitions—not just the acquisition experience itself—impacts announcement returns. Announcement returns are higher for firms with boards that earned higher CARs in past acquisitions: after controlling for the level of experience, a one standard deviation increase in directors' prior CARs leads to an additional 0.44% increase in the average announcement return. Moreover, when we decompose our experience measures by accounting separately for prior acquisitions with positive and negative CARs, we find that our earlier result showing that higher board acquisition experience leads to higher announcement returns is driven entirely by directors who have previously participated in net value-enhancing acquisitions: a one standard deviation increase in such experience increases the average announcement return by 0.67%, which is sizeable relative to the sample mean of 0.49%.

Given the substantial effect that the quality of board acquisition experience has on the value of future acquisitions, it is puzzling why firms seek out directors with acquisition experience regardless of the quality of directors' past acquisitions. Certainly, it is possible that directors with poor-performing acquisitions are brought onto the board for reasons other than acquisition experience. Nonetheless, our results demonstrate that if firms seek directors with acquisition experience to enhance acquisition quality, they may be better served not only to select directors based upon acquisition experience but also based upon the performance of directors' past acquisitions.

Although our findings show that director acquisition experience, particularly when value-enhancing, leads to improved announcement returns for firms on whose boards they serve, a potential concern for this interpretation of our results is the endogenous nature of board composition (Hermalin and Weisbach, 1998, 2003; Adams, Hermalin, and Weisbach, 2010). For example, if experienced directors join better-quality firms, our results could be biased by omitted firm characteristics. We employ an instrumental variables approach to mitigate the concern that endogeneity is driving our results and confirm that board acquisition experience continues to have a significant and positive effect on firms' acquisition announcement returns.