## 2016 Annual Meeting of the FIRN Corporate Finance Research Group

Venue: UNSW Business School Building, Room G26 (Ground Floor)
Date: Friday, August 5, 2016

### Welcome from Meeting Chairs - Ron Masulis and Peter Pham

On behalf of FIRN and UNSW School of Banking & Finance I am pleased to welcome colleagues to the 5th Corporate Finance Research meeting. The aims of the FIRN topic-specific research meetings are to:

- help develop the depth and quality of local research in the field;
- help develop a vibrant and collegial Australian research community
- help connect well-known international academic and journal editor with the local corporate finance community; and
- help create greater exposure of current research being conducted across FIRN institutions.

This year's meeting attracted the largest number of submissions ever which reflects the growing breath of work being undertaken by our researchers. Nine (9) very interesting papers have been selected for this year's program. Group discussion of all presentations is encouraged.

### 2016 Keynote Speaker - David Yermack

The 2016 Corporate Finance Research Group meeting international academic guest is Professor David L. Yermack. David is the Albert Fingerhut Professor of Finance and Business Transformation at New York University Stern School of Business. He serves as Chairman of the Finance Department and Director of the NYU Pollack Center for Law and Business. David teaches joint MBA - Law School courses in Restructuring Firms & Industries and Bitcoin & Cryptocurrencies, as well as PhD research courses in corporate governance, executive compensation, and distress and restructuring.

David has been with NYU Stern since 1994. His primary research areas include boards of directors, executive compensation, and corporate finance. He has published extensively with more than 25 articles in leading academic journals in Finance, Accounting, Economics, and Law. David is a Faculty Research Associate of the National Bureau of Economic Research (NBER) and a past Visiting Scholar at the U.S. Federal Reserve Bank.

David Yermack received his Bachelor of Arts in Economics (1985), Master of Business Administration (1991), Juris Doctor (1991), Master of Arts in Business Economics (1993), and Doctor of Philosophy in Business Economics (1994) from Harvard University.

FIRN is honored to welcome David as our guest presenter at this year's corporate finance group meeting. We encourage all FIRN members working across corporate finance research to take advantage of the opportunity to meet David and work with him during this meeting.

## Program

09:00 - 11:00 **Session Chair:** Petko Kalev *(University of South Australia)*

**CEO Traders and Corporate Acquisitions**
**Authors:** Henry Leung *(University of Sydney)* and Joakim Westerholm *(University of Sydney)*
**Presenter:** **Joakim Westerholm** *(University of Sydney)*
**Discussant:** **Mark Humphrey-Jenner** (*UNSW*)

**Do Directors Learn From Forced CEO Turnover Experience?**
**Authors:** Jesse Ellis *(North Carolina State University)*, Lixiong Guo *(UNSW)*, Shawn Mobbs *(University of Alabama)*
**Presenter:** **Lixiong Guo** *(UNSW)*
**Discussant:** **Buhui Qui** *(University of Sydney)*

**Investor Horizons and Bank Risk-taking**
**Authors:** Shams Pathan *(University of Queensland)*, Trent Seymour *(University of Queensland)*
**Presenter:** **Shams Pathan** *(University of Queensland)*
**Discussant:** **Joakim Westerholm** *(University of Sydney)*

11:00 - 11:30 ***Morning Break***

11.30 - 12:30 **Blockchains and the future of corporate governance**
**Keynote Address:** **David Yermack** *(Stern NYU)*

12:30 - 01:30 ***Lunch***

01:30 - 03:30 **Session Chair:** Neal Galpin *(University of Melbourne)*

**Employee Inside Debt and Firm Risk Taking**
**Authors:** Sudipto Dasgupta *(Lancaster University)*, Yupeng Lin *(University of Hong Kong)*, Takeshi Yamada *(ANU)*, Zilong Zhang *(University of Hong Kong)*
**Presenter:** **Takeshi Yamada** *(ANU)*
**Discussant:** **Chang Mo Kang** (*UNSW*)

