CEO Perquisites and Family Firms

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Research Question

- Is CEO's personal use of perks associated with family ownership and management?
- Why study this association?
- Answer unresolved issues in two research streams
  - family firms literature
  - executive compensation literature, including executive perks

Family Firms Literature

- Why does it catch attention from academics and media
  - *BusinessWeek* cover (Nov. 10, 2003)
  - Quite prevalent in US (1 out 3 in S&P500 are "family firms," defined later), more so in smaller firms
  - % even larger in Asia and Europe (e.g., virtually all local firms listed in HK are family firms)
  - Two interesting agency problems

Family Firms Literature

- Two types of agency problems in family firms
  - "Agency Problem I": between family shareholders and managers:
    - If family members serve as CEO: no agency problems because principal = agent.
    - If CEO is hired from outside: less problems because of monitoring by family shareholders.
  - "Agency Problem II": between family shareholders and minority shareholders
    - The control by family members enables them to seek private benefits at the expense of minority shareholders.

Unanswered question in family firms literature

- What is known so far: there are benefits from family ownership: family firms (in US)
  - Have higher valuation and are more profitable than non-family firms (e.g., Anderson and Reeb, 2003a, Villalonga and Amit, 2006, etc.).
  - Enjoy lower costs of debt (Anderson, Mansi and Reeb, 2003).
  - Engage in less diversification (Anderson and Reeb, 2003b)
  - Provide higher quality financial reporting (Wang, 2006; Ali, Chen and Radhakrishnan 2007)

  ➔ Interpretation: family firms have lower agency problems.

Unanswered question in family firms literature (Cont'd)

- Unknown: do family firms have lower agency problems?
  - The superior performance of family firms is driven by founder CEOs ➔ Villalonga and Amit's (2006) interpretation: founder CEOs have low Agency Problems I and II ➔ but founders also tend to possess special skills and better ability (Wasserman, 2004, 2006).
  - No evidence that family firms expropriate minority shareholders (Agency Problem II)
    - Counter evidence: family CEOs are paid less (Gomez-mejia et al. 2003)

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Unanswered question in research on executive perks

- Negative view of perks in media
  - Business perks:

    “Big Three Automaker CEOs Flew Private Jets to Plead for Public Funds” – *ABC News*, Nov 19, 2008

  - Personal perks:

    Nicki Mulally (the wife of Ford Motor’s new CEO, Alan Mulally) and her five children can travel on Ford’s corporate jets without her husband – *Wall Street Journal*, June 30 2007

Unanswered question in research on executive perks (Cont'd)

- Investors' perspective
  - Market reacted negatively to initial disclosure of personal use of perks (Yermack, 2006)
- Regulators' perspective
  - SEC sanctioned firms for failing to comply with perk disclosure requirement, and
  - adopted a tighter disclosure rule of perks in 2006.
- Researchers' perspective
  - In agency theory literature (Jensen and Meckling, 1976, Grossman and Hart, 1980; Jensen, 1986), CEO perk consumption is used as a representative example of agency problems.

Unanswered question in research on executive perks (Cont'd)

- However, no clear empirical evidence showing perks represent expropriation
  - Rajan and Wulf (2006 JFE): perks (both business and personal uses)
    - are provided to enhance managerial productivity (e.g., corporate jets provided by firms whose headquarters are far away from a major airport)
    - are not related to agency problem variables
  - Yermack (2006 JFE): perks (personal use)
    - are not related to agency problem variables
    - (although market reacted negatively to initial disclosure of personal use of perks).

Contributions of this study

- Is the use of perks related to measures of agency problems?
- Are family firm variables associated with variables related to perk usage?

