

Econ 234C – Corporate Finance
Lecture 14: Corporate Governance

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1 Problem Set 2

Suppose you are interested in the question whether (suboptimal) merger decisions are related to CEO incentives (CEO compensation). You decide to investigate the relationship between (i) firm size and CEO compensation and (ii) merger volume and equity compensation of CEOs using as large as possible a sample that SDC, Compustat and ExecuComp allow you to use.

1. Generate the sample of firms/CEOs for which you have all data necessary to analyze firm size, merger activities AND compensation. Provide detailed summary statistics.
 - Please include a detailed description of each step of the data generating process, especially how exactly you download the data from SDC.

- Be also detailed about the matching process between the data sets: how do you match? (Which identifier?) At what step do you lose how many observations? (Provide a matrix with the details.)
2. Document the stylized features (summary stats full sample, summary stats over time) of merger activities and CEO compensation for your sample.
 3. Relate compensation to size and to mergers.
 4. What do you conclude? What are the limits of what you can conclude from that type of exercise (endogeneity, data issues, ..)?
 5. Do you have an idea how to overcome these limits?

Note: You need to use STATA. Provide a detailed description of your empirical steps and spell out the exact regression specification (regression model, calculation of standard errors). Please include your full do-file. I may ask for your dta-files.

Remarks

1. ExecuComp data

- Note changes in sample composition (smaller sample than S&P 1500 in 1992-1993)

2. How to handle SDC data

- Problem: limited memory of terminal. Solution?
 - *Did you use “custom report”?* (Jung Hoon Kim)
 - *Download by year and stack later.*

3. Merging data sets

- Keep years with and without mergers!
- Problem: SDC does not have permno, gvkey, and different cusip.
 - Solution? Use “cusiper”; don’t use ticker (ever).
 - Use 6-digit CUSIP codes.
 - Problem:
 - * CUSIP codes change over time, frequently after a merger has occurred.
 - * ExecuComp or CRSP/Compustat only retain the latest CUSIP ==> not matched (or, even worse, may matched to a different company since CUSIPs can get reassigned to a different company).

- Solution: use historical CUSIPs, i.e. CUSIPs valid at the exact time of each merger.
- * Use CRSP to obtain historical CUSIP (item NCUSIP) for each day of sample period.
- * Merge historical CUSIPs with compensation data

4. How to measure compensation

- Only options / stock etc. “granted” not exercised!
- Notice change in data format for ‘option grants’ (Galen). How do we deal with this?
 - *best possible combination of variables*

– *dummy for years after change*

5. In the analysis of merger impact on compensation, do you include year fixed effects?

● No, because ...

– *a lot variation in mergers year-specific*

● Yes, because

– *we need to distinguish mergers from “whatelse is going on in this year”*

– *we have cross-sectional variation left*

6. In the analysis of merger impact on compensation, do you include firm fixed effects?

- No, because ...
 - *including post-merger comp into the average*
- Yes, because
 - *want to differentiate from firm-specific variables.*

7. Econometrics and practical empirical advice

- Fiscal versus calendar year
- Cluster standard errors (not just robust)

- Firm fixed effects
- Pick the variables shown in summary stats.
- Give them intuitive names.
- Pick your regressions and justify why you picked those regressions (with those control variables etc.)
- Always show regressions with 'key variables only' (e.g., univariate) and then full set of controls.

2 Problem Set 3

Testing a new capital structure theory – the “Depression Baby Theory of Capital Structure Decisions”

- How does a “Depression Baby” CEO’s decision differ from the decision of Non-Depression Babies?
 - *Note:* Depression Babies are sometimes defined as people born in the 1930s’; sometimes as people who lived through the 1930s’ in their teenage years and early adulthood (e.g., born in the 1920s). You may want to try both definitions.
- In particular, are Depression Babies averse to accessing the market for external financing? Are they particularly averse to equity issues? Or to debt issues?
- How do you interpret the results? (Alternative explanations.)

Remarks

- Sample selection: drop finance, utilities, ...
- Definition of outcome variables (retiring debt); controlling for debt incurred under previous CEO!
- Alternative interpretations for depression coefficient:
 - CEOs who remain into their 70s are different, are incredibly successful,
..