



Doctoral Seminar: Agency and Executive Compensation

Fall 2004

Mondays 9:00 - 12:00, K-MEC 5-75

Assoc. Prof. David Yermack

Office Hours: Mon. 1:30-3:00

Wed. 11:00 - 12:00 and 1:30 - 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 weekly. Evaluation will be based on a series of approximately six problem sets and referee reports due intermittently throughout the course.

1. Overview

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

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

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).

S. Rosen, "The economics of superstars," *American Economic Review* 71, 845-858 (1981).

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

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).

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).

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).

J. McConnell and H. Servaes, "Additional evidence on equity ownership and corporate value," *Journal of Financial Economics* 27, 595-612 (1990).

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

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).

P. Gompers, J. Ishii, and A. Metrick, "Incentives vs. control: An analysis of U.S. dual-class companies," working paper (2004).

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).

J. Core and W. Guay, "Estimating the value of employee stock option portfolios and their sensitivities to price and volatility," *Journal of Accounting Research* 40, 613-630 (2002).

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

6. Valuation Issues With Stock Options

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).

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).

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).

G. Fenn and N. Liang, "Corporate payout policy and managerial incentives," *Journal of Financial Economics* 60, 45-72 (2001).

M. Hanlon, S. Rajgopal, and T. Shevlin, "Are executive stock options associated with future earnings?" *Journal of Accounting and Economics* 36, 3-43 (2003).

J. Bettis, J. Bizjak, and M. Lemmon, "Exercise behavior, valuation, and the incentive effects of employee stock options," *Journal of Financial Economics* (forthcoming).

7. Equity Dilution from Stock Options

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

M. Huson, T. Scott, and H. Weir, "Earnings dilution and the explanatory power of earnings for returns," *Accounting Review* 76, 589-612 (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. Option Repricing and Other Adjustments

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.

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, “An examination of executive stock option repricing,” *Journal of Financial Economics* 61, 207-225 (2001).

N. Chidambaran and N. Prabhala, “Executive stock option repricing, internal governance mechanisms, and management turnover,” *Journal of Financial Economics* 69, 153-189 (2003).

P. Dybvig and M. Lowenstein, “Employee reload options: Pricing, hedging, and optimal exercise,” *Review of Financial Studies* 16, 145-171.

M. Carter and L. Lynch, “The effect of stock option repricing on employee turnover,” *Journal of Accounting and Economics* 37, 91-112 (2004).

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

M. Brenner, R. Sundaram, and D. Yermack, “On rescissions in executive stock options,” *Journal of Business* (forthcoming).

9. **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).

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

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).

B. Ke, S. Huddart, and K. Petroni, "What insiders know about future earnings and how they use it: Evidence from insider trades," *Journal of Accounting and Economics* 35, 315-346 (2003).

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

S Callaghan, P. Saly, and C. Subramanian, "The timing of option repricing," *Journal of Finance* 59, 1651-1676 (2004).

10. 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* (forthcoming).

D. Yermack, "Flights of fancy: Corporate jets, CEO perquisites, and inferior shareholder returns," working paper (2004).

R. Rajan and J. Wulf, "Are perks purely managerial excess?" working paper (2004).

11. 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).

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.

M. Weisbach, "Outside directors and CEO turnover," *Journal of Financial Economics* 20, 431-460.

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).

D. Denis and D. Denis, "Performance changes following top management dismissals," *Journal of Finance* 50, 1029-1057 (1995).

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).

L. Naveen, "Organizational complexity and succession planning," working paper (2004).

M. Clayton, J. Hartzell, and J. Rosenberg, "The impact of CEO turnover on equity volatility," *Journal of Business* (forthcoming).

12. **Transaction Based Compensation**

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).

S. Gilson, "Management turnover and financial distress," *Journal of Financial Economics* 25, 241-262 (1989).

S. Gilson, "Bankruptcy, boards, banks, and bondholders: Evidence on changes in corporate ownership and control when firms default," *Journal of Financial Economics* 27, 355-

388 (1990).

S. Gilson and M. Vetsuypens, "CEO compensation in financially distressed firms: An empirical analysis," *Journal of Finance* 48, 425-458 (1993).

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).

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.

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 illiquid stock and option holdings of target and acquirer CEOs," working paper (2004).

D. Yermack, "Golden handshakes: Rewards for CEOs who leave," working paper (2004).

13. **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).

14. Corruption and Entrenchment

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).

N. Burns and S. Kedia, "The impact of performance-based compensation on misreporting," working paper (2003).

E. Gordon, E. Henry, and D. Palia, "Determinants of related party transactions and their impact on firm value," working paper (2004).

M. Kohlbeck and B. Mayhew, "Related party transactions," working paper (2004).

B. Villalonga and R. Amit, "How do ownership, control, and management affect firm value?" working paper (2004).

15. Regulation

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

K. Murphy, "Reporting choice and the 1992 proxy disclosure rules," *Journal of Accounting, Auditing, and Finance* 11, 497-515 (1996).

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

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

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).

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

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

M. Carter and L. Lynch, "Stock option repricings by any other name? An examination of 6-and-1 option exchanges," working paper (2004).