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CERTAINTY EQUIVALENT OR NO CERTAINTY EQUIVALENT: A STUDY OF RISK AVERSION AND DECISION MAKING

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ABSTRACT

In this paper, I examine data from the television game show "Deal or No Deal" to test whether contestants make rational decisions when large amounts of money are at risk. Findings suggest that risk aversion changes as the sums of money at risk increase. A model is developed which partially explains the main factors affecting risk aversion in the situation given. This study is unique in that large sums of money are actually at risk, rather than experiments involving hypothetical outcomes.

Keywords: certainty equivalent, risk aversion, decision making

CHARACTERISTICS OF FAILED BANKS: THE CASE OF 3Q2009

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ABSTRACT

The purpose of this study is to compare the financial characteristics of failed to surviving banks. We use one-tailed t-tests in examining bank financial ratios to determine if there are statistically-significant differences between banks that survived The Great Recession versus those that failed as of the end of the third quarter in 2009. The results indicate significant differences between surviving and failing banks, implying that it may be possible to detect banks likely to fail before they collapse. This would allow regulators to intervene sooner to avert bank failures and harm to the financial system.

Keywords: bank failures, bank ratios, capital adequacy

INTRODUCTION

The Great Recession plunged the global financial system into disarray. Small banks, which lacked the capital to withstand severe shocks, were harmed, and some of the oldest financial firms disappeared into bankruptcy or acquisition. In the United States, the Federal Reserve took unprecedented steps to contain the damage and stabilize the financial system. Even with these extraordinary measures, 423 commercial banks failed from 2008 through 2012. The greatest number of failures occurred in the third quarter of 2009, when 42 commercial banks failed.

The Federal Deposit Insurance Corporation also acted, closing many failing banks, and providing insurance payouts to the banks' depositors. Given the size and cost of these actions, any metrics that can detect banks headed for insolvency before it happens would be valuable. This preliminary study attempts to find these metrics by performing one-tailed t-tests on the financial characteristics of the 42 banks that failed during 3Q2009, and a set of peer surviving banks of similar asset size and geographic location.

LITERATURE REVIEW

In examining bank failures during The Great Recession, many factors have been suggested as causes, or at least as indicators, that a depository institution may be headed for trouble. Among the determinants, ratio analysis, as noted below, has been shown to be a promising indicator of troubled banks. The research in this field is currently somewhat limited, however, insofar as we are only just coming out of the financial crisis, and so studies of it are ongoing.

Cole and White (2012) found several contributing factors that caused banks to fail. They discovered that one of the most significant influences on a bank's failure is the asset types the bank held. Banks with higher concentrations in real estate construction and development loans, multi-family mortgages, and commercial mortgages consistently had a higher likelihood of failure in the future as compared to banks with larger holdings of residential, single-family mortgage loans or consumer loans. Note, however, that Kyle's (2012) commentary points out that the banks which failed due to these asset types were smaller banks–the larger banks often failed due to sub-prime mortgage loan exposures. Cole and White also found that failed banks often had lower capital ratios, particularly referring to the ratio of equity to assets. Lower liquidity, measured by cash and due to assets, investment securities to assets, and brokered deposits to assets, also contributed to bank failures. Lastly, Cole and White found that lower earnings, as measured by return on assets, indicated banks that were more likely to have failed.

Kyle's (2012) commentary notes that bank managers who believed that housing prices would never fall, looking at the historical record, decided to loosen underwriting standards. Although it is, at first glance, seemingly reasonable to look at historical housing price behavior and therefore deduce that housing prices would not fall, this misses the point of risk management. Managing risk should be proactive–one should be anticipating what might happen. Relaxed lending standards lead to loans being issued to less creditworthy parties. When The Great Recession took hold, these borrowers defaulted on their loans.

Samad (2011) found four specific capital adequacy ratios that were all significantly different between banks that survived the financial crisis and those that failed, with the failed banks having lower ratios in all four cases. The four ratios are equity capital to assets, Tier One capital to risk-weighted assets, Tier One risk-based capital to average total assets, and total risk-based capital to risk-weighted assets.

On the government and regulatory side, the Office of the Inspector General (OIG) (2011) found that management can be complicit in an institution's failure, particularly due to strategic decisions made to grow the firm's asset base, the bank's compensation structure, or funding choices. Some management teams' compensation structures helped encourage the offering of additional loans and loosening of underwriting standards, as some firms tied compensation to increases in the bank's loan portfolio. When compensation is tied strictly to the size of the loan portfolio, rather than the quality of the loans therein, management works its way down the credit quality ladder, loaning to less creditworthy parties, and thereby increasing the bank's risk level. The OIG study also found that additional efforts to increase a bank's business, such as expanding into new activities or markets or performing mergers and acquisitions, sometimes conducted without due diligence, also led to bank failures.

Tied to efforts to increase a bank's asset base, some depository institutions used what the OIG study terms "non-core funding," generally meaning funds from securities such as mortgages rather than deposits, to provide the liquidity necessary for the bank to function. When the real estate market dried up, these banks were left with insufficient capital to meet their daily requirements, and often had to sell the mortgage assets at fire sale prices, thus forcing the banks to absorb heavy losses.

The OIG study also noted that by expanding the bank's asset base so rapidly and with lower-quality loans, a bank's risk management team had a hard time keeping pace. It takes time for the loan portfolio to "normalize" so that the bank can determine the overall riskiness of the portfolio and make corresponding adjustments to its provision for loan losses. Such being the case, some banks suffered from having inadequate internal controls and risk management processes, which allowed the banks to take on more risk than they could actually handle.

Similarly to Cole and White, the OIG's study also found that asset type is a significant influence on the likelihood of bank failure. Specifically, construction, land, and land development, or CLD, loans and commercial real estate, or CRE loans, were contributors to bank failures. The OIG study, however, specifically found that the cause of bank failures was not so much the exposure to commercial mortgages, but the real estate construction and development loans. Banks that failed also often had higher ratios of non-performing assets (NPAs), and hence lower asset quality overall.

The OIG study also had similar findings to Samad, where a bank's failure to maintain sufficient capital to protect against potential losses was found to be a critical determinant of banks that survived versus those that failed. The level of capital adequacy is particularly important insofar as many of those that failed, since they were making riskier CRE and CLD loans, as noted above, should have had even more capital set aside for potential losses than a bank might "normally" have.

METHODOLOGY

The data in this study consists of the 42 commercial banks that failed during the third quarter of 2009 and a paired set of surviving banks. The complete list of banks and financial statement values is available from the authors upon request. The survivors were based on assets and geographic location. The data was obtained from the Federal Financial Institutions Examination Council website. Reported data is as of the end of 2008, at least six months prior to the bank failures. Financial ratios, loan portfolio ratios and capital adequacy measures were calculated for each of the 84 banks in the sample. We examined commonly used ratios including: ROE, ROA, Equity Multiplier (EM), Profit Margin (PM), Asset Utilization (AU), Net Interest Margin (NIM), Spread, and Overhead Efficiency (OE). A one-tailed t-test was performed on these variables, with a general null hypothesis that for each variable, there is no significant difference between the mean ratios for surviving versus failing banks. If the null hypothesis is rejected, the values for these failed bank performance ratios are expected to be consistently less than those of the survivor banks.