→ Providing more evidence of agency problems in family firms

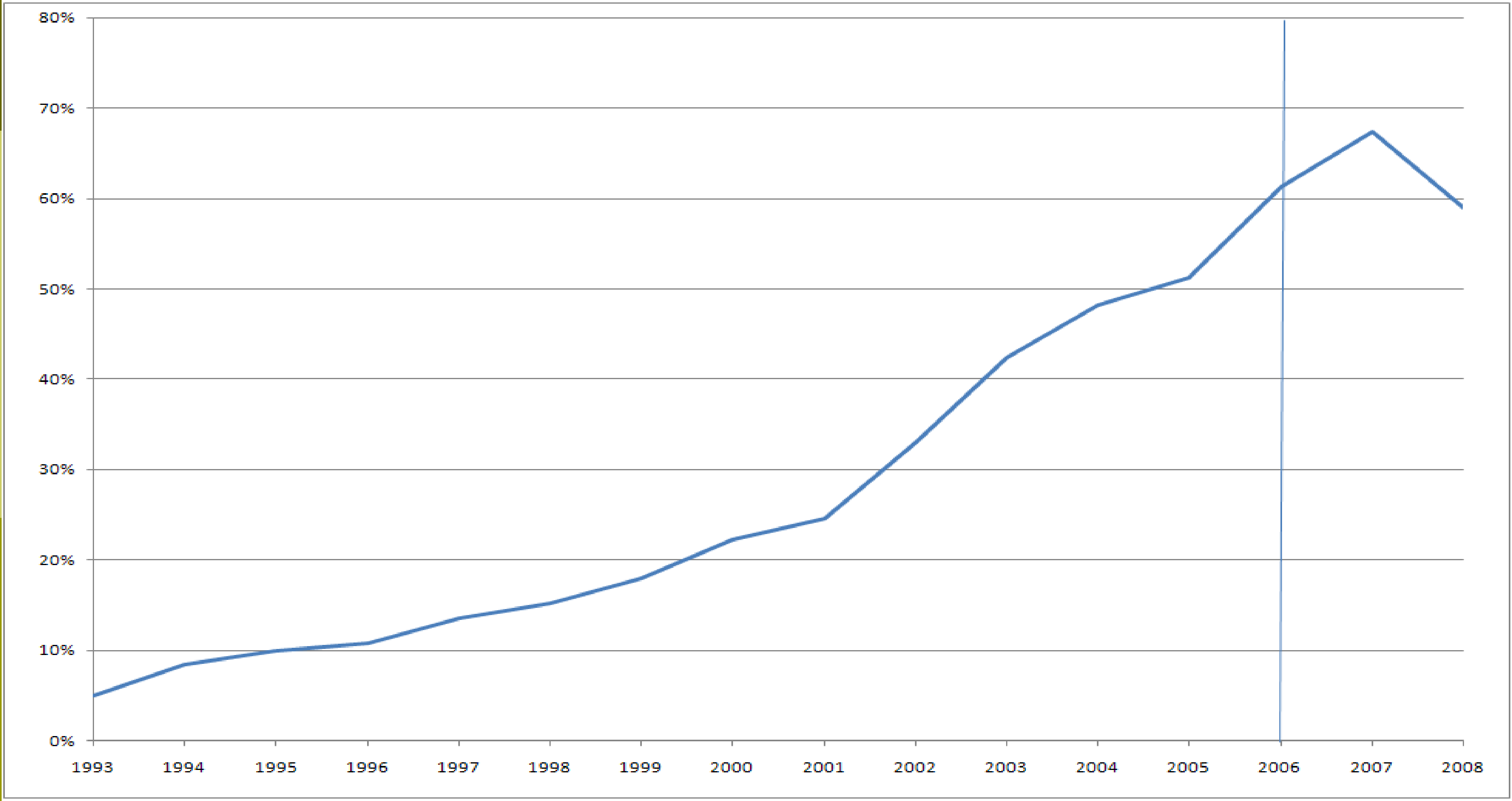
Definition of perks

- In compensation studies, executive perquisites refer to non-monetary compensation given to “selected senior officers,” including
  - personal use of corporate aircraft
  - golf or country club membership
  - home or personal security
  - financial or tax counseling
  - etc.

SEC disclosure rules of perks

- Up to 2005:
  - *SEC 17 CFR 229.402* “Executive Compensation” requires the disclosure of perks if the total value exceeds the lesser of $50,000 or 10% of CEO’s salary plus bonus.
- From 2006:
  - reduced the threshold to $10,000.
- The amount of perks is censored, so we use Tobit regression when examining the amount of CEO perks.

Figure 1
Percentage of S&P 500 Firms Reporting Executive Perk Consumption for Personal Use, 1993 to 2008



Family firm variables

- Family firms (or family ownership)
  - Definition in literature (and *BusinessWeek*):
    - founder and/or descendents served as the top managers or directors, or
    - family members were among the firm's largest shareholders (usually the largest non-institutional shareholders)
  - 177 firms (35%) in S&P 500 are family firms
  - Median ownership: 11%
- Family management: who serves as CEO?
  - Founder: 76 firms (43% of family firms)
  - Descendent: 29 firms (16%)
  - Hired professional: 72 firms (41%)

Table 2
Descriptive statistics of CEO perks (1993-2006)

