

Doctoral Seminar: Agency and Executive Compensation

Fall 2012

Tuesdays & Thursdays 10:30 - 11:50, KMC 5-75

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Office Hours: Tues. 1:30-3:00, Thurs. 12:30-3:00

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This course surveys leading academic research in executive compensation and related areas of managerial incentives, such as stock ownership and the threat of dismissal. Course lectures will be held twice weekly, and the most important readings on each topic are starred (**). Evaluation will be based on a series of approximately six problem sets and referee reports due intermittently throughout the course.

1. Overview

X. Gabaix and A. Landier, “Why has CEO pay increased so much?” *Quarterly Journal of Economics* 123, 49-100 (2008).

S. Gillan, J. Hartzell, and R. Parrino, “Explicit vs. implicit contracts: Evidence from CEO employment agreements,” *Journal of Finance* 64, 1629-1655 (2009).

C. Frydman and R. Saks, “Executive compensation: A new view from a long-run perspective, 1936-2005,” *Review of Financial Studies* 23, 2099-2138 (2010).

** K. Murphy, “Executive compensation: Where we are, and how we got there,” in G. Constantinides, M. Harris, and R. Stulz eds., Handbook of the Economics of Finance (forthcoming).

2. Theory

M. Jensen and W. Meckling, “Theory of the firm: Managerial behavior, agency costs, and ownership structure,” *Journal of Financial Economics* 3, 305-360 (1976).

** E. Fama, “Agency problems and the theory of the firm,” *Journal of Political Economy* 88, 288-307 (1980).

E. Lazear and S. Rosen, “Rank-order tournaments as optimum labor contracts,” *Journal of Political Economy* 89, 841-864 (1981).

I. Dittman and E. Maug, “Lower salaries and no options? On the optimal structure of executive compensation,” *Journal of Finance* 62, 303-343 (2007).

3. Pay-Performance Sensitivity

** P. Healy, “The effect of bonus schemes on accounting decisions,” *Journal of Accounting and Economics* 7, 85-107 (1985).

R. Lambert and D. Larcker, “An analysis of the use of accounting and market measures of performance in executive compensation contracts,” *Journal of Accounting Research* 25 (Suppl.), 85-125 (1987).

M. Jensen and K. Murphy, “Performance pay and top-management incentives,” *Journal of Political Economy* 98, 225-264 (1990).

R. Gibbons and K. Murphy, “Relative performance evaluation for chief executive officers,” *Industrial and Labor Relations Review* 43-S, 30-51 (1990).

** R. Lambert, D. Larcker, and R. Verrecchia, “Portfolio considerations in valuing executive compensation,” *Journal of Accounting Research* 29, 129-149 (1991).

P. Dechow and R. Sloan, “Executive incentives and the horizon problem,” *Journal of Accounting and Economics* 14, 51-89 (1991).

R. Gibbons and K. Murphy, “Optimal incentive contracts in the presence of career concerns: Theory and evidence,” *Journal of Political Economy* 100, 468-505 (1992).

M. Kahl, J. Liu, and F. Longstaff, “Paper millionaires: How valuable is stock to a stockholder who is restricted from selling it?” *Journal of Financial Economics* 67, 385-410 (2003).

J. Neyland, “Wealth shocks and executive compensation: Evidence from CEO divorce,” unpublished manuscript (2010).

4. Incentives and Leverage

K. John and T. John, “Top-management compensation and capital structure,” *Journal of Finance* 48, 949-974 (1993).

R. Sundaram and D. Yermack, “Pay me later: Inside debt and its role in managerial compensation,” *Journal of Finance* 62, 1551-1588 (2007).

A. Edmans and Q. Liu, "Inside debt," *Review of Finance* 15, 75-102 (2011).

C. Wei and D. Yermack, "Investor reactions to inside debt incentives," *Review of Financial Studies* 24, 3813-3840 (2011).

T. Eisert and C. Hirsch, "The manager-shareholder agency conflict: Do banks prefer non-alignment?" Unpublished manuscript (2012).