Consistent with Cole and White, we evaluate the portion of total loans and leases represented by real estate loans, construction and development loans, commercial mortgages, and multifamily mortgages. The null-hypothesis for each variable is that there is no significant difference between the mean ratios for surviving versus failing banks. If the null hypothesis fails, we expect that the failed banks will have a greater exposure to these types of loans than the survivor banks.

As mentioned above, Samad analyzed capital adequacy as a potential cause of bank failures within the U.S. He evaluated four ratios, including the total equity capital as a percent of total assets (EQCTA), Tier One capital as a percentage of average total assets minus intangible assets (T1RBCATA), Tier One capital as a percentage of risk-weighted assets as defined by the appropriate federal regulator for prompt corrective measure (T1RWB), and total risk-based capital as a percentage of risk-weighted assets as defined by the appropriate federal regulator for prompt corrective measure (TRBCRWA). We examined these same four ratios in this study, with a general null-hypothesis that for each variable, there is no significant difference between the mean ratios for surviving versus failing banks. If the null hypothesis fails, we expected that the failing banks will have lower capital ratios.

FINDINGS

Bank Performance Ratios

The descriptive statistics, differences between means, and significance are shown in Table 1. Panel A presents the results for the bank performance ratios. The differences between the means for ROE, ROA, Equity Multiplier (EM), Profit Margin (PM), and Overhead Efficiency (OE) are each statistically significant at the 1% level and exhibit the expected signs. The ROE levels show that failing banks, on average, were generating negative profits with the money invested, whereas surviving banks were, on average, generating positive returns. Since ROE is a function of ROA and EM, it is not surprising that both of these ratios showed similar patterns, with the failing bank data more volatile than that of the surviving banks. The EM indicates that the failing banks generally relied more heavily on debt financing. The failing banks' increased use of debt lead to lower PM than the surviving banks, and the OE ratios show that failing banks were less efficient in generating noninterest income to cover noninterest expenses. The differences between the means for Asset Utilization (AU), Net Interest Margin (NIM) and Spread are not significant.

Table 1
Descriptive Statistics, Difference Between the Means, and Significance

Ratio	Surviving Banks Mean (Non-Failed)	Failed Banks Mean (Failed)	Difference Between Means (Failed-Survived)	p-val.	Signif.
Panel A: Bank performance ratios					
ROE	1.59%	-107.46%	-109.05%	0.0000	***
	13.35%	*115.65%*			
ROA	0.56%	-5.38%	-5.94%	0.0000	***
	2.71%	*5.10%*			
Equity Mult.	9.7461	18.7936	9.0475	0.0000	***
	3.4330	*8.4795*			
Profit Margin	-2.73%	-97.65%	-94.92%	0.0000	***
	31.45%	*105.84%*			
Asset Util.	8.01%	6.18%	-1.83%	0.1302	
	10.32%	*1.20%*			
Net Int Margin	3.70%	3.23%	-0.47%	0.1017	
	2.02%	*1.21%*			
Spread	2.89%	2.91%	0.02%	0.4646	
	1.08%	*1.14%*			
OH Efficiency	26.52%	10.32%	-16.20%	0.0034	***
	34.23%	*15.13%*			

Table 1 Descriptive Statistics, Difference Between the Means, and Significance					
Ratio	**Surviving Banks Mean (Non-Failed)**	**Failed Banks Mean (Failed)**	**Difference Between Means (Failed-Survived)**	**p-val.**	**Signif.**
Panel B: Loan Portfolio Variables					
Real Estate	70.39% *21.53%*	83.53% *9.96%*	13.14%	0.0004	***
Const & Devl	16.36% *14.08%*	32.25% *19.20%*	15.89%	0.0000	***
Commercial	24.98% *14.65%*	30.31% *12.71%*	5.33%	0.0415	**
Multi-Family	3.36% *4.78%*	3.57% *5.48%*	0.20%	0.4286	
1-4 Family	20.02% *13.43%*	15.48% *11.12%*	-4.55%	0.0500	**
Panel C: Capital Adequacy Variables					
EQCTA	14.14% *14.44%*	6.15% *2.25%*	-7.99%	0.0005	***
TIRBCAT	12.54% *12.85%*	6.02% *2.10%*	-6.51%	0.0011	***
TIRWA	19.54% *26.62%*	7.64% *2.67%*	-11.90%	0.0031	***
TRBCRWA	20.75% *26.33%*	9.02% *2.66%*	-11.73%	0.0032	***
Significance levels: 1% (***), 5% (**), 10% (*)					

Loan Portfolio Variables

Panel B provides a summary of the results for the loan concentration variables. As expected, we found that the failed banks had higher concentrations of Real Estate loans (at 1% significance), Construction and Development loans (at 1% significance), and Commercial Loans (at 5% significance). The difference between the means for the 1-4 family residential loans was significant at the 5% level but the sign is opposite from the expectation. The difference between the means for multi-family loans was not significant.

Capital Adequacy

Panel C provides a summary of the results for the capital adequacy variables. Consistent with previous results, we found that the failed banks had poorer capital adequacy levels compared to the set of surviving banks. All results are significant at the 1% level.

CONCLUSIONS

Our analyses show statistically-significant differences between the performance ratios, loan concentration measures, and capital adequacy of banks that failed during 3Q2009 compared to peers that survived. With sample financial data from at least six months prior to failure, there seems to be a period of time where regulators could have noted the soon-to-be-failed banks entering the "danger zone," and stepped in to prevent their collapse. One possible use of this study is to identify possible warning signs that a bank is in trouble. These warning signals may be used to establish more prompt corrective action to possibly save banks from failing. The encouraging statistical results in this preliminary study provide support for undertaking a long-term term study of the nearly 500 commercial banks that failed during The Great Recession.

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MEANING OF WORKING AMONG ACCOUNTANTS IN CHINA, CHILE, GERMANY, ISRAEL, AND SOUTH KOREA

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ABSTRACT

In the current paper we examine differences in the meaning of working between accountants in China, Chile, Germany, Israel, and South Korea. The first of the Work Norms is the concept of Work Centrality (Lawler and Hall 1970; MOW international work team 1987; Zedeck 1992). Work centrality is the general belief about the importance of working within one's life. It can be thought of as the degree to which work is seen as the most important variable for developing one's self-concept or self-image (Super 1953, 1957, Super et al. 1967). The second work norm is the view of work as an Obligation to one's employer, society, and/or family - with the obverse of this being work as an entitlement (Erickson and Vallas 1990, Etzioni 1961, Kohlberg 1963, Piaget 1965, Zedeck 1992). An individual with this work norm believes that he or she works because they ought to contribute to society (or the employer, or the family, etc.) through work. In essence, the obligation to work norm represents an individual's belief that he or she has a responsibility or duty to contribute to social units. The third work norm is intrinsic satisfaction (basically being interested in the work itself) or expected intrinsic rewards from working (Hall 1986, McGregor 1960). It has been reported that across countries and cultures (with the sole exception of the Far East), next to providing economic support, perceived intrinsic rewards are seen as the most important reasons for working. The fourth work norm is the interpersonal or Social work norm (Hall 1986; McBride, Mendoza, and Carraher 1993). Humans tend to be social beings and therefore many work in order to have increased opportunities to interact with others. The final major work norm to be explored in this work, which may seem obvious, is that work is performed to produce income necessary for survival (Hall 1986, Maslow 1954, Zedeck 1992) - which we call the Importance of Pay work norm. A study examining the levels of importance placed on the basic functions of work has found that across eight culturally diverse countries over 60% of all individuals identify this as the most important reason for working (MOW international work team 1987).