	Percentage or Mean		
	Family firms	Non-family firms	Difference[b]
Firms disclosing any CEO personal perks (%)	22.3%	27.7%	-4.47***
Among disclosing firms, % of firms whose CEO personal perks include personal use of corporate aircraft	69.4%	68.7%	---
Disclosed amounts of CEO's total perks (natural log)[a]	10.97	11.14	-2.92**
Percentage of the cost of personal use of corporate aircraft in total perks	55.6%	54.0%	---
Perks-related information from other sources			
Company owns or leases aircraft (%)	50.3%	68.1%	-3.58***
CEO has golf club membership (%)	17.6%	24.6%	-6.72***
No. of firm-year observations	2,478	4,522	

Hypothesis development

- Is perk usage related to measures of agency problems?
  - Re-examination of Yermack (2006), which shows no association
  - Measures of agency problems: excess compensation (Core et al. 1998 JFE) and CEO ownership
  - Difference here: larger sample and longer period
- H1: CEO with excess compensation and lower shareholding are more likely to use personal perks, and they use more when they are offered.

Yermack (2006) and this paper

	Yermack (2006 JFE)	This paper
Sample size	237 firms in Fortune 500	S&P 500
Sample period	1993 – 2002	1993 - 2008
Measures of Agency Problems	1. Excessive compensation 2. CEO ownership	1. Excessive compensation 2. CEO ownership 3. Family firm variables
Focus of perks (from proxy statements)	CEO'S personal use of aircraft	CEO's personal use of all perks (including aircraft)

Summary of H2-H4
Relative to non-family firms

	Family Firms Overall	Founder CEOs	Hired CEOs	Descendent CEOs
H2: use and amount of perks	–	–	–	+
H3: first to use perks in industry	–	–	–	+
H4: cancellation of perks in 2007-08	+	+	+	–

- Rationale
  - CEO's personal use of perks reflects agency problems
  - Family firms face less severe agency problems and
  - Founder CEOs create least, whereas descendent CEOs create most severe agency problems.

Summary of Results

- H1: perk use and amounts are associated with agency problem variables (Tables III and V)
- Relative to non-family firms

	Family Firms Overall	Founder CEOs	Hired CEOs	Descendent CEOs
H2: Use of perks (Table III)	–	–	–	NS
H2: Amount of perks (Table V)	–	–	–	NS
H3: First one to use in Industry (Table VI)	NS	NS	NS	+
H4: Cancellation of perks in 2007-08 (Table VII)	+	+	NS	NS

Table III

Probit Regression of the Likelihood of CEO's Consumption of Any Perquisites

Panel A: Family vs. Non-family Firms

Variables	Predicted Sign	Coefficient	z-statistics	Marginal probability
Intercept	?	-1.34**	-2.06	-
FAMILY	-	-0.29***	-2.87	-0.07
EXCESS_COMP	+	0.01***	4.38	0.00
CEO_OWN	-	-0.01***	-3.73	-0.00
SIZE	-	-0.01*	-1.86	-0.00
LEV	?	-0.39	-1.27	-0.09
AGE	-	-0.01	-1.16	-0.00
TOTINST	-	-0.10	-0.54	-0.03
TREND	+	0.18***	17.95	0.04
ROA	-	-0.03	-0.07	0.01
MB	?	-0.02*	-1.84	-0.00
TENURE	+	0.01	0.96	0.00
Likelihood Ratio	2793.1			
Pseudo R^2	22.2%			
No. of observations	6009			

Table III
Probit Regression of the Likelihood of CEO's Consumption of Any Perquisites

Panel B: Founder CEOs, Descendent CEOs, and Hired CEOs of Family firms vs. Non Family Firms

Variables	Predicted Sign	Coefficient	z-statistics	Marginal probability
Intercept	?	-1.35***	-2.07	-
FOUNDER	-	-0.35**	-2.27	-0.11
DESCENDENT	+	0.27	1.28	0.10
HIRED_CEO	-	-0.27**	-2.23	-0.10
EXCESS_COMP	+	0.01***	4.42	0.00
CEO_OWN	+	-0.01***	-3.87	-0.00
SIZE	-	-0.01	-1.85	-0.00
LEV	?	-0.38	-1.25	-0.09
AGE	-	-0.01	-0.66	-0.00
TOTINST	-	-0.10	-0.52	-0.06
TREND	-	0.18***	18.01	0.05
ROA	+	-0.03	-0.07	0.02
MB	?	-0.02*	-1.82	-0.00
TENURE	+	0.01	1.10	0.00
Likelihood Ratio	2792.5			
Pseudo R^2	22.2%			
No. of observations	6009			