# Program

**When Does Stock Option Compensation Undercut Firm Performance?**

**Authors:** Claire Liu (*UNSW*), Ron Masulis (*UNSW*), Jared Stanfield (*UNSW*)
**Presenter:** **Jared Stanfield** (*UNSW*)
**Discussant:** **Neal Galpin** *(University of Melbourne)*

**The Dark Side of Political Connections in Access to Finance: Evidence from the Use of Trade Credit of Entrepreneur Firms in China**
**Authors:** Nan Xu *(Southwestern University)*, Cai Jing *(Southwestern University)*, Gao Nan *(Zhongnan University)*, Gary Tian (*Macquarie University)*
**Presenter:** **Gary Tian** *(Macquarie University)*
**Discussant:** **Bohui Zhang** (*UNSW*)

03:30 - 04:00 ***Afternoon Break***

04:00 - 06:00 **Session Chair:** Mark Humphrey-Jenner (*UNSW*)

**Can Institutional Investors Improve Corporate Governance through Collective Action?**
**Authors:** Craig Doidge *(University of Toronto),* Alexander Dyck (*University of Toronto*), Hamed Mahmudi (*University of Oklahoma*), Aazam Virani (*University of Arizona*)
**Presenter:** **Aazam Virani** *(University of Arizona)* *UNSW visiting academic
**Discussant:** **Oleg Chuprinin** (*UNSW*)

**Financing Acquisitions with Earn-outs**
**Authors:** Thomas Bates *(Arizona State University),* Jordan Neyland *(University of Melbourne)*, Yoland Wang *(University of Melbourne)*
**Presenter:** **Jordan Neyland** *(University of Melbourne)*
**Discussant:** **Peter Pham** (*UNSW*)

**Corporate Litigation, Takeover Activities, and Shareholder Wealth Implications**
**Authors:** Chelsea Liu *(University of Adelaide)* and Alfred Yawson *(University of Adelaide)*
**Presenter:** **Chelsea Liu** *(University of Adelaide)*
**Discussant:** **Jared Stanfield** (*UNSW*)

06:00 - 6:30 ***Wine and Cheese Reception***
07:00 - 10:00 ***Group Dinner***

## Abstracts

### CEO Traders and Corporate Acquisitions

This paper investigates whether the personal trading decisions of CEOs are related to their corporate acquisition decisions. We find that the personal trading performance of CEOs across all stocks they trade is significantly and positively related to the short-term performance of their mergers, and that CEOs exhibiting greater turnover on their personal common equity portfolios undertake acquisitions more frequently. Hence a CEO's risk aversion, confidence and capability are consistent across their personal and corporate investment decisions.

### Do Directors Learn From Forced CEO Turnover Experience?

We study the dynamic relation between experience and monitoring. We find independent directors become more diligent monitors after experiencing a forced CEO turnover event in another firm. Specifically, their subsequent forced CEO turnover decisions are more sensitive to firm performance and are based upon more private information. The results hold when we only use experience acquired from other firms after the director joined the current firm and when we include director and firm fixed effects. Hence, our results are not driven by firm-director matching or innate director traits. We also find that such experience has important director labor market implications.

### Investor Horizons and Bank Risk-taking

We assess whether investor horizons influence bank risk-taking, and if so what tools that enable this. We find that short- (long-) term investors increase (decrease) risk-taking and substantially deter (improve) performance during the 2007-2009 financial crisis. These relations are more prevalent with competition and strong shareholders’ rights. In contrast to short-term investors, long-term investors engage in more conservative investment, financing, business and loan-monitoring activities. Long- (short-) term investors enable managerial incentives that discourage (encourage) risk-taking. For instance, long-term investors offer more inside debt to CEOs. We use two popular identification strategies – indexing and two-stage least squares – to suggest that these relations are causal.

