Essays on top management and corporate behavior

Wu, H.T.

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Chapter 5

Conclusion

In this dissertation, three chapters examine corporate behavior that is affected by decisions made by the top management, i.e. the decisions to syndicate leveraged buyout deals (Chapter 2), to backdate or otherwise manipulate CEO stock option grant dates (Chapter 3), and the design of CEO compensation with regard to family ownership (Chapter 4).

Chapter 2 studies the considerations behind when senior managers in the private equity industry choose to syndicate the deals or not; and if yes, whom do they select to syndicate the deals with? By using a unique hand-collected dataset of 947 LBO investments, I find that investment size, geographic distance, and investor experience increase syndication likelihood. Besides, management teams with engineers and MBA graduates are prone to syndication. More specifically, Harvard MBAs tend to work with each other while Columbia MBAs are more likely to syndicate with each other as well as with engineers.

There exists a non-linear relationship between syndication and performance, probably due to different inherent nature of deals. MBA graduates seem to affect performance in non-syndicated deals, but not in syndicated ones. It thus suggests that MBAs are good at pre-deal screening, and might further explain why they would seek outside expertise when needed. Finally, the strongest syndication match that enhances value is the "Harvard MBA-and-Harvard MBA" pair. Hence, Harvard MBAs may syndicate with each other because a personal acquaintance enables a better match of skills. For other teams, syndication is likely for the purpose of diversification or future deal reciprocity.

Chapter 3 explores whether firms under option backdating probes have weak corporate governance. More specifically, different from the option repricing mechanism and the managerial power view, my alternative hypothesis is that option backdating or otherwise grant date manipulation is simply one way to reward and/or retain outperforming managers. To pin down the causality, I study the universe of the U.S. top executive stock option grants, and the sample comprises 6,836 stock option grants of the top executives in the S&P 1500 companies between 1999 and 2007. Following Heron and Lie (2009), I estimate the likelihood of option manipulation based on the assumption that, in the absence of manipulation, the abnormal stock returns during the month preceding and following the grant dates should be centered around zero.

Basically, the findings show that, inconsistent with the managerial power view, the option manipulation likelihood is not associated with weak corporate governance. If anything, this likelihood increases with superior governance proxies. It thus suggests that option manipulation behavior is not a result of lax board monitoring or managerial entrenchment. Moreover, the estimates in the post-SOX (Sarbanes-Oxley Act) period resemble the option repricing mechanism, while this act is independent of performance in the pre-SOX period. Regardless, I do not find evidence supporting one main premise of my alternative hypothesis, i.e. outperformance. Other than that, the evidence implies that the passage of the 2002 SOX alters the considerations behind this manipulating practice.

Chapter 4 investigates whether the existence of family influences helps alleviate the traditional principal-agent problem in small corporations. I construct a sample of 168 small publicly-traded U.S. firms between 2001 and 2005. The evidence shows lower agency costs in family firms, despite great variations within the group. Moreover, the pay-performance (elasticity) estimates are highest in non-family firms, followed by passive family firms, and lowest in active family firms. This pattern is more pronounced in total compensation than in basic salary and bonus component. This is consistent with family control acting as a substitute for pay performance as a corporate governance mechanism.

This dissertation presents three essays that add to the research on the influences that the top management exerts on corporate behavior. Taken together, it demonstrates discrepancies among the decisions made by managers with different educational backgrounds as well as a network effect when it comes to cooperation. Additionally, CEO stock option backdating or otherwise manipulation is not a result of inferior corporate governance, and the passage of the 2002 SOX seems to change the considerations behind. Last but not the least, small family firms have lower agency costs, and family ownership and CEO performance pay render substitution roles in corporate governance.