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INSIGHT INTO THE DETERMINANTS OF FOREIGN EXCHANGE RATES AND VARIATIONS IN CAPITAL STRUCTURE ACROSS DIFFERENT NATIONS: THE IMPACT ON THE CONSOLIDATION OF FOREIGN SUBSIDIARIES INTO THE US PARENT'S FINANCIAL STATEMENTS

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ABSTRACT

This paper reflects on Paul Holt's 2004 argument that the translation and consolidation of the financial statements of foreign subsidiaries into the US parent's financial statement provides little useful information because it the data loses the context that the foreign subsidiary operates in. Although Holt states that the recasting of foreign financial statements into US GAAP distorts information and can cause misleading interpretations of items such as debt to equity ratios. He adds that exchange rate conversion may also not provide any useful in formation in regards to price or value in the market where the subsidiary operates. However, he fails to provide insight from the extant literature to support his statements. This study reviews the theoretical and empirical literature in the areas of foreign currency exchange and capital structure across different national context and finds support for Holt's argument. The paper also expands on Holt's suggestion for an alternative reporting method.

ACCOUNTING MAJORS' PERCEPTIONS OF SUSTAINABILITY REPORTING

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ABSTRACT

Companies of all sizes have embraced sustainability in an effort to preserve resources for future generations, while continuing to create value. While companies tend to publicize their sustainable efforts in promotional materials, relatively few issue formal sustainability reports. This is beginning to change. A trend toward formal sustainability reporting is emerging. Investor demand for comparable, relevant, and reliable sustainability information and the continuing development of global reporting guidelines motivate and support this trend. Formal reporting requires the involvement and support of accounting professionals. Accounting majors, many of whom have grown up in an environment that strongly values ecologically and socially responsible corporate behavior, represent the future accounting professionals.

This study investigates accounting students' perceptions regarding sustainability reporting. The study focuses on the perceived benefits to multiple stakeholders, the scope and type of information companies should report, the reporting time frame, and the need for globally accepted sustainability reporting standards. The study finds that overall, accounting students tend to support sustainability reporting of multiple performance indicators relating to environment and safety, employees and community, and corporate governance both in terms of current year and comparative information. Students tend to perceive sustainability reporting as more beneficial to large than to small and midsize companies. Students also tend to believe that high-quality globally accepted sustainability reporting standards will enhance annual reporting.

The results from this study provide important insights into future accounting professionals' perceptions of this important reporting trend. Their support will be necessary to assist companies in reporting useful comparable information about its impact on people and the planet, while creating value for current generations.

INTRODUCTION

During the past decade, a continually increasing number of entities have started formal reporting of their sustainability-related activities. Demand for sustainability-related information appears to motivate this reporting trend. The majority of companies that currently issue sustainability reports follow the guidelines provided by the Global Reporting Initiative (GRI), which allows for a choice among three reporting levels that differ with respect to the types of issues and the number of performance indicators that must be reported (GRI, 2013). Although GRI provides guidelines that can be applied globally across many different industries, other guidelines, some applicable to specific nations/regions or industries, exist as well. This makes inter-company comparability difficult. Sustainability reporting can be very useful to external stakeholders such as investors and customers, but it can also be extremely beneficial to internal users by enhancing the company's ability to effectively and efficiently achieve long-run goals. Relevant, reliable, comparable, and thus useful sustainability reporting requires commitment by an organization's key personnel and by those responsible for the reporting process. Support will be more likely, if accounting professionals understand the long-term benefits of high-quality and comparable reporting. It also requires a consensus regarding the scope, type, and comprehensiveness of the information that will be beneficial to stakeholders. Accounting majors represent the future accounting professionals. Their support is necessary to help continue to motivate the trend toward sustainability reporting and lead to a future in which organizations routinely report their comprehensive performance and their impact on profit, people and planet.

BACKGROUND

Sustainability-related concerns represent a global issue of long-standing nature. In 1987, the World Commission on Environment and Development formally defined sustainability development as a "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (United Nations, 1987, 37). Today, a continually increasing number of companies formally report on their sustainability efforts. While in the 1990, few companies issued sustainability reports, the number has grown to thousands of companies world-wide with 95% of the global 250 companies and 53% of the S&P 500 companies currently issuing sustainability reports (EY & Boston College Center for Corporate Citizenship, 2013). In the U.S., sustainability reporting is voluntary and the nature, extend and quality of the reporting varies considerably. This tends to make inter-company comparisons very difficult.

Sustainability reporting is expected to increase and is motivated by demand from organizations' stakeholders. Stakeholders increasingly expect that companies formally and comprehensively report on their sustainability efforts. According to Ernst & Young, "Shareholder proposals now call for sustainability reports from company suppliers, and ask for more disclosure on how companies are managing specific environmental and safety risks" (EY, 2012). The response by the investment community also supports the trend toward sustainability reporting. The Forum of Sustainable and Responsible Investment (referred to as the US SIF), reports that currently, more than $3 trillion dollars are invested in sustainability and corporate responsibility funds (US SIF, 2012). Companies that implement sustainability programs expect to derive significant benefits including cost savings. Commitment to sustainability reporting likely will also depend on companies' perception that reporting will lead to tangible and/or intangible benefits that in the long-run exceed reporting costs. Furthermore, sustainability reporting may also affect a company's cost of capital. A recent study (Dhaliwal et al., 2011) suggests that high cost of capital companies that voluntarily start reporting about superior social responsibility programs tend to experience a decrease in their cost of capital.

The usefulness of sustainability reporting depends on the scope, detail, and reliability of the information provided. To be useful to investors and other stakeholders the information provided must also be comparable, which necessitates that companies follow uniform standards or guidelines that address format, structure, scope, and specific information content to be reported. To be useful to many stakeholders and to allow for meaningful comparisons, standards for reporting sustainability-related efforts are necessary. While currently, about 63% of the S&P companies that publish sustainability reports utilize the guidelines developed by the GRI (EY & Boston College Center for Corporate Citizenship, 2013), other organizations, such as the U.S.-based Sustainability Accounting Standards Board, are also developing reporting standards.

