

Golden Parachutes under the Microscope: The Xstrata and Glencore Merger

A merger between mining company Xstrata and commodities-trader Glencore would seem like a great opportunity for the two companies to gain market power through the control of both mining and trading, as well as the ability to use subtle trading signals to control mining operations in ways that non-trading miners would not be able to. Whether for power or efficiency reasons, the merger must look attractive to the two firms. It is large and complicated too. In total it involves a market value of around \$58 billion for the two companies; Xstrata employs 70,000 people, Glencore 58,000 people.

The merger has faced resistance from shareholders for a number of reasons, including an interesting one that involves a number that is either really large or really small, depending on your perspective. Xstrata has an executive-retention package (also known as a golden parachute) valued at \$268.5 million, which is a pretty big number even if it divided over many executives. But it is actually a small number compared to the potential gains or losses that the merger itself could generate for shareholders, depending on whether it succeeds or fails. Still, shareholders were sufficiently upset that the package is being modified to make a successful vote for the merger more likely. Golden parachutes do get investors and others upset because they often seem to reward the wrong people. They are triggered when a change in control of a firm occurs, as in an acquisition or a merger. A change in control, in turn, happens if someone thinks that they can run the firm better than the current management, which is more likely to happen if the current management is doing poorly. So; do poorly, get paid for being taken over. Despite the resistance from shareholders, managers want golden parachutes very badly, and with boards of directors being mostly accepting of parachutes if other local firms have them (as I have shown in a study with Jerry Davis), the key issue is how to make golden parachutes so that they don't raise anyone's ire. A recent study by Fiss, Kennedy and Davis has shown some interesting patterns in how this is done. To me the key variable is whether they seek to hide in the crowd by making the parachute similar to that of other firms. This happened more often when takeover activity was high, suggesting that vulnerability to a takeover makes it more important to make the parachute seem normal. This reminds me of the Costa Concordia captain preparing to leave the ship in a lifeboat while having the crew

broadcast don't-panic messages to the passengers, but maybe the comparison is inappropriate. More articles in the press on golden parachutes made them less similar, which makes me think that authors of such contracts probably think they have more freedom to draft them as they wish if "everyone does it." But, as the Xstrata and Glencore situation suggests, the effect of press attention changes if it is directed toward the same firm. I guess some things don't look as good in the spotlight as they do in the shade. References Davis, G.F. & Greve, H. R. 1997. Corporate elite networks and governance changes in the 1980s. American Journal of Sociology, 103(July): 1-37. Fiss, P. C., Kennedy, M. T., & Davis, G. F. 2012. How Golden Parachutes Unfolded: Diffusion and Variation of a Controversial Practice. Organization Science, 23(4): 1077-1099. MacDonald, Alex. 2012. Glencore, Xstrata Set September Date for Merger Vote. Wall Street Journal, July 11 2012.

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