5. Incentives from Ownership

H. Demsetz and K. Lehn, "The structure of corporate ownership: Causes and consequences," *Journal of Political Economy* 93, 1155-1177 (1985).

** R. Mørck, A. Shleifer, and R. Vishny, "Management ownership and market valuation: An empirical analysis," *Journal of Financial Economics* 20, 293-315 (1988).

C. Holderness, R. Kroszner, and D. Sheehan, "Were the good old days that good? Changes in managerial stock ownership since the great depression," *Journal of Finance* 54, 435-469 (1999).

E. Ofek and D. Yermack, "Taking stock: Equity-based compensation and the evolution of managerial ownership," *Journal of Finance* 55, 1367-1384 (2000).

J. Bettis, J. Bizjak, and M. Lemmon, "Managerial ownership, incentive contracting, and the use of zero-cost collars and equity swaps by corporate insiders," *Journal of Financial and Quantitative Analysis* 36, 345-370 (2001).

J. Core and D. Larcker, "Performance consequences of mandatory increases in executive stock ownership," *Journal of Financial Economics* 64, 317-340 (2002).

P. Gompers, J. Ishii, and A. Metrick, "Extreme governance: An analysis of dual-class firms in the United States," *Review of Financial Studies* 23, 1051-1088 (2010).

J. Bettis, J. Bizjak, and S. Kalpathy, "Why do insiders hedge their ownership? An empirical examination," unpublished manuscript (2012).

6. Stock Options - Overview

D. Yermack, "Do corporations award CEO stock options effectively?" *Journal of Financial Economics* 39, 237-269 (1995).

** W. Guay, The sensitivity of CEO wealth to equity risk: An analysis of the magnitude and determinants,” *Journal of Financial Economics* 53, 43-71 (1999).

** J. Core and W. Guay, “The use of equity grants to manage optimal equity incentive levels,” *Journal of Accounting and Economics* 28, 151-184 (1999).

J. Core and W. Guay, “Stock option plans for non-executive employees,” *Journal of Financial Economics* 61, 253-287 (2001).

7. Stock Options - Exercise, Cost and Valuation

** S. Huddart and M. Lang, “Employee stock option exercises: An empirical analysis,” *Journal of Accounting and Economics* 21, 5-43 (1996).

J. Carpenter, “The exercise and valuation of executive stock options,” *Journal of Financial Economics* 48, 127-158 (1998).

B. Hall and K. Murphy, “Stock options for undiversified executives,” *Journal of Accounting and Economics* 33, 3-42 (2002).

** D. Aboody, M. Barth, and R. Kasznik, “Firms’ voluntary recognition of stock-based compensation expense,” *Journal of Accounting Research* 42, 123-150 (2004).

J. Bettis, J. Bizjak, and M. Lemmon, “Exercise behavior, valuation, and the incentive effects of employee stock options,” *Journal of Financial Economics* 76, 445-470 (2005).

J. Bettis, J. Bizjak, J. Coles, and S. Kalpathy, “Stock option grants with performance-based vesting provisions,” *Review of Financial Studies* 23, 3849-3888 (2010).

E. Maug and D. Klein, “How do executives exercise stock options?” unpublished manuscript (2011).

8. Stock Options - Impact on Investors

R. DeFusco, R. Johnson, and T. Zorn, “The effect of executive stock option plans on stockholders and bondholders,” *Journal of Finance* 45, 617-627 (1990).

D. Aboody, “Market valuation of employee stock options,” *Journal of Accounting and Economics* 22, 357-391 (1996).

G. Fenn and N. Liang, “Corporate payout policy and managerial incentives,” *Journal of*

Financial Economics 60, 45-72 (2001).

J. Core, W. Guay, and S. Kothari, "The economic dilution of employee stock options: Diluted EPS for valuation and financial reporting," *Accounting Review* 77, 627-652 (2002).