Accounting professionals play a key role in helping organizations achieve their goals. The issues that relate to sustainability reporting will affect companies and accounting professionals for many years. High-quality sustainability reporting requires the support of current and future accounting professionals; their support will be most likely if they perceive the value and benefits of reporting. The usefulness of sustainability reporting also depends on a consensus among standard setters, corporate decision makers, and accounting professionals with respect to the scope, detail, and reporting time frame. Students majoring in accounting represent the future accounting professionals. Hence, accounting majors' perceptions regarding sustainability reporting are important.

METHODOLOGY

A research instrument was developed that addresses the overall benefits of voluntary sustainability/CSR reporting for multiple stakeholders, the value of globally uniform reporting standards, the need for mandatory reporting; and the scope and level of sustainability reporting focusing on issues of concern to a broad range of stakeholders (environment and safety; employees and community; and corporate governance). The instrument was piloted to assure the clarity of the statements. Study participants were asked to rate their agreement with several statements and to indicate the importance of specific performance indicators using a 5-point scale with "5" equal to "strongly agree" or "very important" and "1" equal to "strongly disagree" or "not at all important."

During the Winter 2013 and Spring 2013 quarters, 115 students enrolled in Intermediate Accounting I and II completed the survey instrument. Participation in the survey was voluntary and students' responses were anonymous. Prior to administering the survey, sustainability reporting was discussed together with several other reporting trends. The survey was administered during the last week of instruction in Intermediate I and the first week of instruction in Intermediate Accounting II to help ensure comparable levels of knowledge across the two courses. Student responses to the survey were summarized and statistically evaluated using Microsoft Excel statistical tests.

RESULTS

Students were asked to rate their level of agreement with the statements that, in the long-run, large companies and small and midsize companies will benefit from voluntary CSR reporting (the term CSR was defined as a synonym of sustainability and used for brevity). Students' mean ratings were 4.29 with respect to large companies and 3.79 with respect to small and midsize companies. Paired-sample t-test reveals that the difference between 4.29 and 3.79 is statistically significant at a 0.05 significance level.

Student participants also were asked to rate their level of agreement with the statement that investors will benefit from CSR reporting and that globally uniform reporting standards would enhance the value of annual reporting; students' mean ratings were 4.06 and 4.18, respectively. The students also were asked to indicate their level of agreement with two statements asserting that CSR reporting should be mandatory for (1) U.S. public companies and (2) U.S. private companies. Their mean ratings were 4.12 with respect to public companies and 3.65 with respect to private companies.

Students were asked to rate the importance of a company reporting on key performance indicators relating to (1) environment and safety, (2) employees and community, and (3) corporate governance. Each area included multiple aspects and differentiated between reporting a company's performance with respect to (a) the current reporting period and (b) changes over the prior years (i.e., trend information). The mean ratings for the environmental and safety-related indicators were greater than "4," which is equivalent to "important," except for reporting of investments in renewable energy (with a mean ratings of 3.89) and transportation-related incidents (with a mean rating of 3.66). The mean ratings were highest with respect to reporting information about current year CO_2 emissions and changes in CO_2 emission trends (mean ratings were 4.38 and 4.37, respectively). Students' mean ratings regarding the importance of reporting employee-related information were highest with respect to current year employee injury rates (mean rating was 4.05) and lowest with respect to the current year composition of management in terms of age, gender and ethnicity (mean rating was 3.01). Students' mean ratings regarding the importance of reporting corporate governance related issues were highest with respect to trend information relating to ethics code violations (mean rating was 4.48) and current year information relating to risk management (mean rating was 4.47). The lowest mean rating related to current year vendor audit information (mean rating was 3.80).

CONCLUSIONS

Sustainability reporting represents an important global reporting trend that requires the support of accounting professionals. Accounting majors represent the future accounting professionals and their support is necessary to help continue to motivate this trend. This study investigates accounting majors' perceptions regarding sustainability reporting focusing on the perceived benefits to multiple stakeholders, the expected scope and type of issues reported, the reporting time frame, and the need for high-quality global sustainability reporting standards.

The study finds that overall accounting majors tend to support sustainability reporting and perceive that reporting of multiple performance indicators relating to environment and safety, employees and community, and corporate governance both in terms of current year and comparative year information as important. Students tend to perceive sustainability reporting as more beneficial to large than to small and midsize companies. Insights gained from this study provide important information for decision makers and standard setters.

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INTERPRETING SEASONAL SALES PATTERNS EXHIBITED BY NON-SEASONAL FIRMS

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ABSTRACT

Publicly traded companies file 10-Q reports after their first, second, and third fiscal quarters, and their 10-K annual filings also include notes on quarterly performance. In this paper, quarterly sales patterns are examined for Six Flags Entertainment, Macy's, Publix Super Markets, and Safeway. As expected, Six Flags and Macy's exhibit a seasonal sales pattern, with the amusement firm's revenues peaking during the warmer months and the department store reporting its highest sales during the end-of-year holiday season. However, of the two supermarkets, only Publix's quarterly sales pattern is what one would expect from a sector whose sales should be fairly even throughout the year. Surprisingly, Safeway reports a quarterly sales pattern much different from Publix's and seemingly at odds with the nature of its business. In addition to explaining this surprising finding for Safeway, this paper highlights the appearance of seasonal patterns among other non-seasonal firms and identifies implications associated with reviewing quarterly data.

INTRODUCTION

To enhance the timeliness of financial data, the Securities and Exchange Commission (SEC) requires that publicly traded firms file quarterly reports on Form 10-Q in addition to their annual-report, 10-K. The format used in reporting on Form 10-Q is well suited to factor out any seasonal sales trends experienced by the firm. Nevertheless, knowledge of seasonal treads is also of interest to those studying a firm's results of operations. This latter information is typically presented in a firm's 10-K but as will be seen, it must be viewed carefully for it can be subject to misinterpretation.

QUARTERLY DISCLOSURES – AN ILLUSTRATION OF THEIR PURPOSE

In the 10-Q filings, firms factor out any seasonality by comparing performance in the current quarter and year-to-date with that of the same time periods in the prior fiscal year. The reason for such a focus is apparent from examining selected data taken from an SEC Form 10-Q filed by Six Flags Entertainment, an operator of amusement parks. As shown in Table 1, in both fiscal 2012 and 2013 sales during the third quarter (Q3) were more than one-half of the combined sales for Q1-Q3, rather than the one-third that one might expect in the absence of seasonality factors. Also, Table 1 reveals that Six Flags would have operated at a net loss for the first nine months in each fiscal year had it not been for its net income in Q3.

