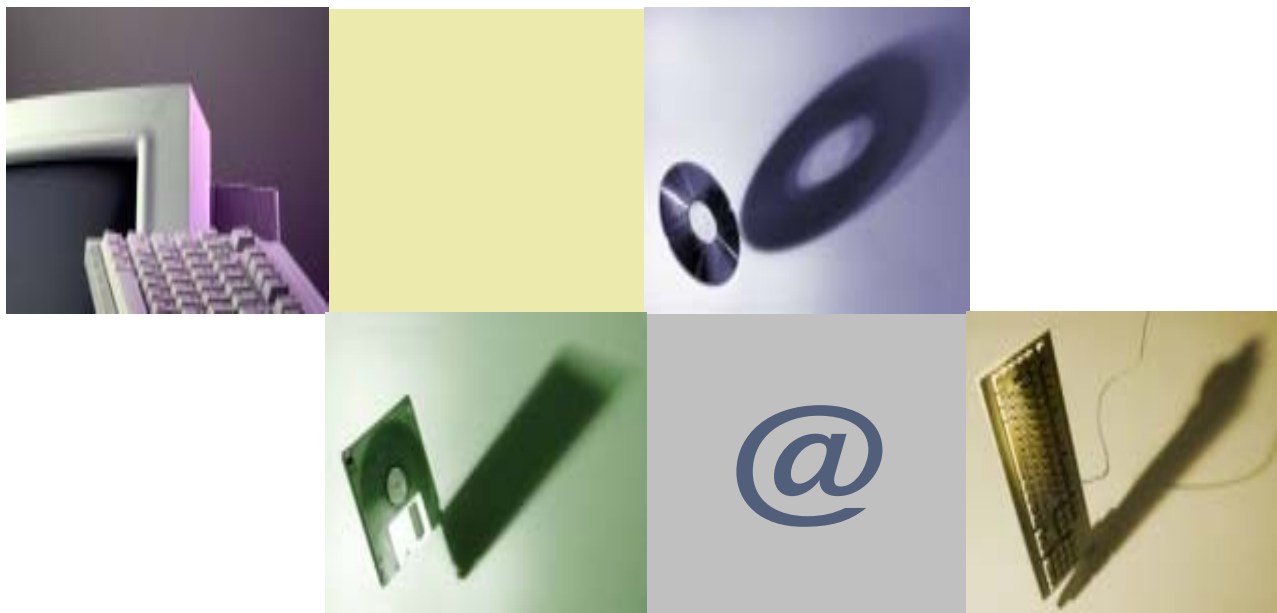


# Comment on “Explaining International Difference in CEO Contracts”



Katsuyuki Kubo

# Summary

- Explains why and when CEO incentive is (not) tied to long term performance
- Long-term incentive plan is used when 1) growth opportunity is higher and 2) reputation is important for CEO



# Summary

- When growth opportunity is high, opportunity cost of not doing long-term project is high.
- When reputation is important and transparency is high, CEOs conduct short-term project to produce early signals of their productivity.
- Hence, it is required to introduce long-term incentive plan.



# Summary-Empirical Analysis

- Firms with high growth opportunities (Market-to-Book Ratio) provide more long-term incentives in countries where more firm-specific information is provided.
- Consistent with theory.



# General Comment

- There is limited international evidence on CEO compensation.
- Few attempt has been made to explain this difference.
- Important contribution to the literature
- Many implication for empirical analysis.



# Comment/Question-1

- What is the implication on CEO's length of service?
- In a company where growth opportunity is high, long-term incentive is used. As long-term incentive is used for CEO retention, length of service would become longer as well.
- Length of service has shortened significantly in the US while stock option becomes popular.



# Comment/Question-2

- Suppose that stock market is efficient enough to incorporate the value of long-term incentive. Is long-term incentive still important? Probably No.
- In other words, in countries where stock market is efficient, there is less need for the use of long-term incentive.
- If this is true, long-term incentive is not important in countries such as the U.S. Is it correct?



# Comment/Question-3

- How long is long-term incentive?
- Long-term incentive is important because CEOs want to produce signals of their productivity.
- If it takes 3 years for outsiders to study ability of CEO, CEOs with more than 3 years experience have less incentive to produce early signals.
- Hence, it is not important to introduce long-term incentive.





# Comment/Question-4

- Why it is not optimal to sell the firm to CEO when she is risk neutral?



# Comment/Question-5

- Other interpretation on the positive correlation between stock option and growth opportunity.
- 1) Stock option is not effective when stock price is declining. In other words, stock option is used in countries when stock market is booming. If this is the case, positive relationship between stock price (market-to-book ratio) and use of stock option.
- 2) In growing firms, it is more difficult for investors to monitor CEOs. In other words, agency cost is high. Hence, stock option is used.



# Comment/Question-6

- Empirically, there are many other factors that determines the use of long-term incentive scheme, i.e. tax, accounting rules, etc.
- Can this theory explain intertemporal difference in CEO contract?
- Use of stock option increased dramatically during 80 90's in the US



Thank you very much.

