

# Layoffs, CEO compensation and post-layoff performance: comments

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# Questions and answers

- Do CEO and BOD substitute equity-based pay for bonus compensation during a time of “substantial political pressure”? YES
- Are stronger CEO in a better position to bargain with BOD? YES
- Can stronger CEO affect firms’ post-layoff market performance? NO

# Methodology and results

- Idea: evaluate compensation structure conditional on external events
- Data: 583 firms during 1992-2004
- Method: regressions of compensation on layoff expenditures
- Interpretation: managerial power perspective more consistent with results than efficient contracting toward shareholder value maximization

# Current debate

- Very relevant given the current debate
- Results surprising in light of current informal evidence: a fifth of the FTSE 100 companies paid out 90% of the maximum possible bonuses in 2008. Results of the paper would imply that bonus should have decreased and should have been substituted by equity-based compensation

# Corporate governance

- Relevance of corporate governance for compensation determination
- Substitution hypothesis:
  - shareholders establish pay-for-performance sensitivity in the context of other governance mechanisms
- Complementarity hypothesis:
  - strong governance necessary to impose a performance-sensitive compensation
- Managerial power perspective
- May add corporate governance variables among the controls as a robustness test? Perhaps governance may explain both compensation and layoffs

# Leverage

- Companies may differ substantially in terms of debt-equity ratio (certainly banks are different)
- The literature suggests that leverage should reduce pay-for-performance sensitivity because of monitoring by debtholders
- Maybe include leverage among the control variables?

# Possible alternative interpretation

- Are bonus and equity-based compensation so different from each other?
- Apart from accounting issues, the main difference is associated with time horizon
- Efficient contracting would interpret results as suggesting that during crises companies extend the horizon of the CEO
- This could be consistent with results if subsequent improvement in performance is obtained in the long run (even though paper extends to 5 years so this alternative interpretation is unlikely)

# The perfect storm

- The credit crisis is the perfect conditioning variable (both layoffs and political pressure)
- Study cross-sectional evidence and lose the time dimension which is not likely to be important to current results anyway (two layoff cycles and evidence of constant increase in equity-based compensation)
- Given the political attention, it is more difficult to believe that in 2008 substitution between bonus and equity was trying to camouflage compensation and that CEOs were in a strong position to bargain with BOD
- Fahlenbrach and Stulz (2009) suggest that banks with CEOs whose incentives were better aligned with the interest of their shareholders performed worse but do not study the bonus/equity separation, only consider 98 banks and use 2006 characteristics
- Possible new contribution to study robustness of results:
  - Consider larger (perhaps international) dataset for 2007-2008,
  - Control for corporate governance and leverage,
  - Distinguish between financial sector and other sectors