Table 1
Selected Data from Third Quarter 2012 Form 10-Q Filed by Six Flags Entertainment

	Third Quarter 2012	Third Quarter 2011	Nine Months Ending 9/30/2012	Nine Months Ending 9/30/2011
Total revenues	$485,143,000	$475,605,000	$926,413,000	$875,613,000
Net income	$271,978,000	$211,177,000	$247,740,000	$115,621,000

As would be expected, the amusement-park business peaks during warm-weather months, many of which are contained within Q3. If Six Flags' 10-Q were to focus on comparing its current-year Q3 with its current-year Q2 or Q1, rather than with its prior-year Q3, it might suggest incorrectly that the firm had only recently developed a plan to achieve operating efficiencies and financial success. However, despite such cautions, knowledge of a firm's distribution of sales across quarters can prove useful to analysts in other decision contexts.

EVIDENCE OF SEASONALITY?

Almost all firms include a table in their 10-Ks that present data by quarter, including sales revenue, for the current and prior fiscal years. Such information is intended to inform analysts as to the degree of seasonality in the firm's sales pattern and any recent changes therein. One way to capture the seasonal nature of a firm's business would be to use data from its 10-Ks to express each quarter's sales as a percentage of its Q1 sales (which we set at 100%). Table 2 presents such information for fiscal years 2012 and 2011 for Six Flags, Macy's, and two regional supermarket chains, Publix and Safeway.

As would be expected, the Table-2 data portray a high degree of seasonality for the amusement-park business. In both fiscal years, Q1 is by far the slowest quarter. Large proportions of revenues are earned during Q2 (April – June) and to an even greater extent Q3 (July – September). The spike in Q4 sales for Macy's also is not surprising given that this department-store chain features merchandise known to sell especially well during the end-of-year gift-giving season.

On the other hand, there is no reason to believe that sales and consumption of the two supermarkets' merchandise would vary substantially from quarter to quarter. Publix reports only minor sales fluctuations by quarter; its largest fluctuation of 7 percent occurs for its Q4, but only for fiscal 2011, and this is a direct result of Publix including an extra (14^{th}) week in its Q4 that year to accommodate its use of 52-53 week reporting periods. Many retailers prefer to have their fiscal years contain an even number of weeks; they might, for example, end each fiscal year on the Saturday closest to the end of January; where that is the case, an extra week is added to Q4 approximately every five or six years to compensate for the fact that most accounting periods would only contain 364 days (52 x 7).

Safeway would seem to be very comparable to Publix in that both are large U.S. supermarket chains, but as seen in Table 2, Safeway reported Q4 sales that exceeded its Q1 sales by approximately 38% in both fiscal years. So what can explain the marked seasonality exhibited by Safeway but not by Publix, when both belong to an industry sector not expected to illustrate a seasonal sales pattern? The answer to these questions cannot lie in some unusual phenomenon that arose in fiscal 2012, because these problematic seasonal sales patterns were observed in fiscal 2011 as well.

Table 2
Quarterly Sales Patterns

Six Flags					**Publix Super Markets**				
Fiscal yr. 2012	**Q1**	**Q2**	**Q3**	**Q4**	**Fiscal yr. 2012**	**Q1**	**Q2**	**Q3**	**Q4**
Sales revenue ($millions)	$66	$375	$485	$144	Sales revenue ($millions)	$7,126	$6,838	$6,702	$7,040
Sales as % of Q1 Sales	100%	568%	735%	218%	Sales as % of Q1 Sales	100%	96%	94%	99%
Fiscal yr 2011					**Fiscal yr 2011**				
Sales revenue ($millions)	$61	$339	$476	$138	Sales revenue ($millions)	$6,836	$6,622	$6,425	$7,295
Sales as % of Q1 Sales	100%	556%	780%	226%	Sales as % of Q1 Sales	100%	97%	94%	107%
Macy's					**Safeway**				
Fiscal yr. 2012	**Q1**	**Q2**	**Q3**	**Q4**	**Fiscal yr. 2012**	**Q1**	**Q2**	**Q3**	**Q4**
Sales revenue ($millions)	$6,143	$6,118	$6,075	$9,350	Sales revenue ($millions)	$10,003	$10,387	$10,049	$13,767
Sales as % of Q1 Sales	100%	100%	99%	152%	Sales as % of Q1 Sales	100%	104%	100%	138%
Fiscal yr. 2011	**Q1**	**Q2**	**Q3**	**Q4**	**Fiscal yr. 2011**				
Sales revenue ($millions)	$5,889	$5,939	$5,853	$8,724	Sales revenue ($millions)	$9,772	$10,196	$10,064	$13,598
Sales as % of Q1 Sales	100%	101%	99%	148%	Sales as % of Q1 Sales	100%	104%	103%	139%

THE EXPLANATION

One possible explanation might seem most unlikely or even bizarre. Is it possible that a firm could include within one of its reporting quarters many more weeks than the 13 weeks that are found in a calendar quarter? Not only is this possible, but it did occur at Safeway and *this alone* explains why this non-seasonal company came to exhibit a seasonal sales patterns not that different from Macy's. Safeway is representative of a number of companies that structure their external reporting to complement an internal-reporting schedule that is sometimes referred to as a four-week progression. External-reporting quarters of 13 weeks each do not achieve this symmetry because 13 is not evenly divisible by 4. On the other hand, a reporting pattern that consisted of three quarters with 12 weeks and one quarter with 16 weeks would not only add up to 52 but would also contain only quarters whose number of weeks are evenly divisible by 4.

Table 3 presents a sampling of firms that each has one external-reporting quarter that contains at least 16 weeks. Five of the nine firms cited in Table 3, including Safeway, added an extra week to their Q4. For the remaining firms, extra weeks were added to Q1 and Q3 in three and one instances, respectively. It is not that surprising that Safeway reported approximately 38% more sales in Q4 than in its Q1 (see Table 2), given that its Q4 contained 33% more weeks than its Q1. It also would not be surprising to learn, for example, that Flowers Foods and Nash-

Finch reported their highest sales on their Forms 10-Q as occurring during Q1 and Q3, respectively.

Table 3
Distribution of Weeks for Form 10-Q Reporting

Company	Q1	Q2	Q3	Q4	Q1 – Q4
Advance Auto Parts	**16**	12	12	12/13	52/53
Costco	12	12	12	**16/17**	52/53
Flowers Foods	**16**	12	12	12/13	52/53
Ignite Restaurant Group	12	12	12	**16/17**	52/53
Nash-Finch Company	12	12	**16**	12/13	52/53
PepsiCo	12	12	12	**16/17**	52/53
Safeway	12	12	12	**16/17**	52/53
Whole Foods	**16**	12	12	12/13	52/53
Wolverine World Wide	12	12	12	**16/17**	52/53

IMPLICATIONS

Users of these financial disclosures need to be aware that there is no SEC requirement that firms divide their 10-Q reporting periods into quarters of 13 weeks each (or 13-13-13-14 in the case of a 53-week year). It follows that care must be taken when seeking to understand the cause of a seasonal sales pattern exhibited by a firm. Does it represent actual differences in sales volume by quarter or does it merely reflect that the firm's reporting quarters are of unequal duration? When examining the quarterly sales pattern for a firm that follows 52-53 week, it must be kept in mind that its Q4 could contain up to 42% more sales days than any other quarter (17 weeks vs. 12 weeks).

