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For Whom Golden Parachutes Shine

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Golden parachutes, those packages that reward top executives if their company is acquired, have attracted much attention from investors and public officials for more than two decades.

Defenders of golden parachutes believe that they provide executives with incentives to facilitate a sale of their companies. While the evidence confirms this, it indicates that golden parachutes have significant costs as well and might fail to serve the interests of shareholders over all.

Shareholder resolutions opposing golden parachutes have often received substantial support over time. Congress adopted tax rules aimed at discouraging large golden parachutes, and the rules created during the financial crisis precluded companies receiving government support from providing golden parachute payments to top executives. Subsequently, the Dodd-Frank Act mandated advisory shareholder votes on all future adoptions of golden parachutes.

Many companies and financial economists, however, continue to believe that golden parachutes are an important and beneficial element of executive pay. Because top executives typically give up independence and control when their companies are acquired, executives that do not have a golden parachute might be excessively reluctant to sell — and often can impede or even derail an acquisition they dislike.

Golden parachutes make acquisitions more attractive to executives, and may prompt them to support a beneficial sale of their company that they would otherwise oppose. It is worthwhile for shareholders to bear the costs of golden parachutes, so the argument goes, for the sake of facilitating such sales.

In [an empirical study](#) of golden parachutes that Alma Cohen, Charles Wang and I have carried out, we confirm that golden parachutes do indeed have a beneficial effect on acquisitions. We find that companies that offer such packages have a higher likelihood of both receiving an acquisition offer and being acquired.

Because golden parachutes make executives more eager to sell, they are also associated with lower premiums in the event of an acquisition. But this effect is sufficiently small so that, over all, golden parachutes are associated with higher expected gains from acquisitions. On average, shareholders in companies with golden parachutes pocket larger benefits from acquisition

premiums, and we find evidence that this association is produced by the effect that golden parachutes have on executives' incentives.

So far, so good. However, when we look beyond acquisitions to examine the relationship between golden parachutes and company value, we find that such packages hardly shine for the shareholders of companies adopting them. Companies that have adopted golden parachutes tend to see their valuations (relative to their industry peers) erode over time. Such companies have lower valuation already before adopting a golden parachute, but their value declines further in the subsequent several years.

We find a similar pattern when analyzing the stock returns of companies with and without a golden parachute during the period of more than 15 years for which we have data. Companies that adopted golden parachutes have lower (risk-adjusted) stock returns relative to those that didn't — both during the two-year period surrounding the adoption and in the next several years.

What explains this pattern? Why do companies with golden parachutes fail to deliver for their shareholders overall even though they provide them with more benefits in the form of acquisition premiums? This pattern could be at least partly a result of the adverse effect that golden parachutes have on the incentives and performance of executives not facing an acquisition offer.

The market for corporate control benefits shareholders not just by providing the prospect of pocketing an acquisition premium but also by affecting performance more generally. Executives face the possibility that they might be ousted if they underperform. By ensuring executives of a cushy landing in the event of an acquisition, golden parachutes weaken the disciplinary force exerted by the market for corporate control.

Our corporate system provides executives with a significant power to impede or facilitate an acquisition. Golden parachutes are offered as a remedy to the concern that executives will deviate from shareholder interests in exercising this power. But this remedy is a highly imperfect one. While it does lead to more acquisitions, it also carries significant countervailing costs with it. Golden parachutes are not the easy fix for the incentives of executives as some might have hoped.

More work should be done to fully understand the consequences of golden parachutes and how they should be used. In the meantime, however, the evidence suggests that investors should continue to pay close attention to the use — and potential costs — of golden parachutes.