# Abstracts

**Employee Inside Debt and Firm Risk Taking**

Using a sample of 2104 Japanese firms, we investigate the effect of employee deposits – a form of employee inside debt – on firms' risk-taking behavior. Our identification strategy utilizes a new law in 2003 that changed the priority of employee deposits in bankruptcy and led to large scale withdrawals of employee deposits. Our results indicate that firms with higher levels of employee deposits have lower total risk, systematic risk, and idiosyncratic risk, engage in less risk-taking investment, and have higher leverage. Our findings suggest that the holding of the company's debt by its employees can reduce the agency costs of debt.

**When Does Stock Option Compensation Undercut Firm Performance?**

The existing literature concludes that executive stock option compensation leads to riskier firm policies, but is mixed on whether it improves firm performance. We find that CEO stock option compensation weakens firm trading relationships with large customers. We also document that supplier CEOs receive less stock option compensation when firms have large customers, leading to improved firm performance. Using import tariff reductions as exogenous shocks to existing customer relationships, we show that the above relations are causal. Overall, this study provides insights into how firms with major customers perform better by reducing CEO option-based compensation.

**The Dark Side of Political Connections in Access to Finance: Evidence from the Use of Trade Credit of Entrepreneur Firms in China**

This paper studies the impact of political connections on firms' informal financing activities. Using the data of listed entrepreneurial firms in China, we show that connected firms have a greater difficulty in obtaining trade credit, and incur a higher cost for obtained trade credit. We also find that connected firms have more interest-bearing notes payable and less interest-free accounts payable. Our results further suggest that the impact of political connections on trade credit becomes weaker when firms locate in regions with an effective legal system. Further studies indicate the lower credit reputation of connected firms stems from two channels: (1) they typically have a higher proportion of late payment of payables (more than one year) and overdue payment of payables (more than three years); (2) they are perceived as a special group protected by government and treated with regulatory favors, which creates more obstacles to the collection of trade credit through the legal system.

# Abstracts

### Can Institutional Investors Improve Corporate Governance through Collective Action?

Can institutional investors generate sufficient power through collective action to drive improvements in governance? We use proprietary data on the private communications of a formal coalition of Canadian institutional investors and find that its private engagements influenced firms' adoption of majority voting and say-on-pay advisory votes, improved compensation structure and disclosure, and influenced CEO incentive intensity. Spillovers to non-engaged firms occur through board interlocks and to firms in which the CCGG is expected to be more powerful in a voting contest. This form of activism is both a substitute and complement to other interventions to address governance concerns.

### Financing Acquisitions with Earn-outs

We present evidence that earnout agreements in acquisitions provide a substantial source of financing to acquirers, averaging 10.71% of acquirer size. Bidders with earnouts are significantly less likely to access external debt or equity to fund acquisitions, consistent with substitution for costly external finance. However, these bids garner higher premiums, suggesting bidders compensate target shareholders for deferring payment. The use of earnouts depends on acquirers' ability to finance investment, as financially constrained acquirers are twice as likely to use an earnout as unconstrained acquirers. We also document supply-side effects, as earnouts are more likely when target parents have higher cash holdings. Overall, our evidence suggests acquirers use earnouts as part of a broader financing decision in acquisitions.

### Corporate Litigation, Takeover Activities, and Shareholder Wealth Implications

We examine the role of corporate litigation in the market for corporate control. By examining a diverse range of lawsuits filed in the U.S. Federal Courts, we document significantly different impacts of various allegations on the vulnerability of sued firms to takeovers, as well as their bidding behaviors. In particular, environmental, antitrust and intellectual property litigation deter takeovers targeting the sued firms; in contrast, securities lawsuits are associated with increased vulnerability to takeovers. In addition, environmental and securities lawsuits impede the sued firms' likelihood of acquiring other firms. These results are robust after controlling for the merit of the lawsuits, and employing a propensity score matched sample by size and industry. Further, we document significant negative shareholder wealth effects of environmental litigation in the M&A market. A bidder tends to experience more negative announcement returns, when acquiring a target that previously experienced environmental lawsuits; similarly, more negative announcement returns are experienced by target firms if acquired by bidders previously accused of environmental violations.