Analysts must be equally vigilant when making inter-company comparisons. Just as the quarterly sales patterns of Publix vs. Safeway could not be directly compared, the same would be true should one attempt to compare Costco, PepsiCo, Whole Foods, and Wolverine World Wide with, respectively, BJ's, Coca-Cola, Harris Teeter, and Timberland, peers of theirs that divide their fiscal years into quarters of 13-13-13-13/14.

The bottom line is that some firms prepare 10-Q submissions to the SEC that are really what one might more accurately refer to as 10-Is, given that they surely are interim reports but do not each necessarily encompass an exact quarter of a calendar year.

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ETHICS AND PAY SATISFACTION DIFFERENCES BETWEEN CHINA AND THE USA

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ABSTRACT

In the current paper we examine variations in ethics and compensation satisfaction differences between business people in China and the USA. We find that the pay satisfaction constructs are quite different between China and the USA. We also found large differences in the dominant compensation satisfaction levels between the two countries. We also found differences in terms of whether assessments are done in rural, suburbs, or urban areas – with larger variations within the countries than between the countries. Individuals earn far larger amounts in urban areas than rural areas.

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COMPARATIVE STATICS OF OPTIMAL WEIGHTS ON MYOPIC PERFORMANCE MEASURES

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ABSTRACT

This paper examines the comparative statics of optimal weights on the use of myopic performance measures in a multitask agency model. Using Linear, Exponential, Normal (LEN) setting, the paper shows that when current investments in research and development (R&D) have higher future impact on firm value, i.e., for high growth firms, optimal weight on the accounting performance measure should be lower. In addition, an increase of firm's growth opportunity will lead to an increase in the weight of the additional performance measure relative to the weight of accounting income. Furthermore, the paper shows that an increase in manager's risk aversion increases the weight on the additional performance measure over accounting performance measure.

INCENTIVE COMPENSATION FOR BANK CEOS AND CFOS BEFORE AND AFTER THE FINANCIAL CRISIS

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ABSTRACT

The recent financial crisis has resulted in increased scrutiny of bankers' pay, as many argued flawed compensation schedules aggravated the financial crises. In this paper we examine the impact of recent compensation regulation on bankers' incentive compensation implemented in response to such criticism. The regulations were intended to change the relative make-up of incentive compensation to encourage a long-term perspective in decision-making, and to limit excessive risk-taking. We examine the relative mix of cash, stock, and option-based compensation to determine if the regulations had their intended direct effect. Our results indicate that for the most part, the regulations did indeed have their desired impact.

INTRODUCTION AND LITERATURE REVIEW

The recent financial crises have resulted in both significant public pressure and government regulation to limit bankers' compensation. Politicians and the public press have decried the "outrageous" pay taken home by bankers during the recent economic troubles. Congress has enacted legislation to limit pay, and more specifically to limit the types of incentive pay.

In response to the banking crises and in part the public outrage at bankers' compensation during this period, Congress passed several sets of legislation to try and address this issue. In October of 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA), limiting the executive pay on those firms receiving TARP (Troubled Asset Relief Program) funds (Martin, Adkins and Oehmann III, 2009.) Additional limitations were added under the American Recovery and Reinvestment Act of 2009 (ARRA), which was enacted in February of that year; some of these proscriptions apply retroactively (Martin, et al., 2009). Both of these Acts were modified and updated since their introduction to try and better achieve their objectives.

In addition, to the strict legal requirements singling out the TARP-affected firms, other, more subtle (or not-so-subtle), pressures were put on the banking industry to limit pay. Kenneth Feinberg, Treasury master for executive compensation (Obama's "pay czar") proclaimed that nearly 80% of $2 billion in 2008 banker bonuses was unmerited, and that the criteria used to award the bonuses was "haphazard." (New York Times, July 23, 2010, Eric Dash) He therefore pushed boards to use more stock and less cash in their compensation packages. This was intended to limit excessive risk-taking. Towards this objective, he also promoted the use of more deferred compensation with a vesting time-frame of 3-5 years.

Fahlenbrach and Stulz (2011) nicely summarize the arguments made for regulating incentive compensation. "The argument seems to be that executives' compensation was not properly related to long-term performance…"(p. 11) "…CEOs had strong incentives to focus on the short run instead of the long run. Another version [of the poor incentives argument] is that option compensation gave incentives to CEOs to take more risks than would have been optimal for shareholders. (p. 12.) They note that previous studies find that bank executives receive less of their pay in the form of stock and options (and therefore more in cash) than in other industries. (Adams and Mehran, 2003, Houston and James, 1995.)

THE PURPOSE OF THIS STUDY

We wish to examine whether indeed the compensation restrictions have had their intended effect of altering the composition of banking executives' compensation. Did the EESA, ARRA, and related compensation regulations, along with the accompanying public and political pressure, result in the managers' compensation packages being altered to promote better long-term decision-making and to discourage unnecessary risk-taking? To attempt to answer these questions, we will test the following three hypotheses:

H1 *The relative use of cash-based incentive compensation has declined in response to the regulations.*

H2 *The relative use of stock-based incentive compensation has increased in response to the regulations.*

H3 *The relative use of option-based incentive compensation has declined in response to the regulations.*

RESULTS

First we look at the test of our first hypothesis, that the restrictions placed on managerial compensation, as well as the accompanying public and political pressures, led to a decline in the relative percentage of cash incentive compensation received by the bank executives. We will test this hypothesis by look at that change in the relative percentage of (cash bonus and incentive compensation)/total incentive compensation, CHGCASHPCT (See Table 4). To get a sense of the fullest impact of the regulations, we will look at the change over the entire sample period ending in 2010. Since it is not entirely clear to us when we should expect to see the compensation packages be changed in response to the regulations and the increased scrutiny, we consider three different "starting points." We use the 2007 relative compensation schemes as a base since this is well before the first regulations, ARRA, were put in place in 2008. We use also 2008 as another starting point, since the initial ARRA regulations were put in place in 2008, and therefore 2009 would be the first complete fiscal year in which the boards could fully respond to the new requirements. And finally we use the averaged measures over the 2007-08 period as a base. As we've seen, these (and the other) components fluctuate considerably from year to year for a variety of reasons, and therefore the 2-year averages may give a more representative measure of the boards' long-term intentions about the relative influence of these measures.

The results are presented in Table 4. We begin with the results for the CEOS. None of the changes in the percentage of cash incentive compensation over time, regardless of how we define the starting point, are significantly different from 0. There is no support for our hypothesis that the CEOs will receive less cash incentive pay in response to the new bank pay regulations. We reach the same conclusion for this hypothesis with respect to the CFOs and the combined sample. There is practically no statistical support for our hypothesis that this form of compensation would be reduced in importance, and correspondingly stock-linked compensation plans would be substituted in its place.