9. Stock Options - Repricing and Reloading

P. Saly, "Repricing executive stock options in a down market," *Journal of Accounting and Economics* 18, 325-356 (1994).

T. Hemmer, S. Matsunaga, and T. Shevlin, "Optimal exercise and the cost of granting employee stock options with a reload provision," *Journal of Accounting Research* 36, 231-255 (1998).

** V. Acharya, K. John, and R. Sundaram, "On the optimality of resetting executive stock options," *Journal of Financial Economics* 57, 65-101 (2000).

M. Brenner, R. Sundaram, and D. Yermack, "Altering the terms of executive stock options," *Journal of Financial Economics* 57, 103-128 (2000).

S. Johnson and Y. Tian, "The value and incentive effects of nontraditional executive stock option plans," *Journal of Financial Economics* 57, 3-34 (2000).

** M. Carter and L. Lynch, "The consequences of the FASB's 1998 proposal on accounting for stock option repricing," *Journal of Accounting and Economics* 35, 51-72 (2003).

M. Chen, "Executive option repricing, incentives, and retention," *Journal of Finance* 59, 1167-1199 (2004).

10. Stock Options - Timing and Backdating

** D. Yermack, "Good timing: CEO stock option awards and company news announcements," *Journal of Finance* 52, 449-476 (1997).

E. Lie, "On the timing of CEO stock option awards," *Management Science* 51, 800-812 (2005).

** R. Heron and E. Lie, "Does backdating explain the stock price pattern around executive stock option grants?" *Journal of Financial Economics* 83, 271-295 (2007).

D. Cicero, "The manipulation of executive stock option exercise strategies: Information

timing and backdating,” *Journal of Finance* 64, 2627-2663 (2009).

R. Sen, “The returns to spring-loading,” unpublished manuscript (2009).

E. Fich, J. Cai, and A. Tran, “Stock option grants to target CEOs during private merger negotiations,” *Journal of Financial Economics* 101, 413-430 (2011).

11. Insider Trading

D. Carlton and D. Fischel, “The regulation of insider trading,” *Stanford Law Review* 35, 857-895 (1983).

L. Meulbroek, “An empirical analysis of illegal insider trading,” *Journal of Finance* 47, 1661-1699 (1992).

** C. Bettis, J. Coles, and M. Lemmon, “Corporate policies restricting trading by insiders,” *Journal of Financial Economics* 57, 191-220 (2000).

J. Carpenter and B. Remmers, “Executive stock option exercises and inside information,” *Journal of Business* 74, 513-534 (2001).

D. Roulstone, “The relation between insider-trading restrictions and executive compensation,” *Journal of Accounting Research* 41, 525-551 (2003).

D. Yermack, “Deductio’ *ad absurdum*: CEOs donating their own stock to their own family foundations,” *Journal of Financial Economics* 94, 107-123 (2009).

12. Perquisites

R. Carter and R. Stover, “Management ownership and firm compensation policy: Evidence from converting savings and loan associations,” *Financial Management* 20, 80-90 (1991).

K. Kahle and K. Shastri, “Executive loans,” *Journal of Financial and Quantitative Analysis* 39, 791-811 (2004).

** R. Rajan and J. Wulf, “Are perks purely managerial excess?” *Journal of Financial Economics* 79, 1-33 (2006).

** D. Yermack, “Flights of fancy: Corporate jets, CEO perquisites, and inferior shareholder returns,” *Journal of Financial Economics* 80, 211-242 (2006).

J. Edgerton, “Agency problems in public firms: Evidence from corporate jets in leveraged buyouts,” *Journal of Finance* (forthcoming).

B. Bushee, J. Gerakos, and L. Lee, “Corporate jets and private meetings with investors,” unpublished manuscript (2012).

D. Yermack, “Tailspotting: How disclosure, stock prices, and volatility change when CEOs fly to their vacation homes,” unpublished manuscript (2012).

E. Maug, A. Niessen-Ruenzi, and E. Zhivotova, “Pride and prestige: Why some firms pay their CEOs less,” unpublished manuscript (2012).

