Research Title and Abstract as provided upon application to CERF

Research Title

Employees as Creditors: the Disciplinary Role of Pension Deficits in the Market for Corporate Control

Abstract

We aim to examine the disciplinary role of corporate pension deficits in the market for corporate control. We conjecture that companies with larger pension deficits are less likely to engage in diversifying mergers, experience higher merger announcement returns, pay lower premiums to targets, and use a higher percentage of cash in their payment. These results should be more evident for acquirers with pension plans that are dominated by actively working employees or collectively bargained by employees. Our findings would indicate that corporate pension deficits provide employees with strong incentives to monitor managerial performance and influence managers to make value-enhancing investment decisions.

Key Research Findings to date

I examine the disciplinary role of corporate pension deficits, as inside debt owed to employees, in the market for corporate control. We find that acquirers with larger pension deficits experience higher announcement returns. These results are more evident for acquiring firms where employees have stronger monitoring incentives and negotiation power. We also find that acquirers with larger pension deficits are more likely to experience an improvement in labor productivity but are less likely to become a target post acquisition. Our findings indicate that corporate pension deficits provide employees with strong incentives to influence managers to make value-enhancing investment decisions.

Project Update - Upload a Word Document

I have finished writing the paper, and submitted the paper to Journal of Finance. Unfortunately, it was rejected because one of the two referee reports was negative. I am revising the paper now for submission to Management Science.

Overall, we document that DB firms with larger pension deficits tend to make higher quality acquisitions. Specifically, we define pension deficits as the gap between pension liabilities and pension assets scaled by firms' total assets adjusted for pension related items. Our main results are that the ratio of pension deficits to total assets of a bidder is positively associated with the bidder's three-day cumulative announcement returns. This positive association is not only statistically significant but also economically significant. A one-standard deviation increase in pension deficits results in an approximately 0.34% increase in acquirer returns. We then conduct a battery of additional tests to ensure that our results are robust to alternative empirical specifications and variable definitions.

We contribute to the existing literature in two important ways. First, our paper sheds light on the governance role of pension deficits. Previous studies show that debt serves as an important mechanism to control managerial discretion, but no study investigates how pension deficits as inside debt owed to employees affect managerial behaviors and firm value. We show that pension deficits play an important disciplinary role in influencing managers to make value-enhancing acquisition decisions. Second, our study extends the literature on the stakeholder theory of the firm by showing that employees have strong incentives to exert pressure on managerial behaviors when their claims on firm value are at stake. Further, we show that conflicts between employees and shareholders are mitigated when a large portion of workers' retirement claims is tied to managers' investment quality, thereby identifying an important channel through which pension plan funding status is linked to shareholder wealth. Our results therefore are consistent with Acharya, Myers, and Rajan (2011), who argue that employees can act as an internal governance mechanism for the management.