Table 4
Relative Changes in Compensation Components over the Sample Period
(*,**,*** = significant at an alpha of .05, .01, .001, respectively)

	2007-10		2008-10		2007/8-2010	
Panel A. CEOs						
CHGCASHPCT	-9.22%		14.86%		2.82%	
CHGSTOCKPCT	38.20%	***	18.61%	**	28.41%	***
CHGOPTPCT	-25.30%	***	-29.80%	***	-27.55%	***
Panel B. CFOs	**2007-10**		**2008-10**		**2007/8-2010**	
CHGCASHPCT	-8.35%		12.98%		2.32%	
CHGSTOCKPCT	29.90%	***	12.10%	*	21.00%	***
CHGOPTPCT	-25.20%	***	-28.70%	***	-26.95%	***
Panel C. CEO & CFOs combined	**2007-10**		**2008-10**		**2007/8-2010**	
CHGCASHPCT	-8.70%	*	13.97%		2.64%	
CHGSTOCKPCT	34.00%	***	15.40%	**	24.70%	***
CHGOPTPCT	-25.20%	***	-29.30%	***	-27.25%	***

Next we look at our second hypothesis, that the boards of directors would implement compensation schedules with increased stock-based incentives in order to better link managerial compensation to that of the shareholders, and to encourage managers to take a longer-term perspective in decision making. To evaluate this claim, we look at the variable representing the change in the percentage of stock awards over time, CHGSTOCKPCT. We see that for the CEOs there is a statistically and economically significant increase in the relative use of stock awards regardless of which time period is considered. The relative use of stock-based incentives increases by a mean (median) of 18 (13) to 38 (41) percentage points. These results resoundingly support our hypothesis. It is evident that the compensation schemes were changed in line with the intentions of the new regulations.

For the CFOs, we reach the same qualitative conclusions. The relative use of stock awards increases by 12 (3) -30 (9) percentage points depending on the measure. These results are not as significant either statistically or economically as they were for the CEOs. Interestingly, the CFOs received less increased incentive to focus on the longer term than the CEOs.

For the combined sample, the results are again totally supportive of our hypothesis. The relative use of stock awards increased by from 15.4 (3.7) to 34 (15.4) percentage points over our sample period. Both statistically and economically, the regulations seemed to have their intended initial effect: to increase stock-based compensation so that managers would be more inclined to make rational long-term decisions. (Whether the managers in fact do this is a subject for further study.)

Finally, we look at the change in the relative use of option awards, CHGOPTPCT. For CEOs, the evidence is once again clear and convincing: the hypothesis that the relative use of options would decline in response to the regulatory pressures is soundly supported. All three time-frame measures are both statistically and economically significant, implying that the relative use of options decreased by about 25 (15) to 30 (26) percentage points during this study.

The relative decline in the use of options to compensate CFOs was just as significant. The relative use of options decreased by about 25 (12) to 29 (20) percentage points over the course of the study. And as expected, the results for the combined sample mirror those just cited in both statistical and economic significance. The evidence soundly supports our hypothesis that the relative use of options will decline in response to the new compensation legislation.

CONCLUSION

Based upon our results, the evidence in large part supports the proposition that the compensation regulations imposed in response to the financial crises had their initial desired effect. There was a significant increase in the relative use of stock-based compensation over the sample period. The results were both statistically and economically significant. This should induce managers to take a longer-term perspective when making decisions, and better align their interests with those of their shareholders. The relative use of options, on the other hand, declined significantly from 2007-2010, also in line with our predictions. And again the results were both statistically and economically significant. If theory holds, this relative reduction should lead managers to avoid excessively risky projects not in their shareholders' best interests.

The only hypothesis not supported related to the use of cash-based incentives. We did not find any support for the suggested impact of a decrease in the relative use of cash based incentives. Statistically, this measure didn't really change over the 4-year period.

Further study, after we accumulate a few more years of results, can attempt to determine whether these primary effects had their intended secondary effects on the managers' focus on the long term, and a reduction in risk-taking.

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CEO'S SHARE OF TOP-MANAGEMENT COMPENSATION, CHARACTERISTICS OF THE BOARD OF DIRECTORS AND FIRM-VALUE CREATION

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ABSTRACT

The study examines if certain board of directors characteristics influence the CEO's Pay Slice (CPS), i.e. the CEO's share of the combined compensation received by the five top-paid executives of the firm. The results show that the CPS is positively affected by the percentage of independent directors and negatively linked to director stock ownership. We also examine if CPS increases company valuation by investors, as predicted by the tournament theory. Our results upheld this view, showing that there is a positive link between CPS and company market value as predicted by the tournament theory. Although the effect is significant at a threshold of 95%, CPS only explains a small percentage of the variance in company market value.

INTRODUCTION

The media attention concerning the compensation received by Chief Executive Officers (CEOs) has increased in the past two decades due to the growing gap vis-à-vis the middle class income (Abma, 2012 and Anderson et al. 2004), the financial scandals in the wake of the recent global crisis, and the "Occupy Wall Street" movement (Sharma and Huang, 2010). In terms of corporate governance, CEO compensation is ultimately the board's responsibility. The board of directors, by determining CEO compensation, contributes to establish the company's compensation structure, especially by setting the gap between CEO compensation and that of the other company executives.

LITERATURE REVIEW

The first research question is formulated as follows: Can board characteristics partially explain the CEO pay slice (CPS), i.e. the CEO's share of the combined remuneration of the five top-paid executives. Boards receive important powers from shareholders who appoint them. In fact, Fama and Jensen (1983) argued that they constitute the main mechanism of internal corporate governance. Thus, boards can hire and fire company top officials (including the CEO) and also they set the level and other aspects of compensation (Farrell & Whidbee, 2000; Yermack, 2004). We therefore reason that traits of the boards connected in previous literature as potential value drivers could have an impact in the determination of CEO's share in total top-management compensation. The board characteristics which are studied in our article are independence, size, total director compensation, stock-based director compensation, director stock ownership, directors' average number of tenure years on the board and the CEO's dual position as Chairman of the Board.

The second research question is connected with the impact that a greater CPS may have on firm market-valuation. Two theoretical views have been proposed to address this question. The tournament theory, which was initially formulated by Lazear and Rosen (1981), sustains that the compensation gap between the CEO and other executives, could be a source of motivation for the latter. This enhanced motivation could create company value. The fair-wage view, on the contrary, claims that the increased competition among the members of the executive team could be detrimental to cooperation, which in turn would be harmful for the company (Pfeffer, 1995; Deusch, 1985 and Levine, 1991). If a greater CPS is a source of value creation, our study will support the tournament theory, whereas a negative link between CPS and firm value will upheld the fair-wage theory.

This study makes a unique contribution to the academic literature. To the best of the authors' knowledge, it is the first to examine if board characteristics are determinants of CPS and if the latter can be a driver of the company's market value. The study addresses this question in the context of Canadian capital markets. Specifically, it examines the research questions using as a sample the constituent firms of the S&P/TSX 60 index, which are the largest public Canadian companies.

