

Doctoral Seminar: Agency and Executive Compensation

Spring 2010

Mondays & Wednesdays 1:30 - 2:50, KMC 5-75

Prof. David Yermack

Office Hours: Mon. 10:30-1:30, Weds. 11:00-12:00

Office: K-MEC 9-56, 998-0357

E-mail: dyermack@stern.nyu.edu

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 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

K. Murphy, "Executive compensation," in O. Ashenfelter and D. Card eds., *Handbook of Labor Economics*, Vol. 3b, Ch. 38, 2485-2563 (1999).

J. Core, W. Guay, and D. Larcker, "Executive equity compensation and incentives: A survey," *Economic Policy Review - Federal Reserve Bank of New York* 9:1, 27-50 (2003).

L. Bebchuk and J. Fried, *Pay Without Performance* (Boston: Harvard University Press, 2004).

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

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

C. Frydman and R. Saks, "Executive compensation: A new view from a long-run perspective, 1936-2005," *Review of Financial Studies* (forthcoming).

S. Kaplan and J. Rauh, "Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes?" *Review of Financial Studies* (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).

G. Baker, M. Jensen, and K. Murphy, "Compensation and incentives: Practice vs. theory," *Journal of Finance* 43, 593-616 (1988).

A. Edmans and X. Gabaix, "Is CEO pay really inefficient? A survey of new optimal contracting theories," *European Financial Management* 15, 486-496 (2009).

A. Edmans, X. Gabaix, and A. Landier, "A multiplicative model of optimal CEO incentives in market equilibrium," *Review of Financial Studies* 22, 4881-4917 (2009).

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).

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

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).

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

D. Kim and J. Yang, "Beating the target: A closer look at annual incentive plans," working paper (2009).

4. 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).

J. Bettis, J. Bizjak, and S. Kalpathy, "Insiders' use of hedging instruments: An empirical examination," unpublished manuscript (2009).

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

5. 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).

6. 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,” unpublished manuscript (2008).

E. Maug and D. Klein, “How do executives exercise stock options?” unpublished manuscript (2008).

7. 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).

8. 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).

9. 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 (2009).

D. Cicero, "The manipulation of executive stock option exercise strategies: Information timing and backdating," *Journal of Finance* (forthcoming).

R. Sen, "The returns to spring-loading," working paper (2009).

E. Fich, J. Cai, and A. Tran, "Stock option grants to target CEOs during private merger negotiations," working paper (2009).

10. **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).

F. Brochet, "Information content of insider trades before and after the Sarbanes-Oxley Act," *Accounting Review* (forthcoming).

11. **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).

A. Andrews, S. Linn, and H. Yi, "Corporate governance and executive perquisites:

Evidence from the new SEC disclosure rules,” working paper (2009).

K. Chen, T. Chen and K. Hui, “CEO perquisites and family firms,” working paper (2009).

Y. Grinstein, D. Weinbaum, and N. Yehuda, “The economic consequences of perks disclosure,” working paper (2009).

12. 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).

M. Weisbach, “Outside directors and CEO turnover,” *Journal of Financial Economics* 20, 431-460 (1988).

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

D. Yermack, “Higher market valuation of companies with a small board of directors,” *Journal of Financial Economics* 40, 185-211 (1996).

D. Denis, D. Denis, and A. Sarin, “Ownership structure and top executive turnover,” *Journal of Financial Economics* 45, 193-221 (1997).

** 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).

** D. Jenter and F. Kanaan, "CEO turnover and relative performance evaluation," unpublished manuscript (2008).

S. Kaplan and B. Minton, "How has CEO turnover changed? Increasingly performance sensitive boards and increasingly uneasy CEOs," unpublished manuscript (2006).

13. **Founding Families**

** 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).

14. **Compensation and M&A**

R. Walkling and M. Long, "Agency theory, managerial welfare, and takeover bid resistance," *RAND Journal of Economics* 15, 54-68 (1984).

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

A. Agrawal and R. Walkling, "Executive careers and compensation surrounding takeover bids," *Journal of Finance* 49, 985-1014 (1994).

J. Cotter and M. Zenner, "How managerial wealth affects the tender offer process," *Journal of Financial Economics* 35, 63-97 (1994).

** M. Bertrand and S. Mullainathan, "Corporate governance and executive pay: Evidence from takeover legislation," working paper (1999).

** C. Lefanowicz, J. Robinson, and R. Smith, "Golden parachutes and managerial incentives in corporate acquisitions: Evidence from the 1980s and 1990s," *Journal of Corporate Finance* 6, 215-239 (2000).

S. Datta, M. Iskandar-Datta, and K. Raman, "Executive compensation and corporate acquisition decisions," *Journal of Finance* 56, 2299-2336 (2001).

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).

** Y. Grinstein and P. Hribar, "CEO compensation and incentives: evidence from M&A bonuses," *Journal of Financial Economics* 73, 119-143 (2004).

** 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.

15. **The Market 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).

16. **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).

J. Core, R. Holthausen, and D. Larcker, “Corporate governance, chief executive officer compensation, and firm performance,” *Journal of Financial Economics* 51, 371-406 (1999).

Y. Cheung, R. Rau, and A. Stouraitis, “Tunneling, propping, and expropriation: Evidence from connected party transactions in Hong Kong,” *Journal of Financial Economics* 82, 343-386 (2006).

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

J. Engelberg, P. Gao, and C. Parsons, “The value of a rolodex: CEO pay and personal networks,” working paper (2009).

17. **Disclosure and Regulation**

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

T. Perry and M. Zenner, “Pay for performance? Government regulation and the structure of compensation contracts,” *Journal of Financial Economics* 62, 453-488 (2001).

J. Hartzell and L. Starks, “Institutional investors and executive compensation,” *Journal of Finance* 58, 2351-2374 (2003).

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

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

K. Murphy and T. Sandino, “Executive pay and ‘independent’ compensation consultants,” *Journal of Accounting and Economics* (forthcoming).

C. Kuhnen and A. Niessen, “Is executive compensation shaped by public attitudes?” working paper (2009).

18. **Compensation and the Crisis**

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

I. Cheng, H. Hong and J. Scheinkman, “Yesterday’s heroes: Compensation and creative risk-taking,” working paper (2009).

A. Edmans, X. Gabaix, T. Sadzik, Y. Sannikov, “Dynamic incentive accounts,” working paper (2009).

R. Fahlenbrach and R. Stulz, “Bank CEO incentives and the credit crisis,” working paper (2009).

Goldman Sachs Compensation Practices (2009).