L. Siming, “Orders of merit and CEO compensation: Evidence from a natural experiment,” unpublished manuscript (2012).

13. CEO Turnover

A. Coughlan and R. Schmidt, “Executive compensation, management turnover, and firm performance: An empirical investigation,” *Journal of Accounting and Economics* 7, 43-66 (1985).

J. Warner, R. Watts, and K. Wruck, “Stock prices and top management changes,” *Journal of Financial Economics* 20, 461-492 (1988).

K. Murphy and J. Zimmerman, “Financial performance surrounding CEO turnover,” *Journal of Accounting and Economics* 16, 273-315 (1993).

** R. Hayes and S. Schaefer, “How much are differences in managerial ability worth?” *Journal of Accounting and Economics* 27, 125-148 (1999).

M. Huson, R. Parrino, and L. Starks, “Internal monitoring mechanisms and CEO turnovers: A long-term perspective,” *Journal of Finance* 56, 2265-2297 (2001).

C. Fee and C. Hadlock, “Raids, rewards, and reputations in the market for managerial talent,” *Review of Financial Studies* 16, 1315-1357 (2003).

M. Huson, P. Malatesta, and R. Parrino, “Managerial succession and firm performance,” *Journal of Financial Economics* 74, 237-275 (2004).

M. Clayton, J. Hartzell, and J. Rosenberg, “The impact of CEO turnover on equity volatility,” *Journal of Business* 78, 1779-1808 (2005).

L. Naveen, "Organizational complexity and succession planning," *Journal of Financial and Quantitative Analysis* (2006).

D. Yermack, "Golden handshakes: Rewards for CEOs who leave," *Journal of Accounting and Economics* 41, 237-256 (2006).

B. Nguyen and K. Nielsen, "What death can tell: Are executives paid for their contributions to firm value?" Unpublished manuscript (2010).

** D. Jenter and K. Lewellen, "Performance-induced CEO turnover," unpublished manuscript (2010).

J. Coles, A. Wang, and F. Li, "Industry tournament incentives," unpublished manuscript (2012).

14. Family Firms

** W. Johnson, R. Magee, N. Nagarajan, and H. Newman, "An analysis of the stock price reaction to sudden executive deaths: Implications for the managerial labor market," *Journal of Accounting and Economics* 7, 151-174 (1985).

R. Anderson and D. Reeb, "Founding-family ownership and firm performance: Evidence from the S&P 500," *Journal of Finance* 58, 1301-1328.

B. Villalonga and R. Amit, "How do family ownership, control, and management affect firm value?" *Journal of Financial Economics* 80, 385-417 (2006).

** M. Bennedsen, K. Nielsen, F. Perez-Gonzalez, and D. Wolfenzon, "Inside the family firm: The role of families in succession decisions and performance," *Quarterly Journal of Economics* 122, 647-691 (2007).

A. Ellul, M. Pagano, and F. Panunzi, "Inheritance law and investment in family firms," unpublished manuscript (2009).

M. Bennedsen and L. Van der Heyden, "When MBAs meet Henokiens: What can we learn from long-lived family firms?" Unpublished manuscript (2010).

P. Bunkanwanicha, J. Fan, and Y. Wiwattanakantang, "Why do shareholders value marriage?" Unpublished manuscript (2010).

V. Mehrotra, R. Morck, J. Shim, and Y. Wiwattanakantang, "Adoptive expectations: Rising sons in Japanese family firms," unpublished manuscript (2011).

15. Compensation and M&A

R. Lambert and D. Larcker, “Golden parachutes, executive decision-making, and shareholder wealth,” *Journal of Accounting and Economics* 7, 179-203 (1985).

** M. Bertrand and S. Mullainathan, “Corporate governance and executive pay: Evidence from takeover legislation,” unpublished manuscript (1999).

J. Hartzell, E. Ofek, and D. Yermack, “What’s in it for me? CEOs whose firms are acquired,” *Review of Financial Studies* 17, 37-61 (2004).

