Investor myopia and CEO horizon incentives

Discussant:
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What they do..

- Divergence of investment horizons between managers and shareholders is an important agency problem.

- Equity payments to managers reduce myopic behavior. 
  - Murphy (1985); Jensen and Murphy (1990)

- If managers plan to sell shares, equity holdings may increase myopic behavior.
  - Stein (1989)

- Whether managers can sell depends on vesting schedules.
What they do..

Authors calculate novel measure of horizon incentives based on stock/option vesting schedules

Examine

- How compensation contracts provide horizon incentives
- Does investment horizon of controlling shareholder affect horizon incentives
- Role of institutional investors in offsetting myopic behavior
- Effect of horizon incentives on performance
Strengths of paper

- Very interesting idea
  - prior work has, for the most part, ignored incentives from vesting schedules
- Appropriate setting to examine this issue
  - VC-backed versus non-VC-backed IPOs
  - VC has potentially shorter horizon
  - VC has motive and opportunity to affect manager’s horizon incentives
- Well-written, careful empirical analysis
What is the right measure of horizon incentives?

Authors use

- Compensation duration: Weighted duration of annual stock grants, option grants, salary, and bonus
- Equity duration: Weighted duration of annual stock grants and option grants
- %unvested: ratio of unvested to total option holdings
What is the right measure of horizon incentives?

- % unvested more credible measure
- More likely that portfolio incentives matter
- But this measure does not include shares granted (both vested and unvested)
- Mean CEO ownership 9% for VC firms, 17% for non-VC (Table 1)
- Too big a component to ignore
Do horizon incentives matter?

- Authors provide only indirect evidence that firms with shorter horizon incentives exhibit greater myopia.
  - BHAR results suggest shorter horizon incentives lead to myopia
  - But other reasons why BHAR could be positively related to horizon incentives
  - VCs give shorter horizon incentives. Also, because they add value, their exit is bad for firms
    - Appears that shorter horizon incentives leads to poor performance in future
Do horizon incentives matter?

- VCs could be trying to maximize their exit price after lockup expiration (through biased forecasts, delayed release of bad news etc).
  - This may be unrelated to myopic behavior by managers themselves
- Could provide more direct evidence by examining how exactly the firm implements myopic behavior.
  - Less R&D?
  - More earnings management?
Why is market monitoring important only for VC-firms?
- Assume post-IPO long-horizon incentives increase in institutional ownership for VC firms. Why not for non-VC firms?
- Control for whether VC has exited?

Appropriate measure of institutional monitoring
- Active investors, not total
Are all managers myopic?

- What about CEO of non-VC firm?
  - He/she is selling during and after the IPO
  - Secondary shares offered and decrease in shareholding both higher for non-VC firms
  - Thus, has same short-term orientation as VC investor?
  - Has no institutional holding pre-IPO.
  - What prevents him from giving himself and other top execs a bunch of short horizon incentives?
Are all managers myopic?

- **Offsetting effects**
  - Career concerns (Fama, 1980; Holmstrom, 1982)
  - Board service (Brickley, Coles, and Linck, 1999)
Other factors

- Post IPO, VC firms grant shorter horizon incentives relative to non-VC firms
  - Need to have just VC post-IPO and non-VC post-IPO (as in Table 5)
- Post IPO, VC firms with low institutional holding have shortest horizon incentives
  - Need to compare $\beta_3$ with $\beta_4$, $\beta_5$, $\beta_6$

<table>
<thead>
<tr>
<th></th>
<th>Coef.</th>
<th>Compensation duration</th>
<th>% Equity</th>
<th>Equity Duration</th>
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</thead>
<tbody>
<tr>
<td><strong>VC Pre-IPO</strong></td>
<td>$\beta_1$</td>
<td>0.29***</td>
<td>0.144***</td>
<td>2.219***</td>
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<td></td>
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<td>-2.17</td>
<td>-2.11</td>
<td>-5.62</td>
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<tr>
<td><strong>Non VC Pre-IPO</strong></td>
<td>$\beta_2$</td>
<td>0.122</td>
<td>0.073***</td>
<td>1.969***</td>
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<td>-0.64</td>
<td>-1.21</td>
<td>-4.61</td>
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<tr>
<td><strong>VC Low Inst. Own</strong></td>
<td>$\beta_3$</td>
<td>0.377***</td>
<td>0.141***</td>
<td>2.49***</td>
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<td>-2.53</td>
<td>-2.61</td>
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</tr>
<tr>
<td><strong>Non VC Low Inst. Own</strong></td>
<td>$\beta_4$</td>
<td>0.441***</td>
<td>0.153***</td>
<td>2.203***</td>
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<td>-2.55</td>
<td>-2.25</td>
<td>-4.22</td>
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<tr>
<td><strong>VC High Inst. Own</strong></td>
<td>$\beta_5$</td>
<td>0.501***</td>
<td>0.202***</td>
<td>2.502***</td>
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<td>-3.86</td>
<td>-3.39</td>
<td>-6.21</td>
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<tr>
<td><strong>Non VC High Inst. Own</strong></td>
<td>$\beta_6$</td>
<td>0.383</td>
<td>0.153***</td>
<td>2.644***</td>
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<td>-1.48</td>
<td>-1.47</td>
<td>-5.81</td>
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Other factors

- Logistic model in table 8 not described in paper or tables
- Captures the probability of equity sales?
- Is there any firm for which this is zero?
- Duration results explanation?
- VC results explanation?

<table>
<thead>
<tr>
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<th>Logistic</th>
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<th>Logistic</th>
<th>Level</th>
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<td></td>
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<td>-2</td>
<td>-3</td>
<td>-4</td>
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<tr>
<td>Comp Long</td>
<td>-0.542 ***</td>
<td>-0.176 ***</td>
<td>(-3.64)</td>
<td>(-2.89)</td>
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<td>Compensation duration</td>
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<td>-0.077 ***</td>
<td>(-0.62)</td>
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<td>VC</td>
<td>0.964 ***</td>
<td>0.001</td>
<td>0.89 ***</td>
<td>-0.012</td>
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<td>-3.89</td>
<td>-0.01</td>
<td>-3.7</td>
<td>(-0.03)</td>
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<tr>
<td>12-month return</td>
<td>0.329 ***</td>
<td>0.212 ***</td>
<td>0.26 **</td>
<td>0.197 ***</td>
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<td>-2.31</td>
<td>-2.71</td>
<td>-1.8</td>
<td>-2.71</td>
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</table>
Other factors

- Argue that market is not able to see through this because of information asymmetry.
  - So is myopic behavior more likely where information asymmetry is largest?
- Cai & Vijh (forthcoming JF) state that vested options may be exercised, but underlying shares may not be sold immediately