

Comments on Reputation Penalties for Poor Monitoring of Executive Pay: Evidence from Option Backdating

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March 28, 2019

Summary

- Comparing Directors at Companies with Backdating to Directors at Companies without Backdating:
 - Votes Withheld Go Up, esp. for members of comp. committee
 - Turnover increases
 - No spillover to directorial positions at other companies for directors involved in backdating at one company.
- Mixed Story for Corporate Governance.
- Hard to Argue with Broad Conclusions. Nice contribution to literature.

Why not use Director Fixed Effects?

- Paper uses “pooled director level OLS.”
- Identification comes from cross sectional variation in whether directors were at firms that backdated.
- Potential Omitted Variable Bias- unobservable director or firm traits correlated with existence of backdating .
- Solution: Use director fixed effects. Identification comes from within-director change in info about backdating. Exploit panel. More convincing.

RiskMetrics

- RiskMetrics effect larger than options backdating effect by multiple of 3-10.
- Controlling for RM withhold recommendation related to back dating, do the other variables still matter? Or are they things correlated with RM recommendation?

RiskMetrics Ctd

- Documentation of imperfect correlation of votes withheld with RM recommendation shows that some voters do not follow RM, but we already know this from the fact that vote is not unanimous.
- Still could be large number of voters (around 15%) that follow RM mechanically (and everyone else ignores RM and evaluates for self) rather than context dependent following of RM

Risk Metrics ctd.

- Study how RiskMetrics makes withhold recommendation decision using same independent variables studied here.
 - E.g. How does size of restatement affect probability of withhold from RM?
 - Does involvement in backdating increase probability of withhold recommendation from RM?

Interpretation

- Paper, as written, focuses on demand for director services.
- Involvement in backdating may affect director labor supply as well as demand, it makes salient the cost of serving as a director (negative publicity etc..)
- Both effects push in same direction, but interpretation changes.
- Higher turnover due to both demand and supply effects.
- Absence of reduction in directorships at other firms tells us something interesting about labor supply of directors as well as labor demand.