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** J. Cai and A. Vijh, “Incentive effects of stock and option holdings of target and acquirer CEOs,” *Journal of Finance* 62, 1891-1933 (2007).

U. Malmendier and J. Tate, “Who makes acquisitions? CEO overconfidence and the market’s reaction,” *Journal of Financial Economics* 89, 20-43 (2008).

D. Jenter and K. Lewellen, “CEO preferences and acquisitions,” unpublished manuscript (2011).

E. Fich, A. Tran, and R. Walkling, “On the importance of golden parachutes,” *Journal of Financial and Quantitative Analysis*, forthcoming.

16. Incentives for Directors

S. Gilson, “Bankruptcy, boards, banks, and blockholders: Evidence on changes in corporate ownership and control when firms default,” *Journal of Financial Economics* 27, 355-387 (1990).

S. Kaplan and D. Reishus, “Outside directorships and corporate performance,” *Journal of Financial Economics* 27, 389-410 (1990).

J. Brickley, J. Linck, and J. Coles, “What happens to CEOs after they retire? New evidence on career concerns, horizon problems, and CEO incentives,” *Journal of Financial Economics* 52, 341-377 (1999).

K. Farrell and D. Whidbee, “The consequences of forced CEO succession for outside directors,” *Journal of Business* 73, 597-627 (2000).

J. Coles and C. Hoi, “New evidence on the market for directors: Board membership and Pennsylvania Senate Bill 1310,” *Journal of Finance* 58, 197-230 (2003).

J. Harford, “Takeover bids and target directors’ incentives: The impact of a bid on directors’ wealth and board seats,” *Journal of Financial Economics* 69, 51-83 (2003).

** D. Yermack, “Remuneration, retention and reputation incentives for outside directors,” *Journal of Finance* 59, 2281-2308 (2004).

17. Interlocks, Tunneling, Celebrity and Private Benefits

** K. Hallock, “Reciprocally interlocking boards of directors and executive compensation,” *Journal of Financial and Quantitative Analysis* 32, 331-344 (1997).

U. Malmendier and J. Tate, “Superstar CEOs,” *Quarterly Journal of Economics* 124, 1593-1638 (2009).

J. Engelberg, P. Gao, and C. Parsons, “The price of a CEO’s rolodex,” *Review of Financial Studies* (forthcoming).

W. Mayew, C. Parsons, and M. Venkatachalam, “Voice pitch and labor market success,” unpublished manuscript (2012).

18. Disclosure and Regulation

Rogers v. Hill et al., 289 U.S. 582 (1933).

** N. Burns and S. Kedia, “The impact of performance-based compensation on misreporting,” *Journal of Financial Economics* 79, 35-76 (2006).

J. Core, W. Guay and D. Larcker, “The power of the pen and executive compensation,” *Journal of Financial Economics* 88, 1-25 (2008).

K. Murphy and T. Sandino, “Executive pay and ‘independent’ compensation consultants,” *Journal of Accounting and Economics* 49, 247-262 (2010).

J. Cai and R. Walkling, “Shareholders’ say on pay: Does it create value?” *Journal of Financial and Quantitative Analysis* 46, 299-339 (2011).

C. Kuhnen and A. Niessen, “Public opinion and executive compensation,” *Management Science* 58, 1249-1272 (2012).

A. Call, S. Kedia, and S. Rajgopal, “Blinded by incentives: Do rank and file stock options deter employee whistle-blowing?” Unpublished manuscript (2012).

19. Compensation and the Crisis

R. Fahlenbrach and R. Stulz, “Bank CEO incentives and the credit crisis,” *Journal of Financial Economics* 99, 11-26 (2011).

P. Bolton, H. Mehran, and J. Shapiro, “Executive compensation and risk taking,” unpublished manuscript (2011).

S. Van Bakkum, “Inside debt and enterprise-wide bank risk,” unpublished manuscript (2012).