S.D. adjusted for time and industry clusterings

Table V
Tobit Regression of the Disclosed Costs of a CEO's Total Perks

Panel A: Family vs. Non-Family Firms

Variables	Predicted Sign	Coefficient	t-statistics
Intercept	?	-5.43**	-2.24
FAMILY	-	-1.19***	-3.00
EXCESS_COMP	+	0.01***	5.09
CEO_OWN	-	-0.01***	-3.64
SIZE	-	-0.01**	2.08
LEV	?	-1.33	1.08
AGE	-	-0.01	-0.44
TOTINST	-	-0.40	-0.54
TREND	-	0.72***	17.79
ROA	+	-0.38	-0.20
MB	?	-0.07*	-1.77
TENURE	+	0.03	1.13
Adjusted R^2	11.2%		
N	6009		

Table V
Tobit Regression of the Disclosed Costs of a CEO's Total Perks

Panel B: Founder CEOs, Descendent CEOs, and Hired CEOs of Family Firms vs. Non-Family Firms

Variables	Predicted Sign	Coefficient	z-statistics
Intercept	?	-5.44**	-2.25
FOUNDER	-	-1.42***	-2.27
DESCENDENT	+	1.11	1.33
HIRED_CEO	-	-1.10**	-2.35
EXCESS_COMP	+	0.01***	5.10
CEO_OWN	-	-0.01***	-3.73
SIZE	-	-0.01**	-2.06
LEV	?	-1.31	-1.07
AGE	-	-0.01	-0.45
TOTINST	-	-0.38	-0.52
TREND	-	0.72***	17.81
ROA	+	-0.38	-0.20
MB	?	-0.07*	-1.75
TENURE	+	0.03	1.21
Pseudo R^2	11.2%		
N	6009		

Table VI
Leader and followers of perk usage within industry

	Founder CEO	Hired CEO	Descendent CEO	Non-family CEO
First user of perk	10 (13.16%)	11 (15.28%)	7 (24.14%)**	36 (11.11%)
Follower of perk usage	40 (52.63%)	38 (52.78%)	13 (44.83%)	228 (70.59%)
Never use perk	26 (34.21%)	23 (31.94%)	9 (31.03%)	59 (18.3%)
Total	76 (100%)	72 (100%)	29 (100%)	323 (100%)

Table VII
Cancellation of perks in 2007-08

	Founder CEO	Hired CEO	Descendent CEO	Non-family firms
Firms cancelling perks in 2007-08	17 (34%)***	7 (14.28%)	6 (30%)	44 (16.67%)
Number of perk users in 2006 or 2007	50 (100%)	49 (100%)	20 (100%)	264 (100%)

Voluntary disclosure of perks and family firms

- What is voluntary perk disclosure?
  - Before 2006, disclosure necessary if personal perks > \$50k
  - Starting from 2006, the threshold was reduced to \$10k
  - In 2005, 71 firms disclosed perks < \$50k ➔ voluntary
  - In 2006, additional 68 firms disclosed perks < \$50k for the first time ➔ “forced disclosure”

Table VIII
Voluntary perk disclosure in 2006

	Founder CEO	Hired CEO	Descendent CEO	Non-family firms
(1) Voluntary disclosure of perks in 2005	6 (60%)	17 (63.0%)	4 (36.4%)	44 (48.4%)
(2) “Forced” disclosure of perks in 2006	4 (40%)	10 (37.0%)	7 (63.6%)	47 (51.6%)
Difference in (1) & (2)	20%	25.92%	-27.28%	-3.30%
Number of firms with perks less than $50000 in 2005 and 2006	10	27	11	91

- Implication
  - Founder and hired CEOs are more likely (NS) to voluntarily disclose perk use ➔ no bias in results

Robustness Tests

- S.D. adjusted for both firm and time clusterings
- Fama-MacBeth approach
  - Annual regressions
  - Test significance of mean of annual coefficients
- Hazard model
  - Model dependent variable (disclosure of perks) as survival time
- Censored perks amount to $50k (due to disclosure threshold prior to 2006)
- Results generally hold up

Conclusions and Contributions

- Provide evidence that CEO personal use of perks is indication of agency problems
  - Excessive compensation and CEO ownership are determinants of CEO’s perk consumption

- Provide more direct evidence on the relation between family ownership and agency problems
  - Family firms provides less personal perks to CEOs
  - Founder and hired-CEOs get less personal perks
  - Descendant-CEOs more likely to be first in industry to get perks for personal use
  - Founder CEOs more likely to cancel perks in economic downturn

Q&A

Thank You!