MODELS

Boards characteristics

The first model seeks to determine whether certain characteristics of the board of directors may explain CPS.

$$CPS_{i,t} = \beta_0 + \beta_1 \, Assets_{i,t} + \beta_2 \, LEV_{i,t} + \beta_3 \, SECM_{i,t} + \beta_4 \, SECE_{i,t} + \beta_5 \, SECIF_{i,t} + \beta_6 \, FAM_{i,t} + \beta_7 \, IND_{i,t} + \beta_8 \, SIZE_{i,t} + \beta_9 \, REMA_{i,t} + \beta_{10} \, REMAA_{i,t} + \beta_{11} \, OWN_{i,t} + \beta_{12} \, TEN_{i,t} + \beta_{13} \, DUAi,t + \varepsilon \; i,t \qquad (1)$$

where

$CPS_{i,t}$ = CEO compensation divided by compensation of five top-paid executives of firm *i* six months after year-end *t*;
$Assets_{i,t}$ = Total assets of firm i at year-end t;
$LEV_{i,t}$ = Total liabilities divided by total assets of firm i at year-end t;
$SECM_{i,t}$ = Dummy variable set to one if firm i is in the mining and metals sector at year-end t, and set to zero otherwise;
$SECE_{i,t}$ = Dummy variable set to one if firm i is in the energy at year-end t; and set to zero otherwise;
$SECF_{i,t}$ = Dummy variable set to one if firm i is in the financial sector at year-end t; and set to zero otherwise;
$FAM_{i,t}$ = Dummy variable set to one if firm i is controlled by a family at year-end t; and set to zero otherwise;
$IND_{i,t}$ = The percentage of independent directors serving in the board during fiscal period t for company i;
$SIZE_{i,t}$ = The number of directors serving on the board during fiscal period t for company i;
$REMA_{i,t}$ = Total director compensation during fiscal period t for company i;
$REMAA_{i,t}$ = Directors' stock-based compensation as a percentage of their total remuneration during fiscal year t and firm i;
$OWN_{i,t}$ = The percentage of common shares outstanding held by directors in fiscal period t for company i;
$TEN_{i,t}$ = The directors' average number of years of tenure on the board in fiscal period t for company i.
$DUA_{i,t}$ = Dummy variable set to one if different individuals serve as chairman of the board and CEO in fiscal period t for company *i*, and set to zero otherwise.
$\varepsilon_{i,t}$ = error term.

Larger CPS and firm value creation

The second model examines if a larger CPS may be linked to higher firm market values. The control variables are those of Ohlson's (1995) model, total book value of the equity and net earnings. The variables associated to the hypothesis are then added to the equation.

$$MV_{i,t} = \beta 0 + \beta 1\ BV_{i,t} + \beta 2\ EAR_{i,t} + \beta 3\ CPS_{i,t} + \varepsilon\ i,t \qquad (2)$$

where

$MV_{i,t}$ = Market value of firm i six months after year-end t;
$BV_{i,t}$ = Total book value of equity of firm i at year-end t ;
$EAR_{i,t}$ = Earnings of firm i at year-end t ;
$CPS_{i,t}$ = CEO compensation divided by compensation of the five top-paid executives in firm i six months after year-end t;

RESULTS

CPS and board of directors' characteristics

The results indicate that CPS is positively related to the independence of the board of directors and negatively linked to director stock ownership. The positive link between CPS and the percentage of independent board directors could be explained by the greater dependence of outsider-dominated boards on the CEO, who has an enhanced access to information about the company. The negative relationship observed for director stock ownership could be explained by tighter controls on CEO compensation by the directors exhibiting better alignment with shareholder interests.

Table 1
Ratio of CEO vs. Top-Management Compensation

Independent Variables[1]	Coefficient	t
Constant	0.285	2.704***
Assets	-1.33E -13	-1.207
LEV	0.107	1.617
SECM	0.085	3.198***
SECE	0.020	0.812
SECIF	0.023	0.544
FAM	0.041	1.312
IND	0.177	1.796*
SIZE	-0.006	-1.196
REMA	-2.57E -9	-0.739
REMAA	-0.028	-0.824
OWN	-0.003	-3.349***
TEN	-0.004	-1.036
DUA	0.041	1.450
N		301
R^2		0.188
Adjusted R^2		0.151
Increase in adjusted R^2		0.110***

[1]$Assets_{i,t}$ = total assets of firm *i* at year-end *t*; $EAR_{i,t}$ = earnings of firm *i* at year-end *t* ; $IND_{i,t}$ = The percentage of independent directors in fiscal period *t* for company i*;* $SIZE_{i,t}$ = The number of directors on the board during fiscal period *t* for company *i*; $REMA_{i,t}$ = Total director compensation; $REMAA_{i,t}$ = Percentage of directors' compensation that is stock-based; $OWN_{i,t}$ = The percentage of common shares outstanding held by directors in fiscal period *t* for company *I*; $TEN_{i,t}$ = The directors' average-number years of tenure on the board in fiscal period *t* for company *i*.

Effect of CPS on firm value

The CPS coefficient is positive and significant at 95%. Thus, it upholds the tournament theory view, which states that greater levels of CPS can drive up firm value creation. This result may be partially explained by the nature of our firm sample. The constituents of the S&P/TSX index are the largest public Canadian corporations, with only one firm belonging to the technology sector. In large firms, compensation structures based on the tournament theory would be favored to compensate for the agency costs due to the high number of hierarchical levels (Siegel and Hambrick, 2005). Moreover, according to the same authors, the technology sector would require more collaboration. It would therefore not be conducive to the establishment of a compensation structure of the tournament type. It is worth to mention that although the result is significant and positive, the CPS explains only a fraction of the total market value of a company.

Table 2
Statistical Analysis of the Model on Company Market Value

Independent variables[1]	Expected	Coefficients	t
Constant[1]		-73 M	-0,042
BV	+	1,145	12,525***
EAR	+	3,910	6,884***
CPPS[1]	?	8 896 M	2,397**
N		301	
R^2		0.657	
Adjusted R^2		0.653	

[1]$BV_{i,t}$ = Market value of firm i six months after year-end t; EARi,t = earnings of firm i at year-end t ; $CPS_{i,t}$ = CEO compensation divided by the combined compensation of 5 top-paid executives of firm i six months after year-end t.

CONCLUSION

In conclusion, it appears that boards with a larger percentage of independent directors favor a tournament-type salary-structure, whereas those exhibiting a high director stock ownership attempt to contain CPS, confirming the fair-wage theory. The results also indicate that CPS is associated with a higher market value after considering the control variables of the model proposed by Ohlson (1996).

Research in the Canadian context ensures that the companies in mining and metals, energy and financial sectors are overrepresented. This was partially addressed by means of the inclusion of three control variables to isolate the effect of each of these sectors. It appears that the CPS would be higher in the mining and metals industry. This study opens the door to a new area of research on the responsibility of boards not only in terms of supervision, evaluation and remuneration of the CEO, but also in terms of its effective and equitable nature vis-à-vis the entire management team.

References are available upon request.