

Executive Celebrity and Shareholder Wealth

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Extant literature suggests the impact of executive celebrity on shareholder wealth can be positive or negative. Recently, the Wall Street Journal, published its inaugural ranking of the twenty-five Best CFOs. We control for systematic market factors, industrial sector effects, and cross-correlation associated with the common event date. We observe a significant decrease in shareholder returns of the ranked companies on the day of the announcement, which is consistent with many of the prior studies, but the wealth loss is reversed two days after announcement. The findings demonstrate a semi-efficient market in which investors initially react, but then revert to fundamentals.

INTRODUCTION

Executive celebrity can manifest itself in many forms, but often awards or rankings are more recognizable and common ways to denote it. The *Wall Street Journal* provides a source of executive celebrity with the inaugural publication of its list of twenty-five “Best CFOs” on July 31, 2012. This type of external recognition for individual performance and the executive celebrity that it creates, constitutes an additional input that may impact shareholder wealth. The greater the credibility of the source, the greater should be the expected influence of the recognition. The extensive readership of the *Wall Street Journal* is testament to its credibility.

We treat inclusion in the *Best CFOs* list as achievement of executive celebrity, and examine the market returns of the *BEST CFOs* companies surrounding the announcement of the *Wall Street Journal* rankings. Returns are modeled using the Fama-French (1996) 3-factor model with the Carhart (1997) momentum factor, industrial sector effects are captured by also modeling the returns on industrial-sector-matched iShares as a control group, and the *t*-statistic is modified to control for the effects of cross-correlation associated with the common event date (Kolari and Pynnönen, 2010). We observe a significant decrease in shareholder returns of the ranked companies on the day of the *Best CFOs* announcement that becomes only marginally significant on the following day and insignificant thereafter. The results suggest a partially efficient market that is temporarily influenced by the rankings, perhaps through the trading of less sophisticated investors responding to the announcement as a heuristic signal, and then subsequently corrected by the market.

The organization of this paper consists of an examination of the relevant literature, description of the sample study and methodology, analysis and findings, and conclusions drawn from the findings.

LITERATURE REVIEW

Extant literature provides a mixture of findings concerning the impact of executive celebrity on shareholder wealth. Performance rankings and awards are often viewed in a negative light. In fact, several studies find that executive celebrity destroys shareholder wealth. A study that examines executive awards from a variety of sources observes a negative effect on shareholder wealth for the three years following the award (Malmendier and Tate, 2009). Underperformance subsequent to reaching the top position in a company is commonly termed the *CEO Disease* (Byrne, Symonds, and Siler, 1991). A value-destroying trend in earnings management is found to follow the attainment of CEO awards. After reaching CEO celebrity status, earnings may be managed to exactly meet earnings forecasts, producing a more negatively skewed earnings-surprise distribution (DeGeorge, Patel, and Zeckhauser, 1999). Management influence on earnings inflation for the purpose of sustaining superstar status is more prevalent in companies with weak corporate governance. Moreover, companies with poor corporate governance are more likely to increase in the level of CEO compensation following celebrity status (Gompers, Ishii, and Metrick, 2003). CEOs who achieve celebrity status are rarely terminated, which implies that celebrity status is a means to entrenchment and power, but these companies are also more susceptible to hostile takeover (Morck, Shleifer, and Vishny, 1989).

From a different perspective, CEO awards may produce a type of *hubris* in which the CEO's life style gravitates to the *jet set*, rather than maximizing shareholder wealth (Roll, 1986; and Malmendier and Tate, 2009). Access to a corporate jet (Yermack, 2006) or the acquisition of a large mansion (Liu and Yermack, 2007) is observed to be associated with underperforming CEOs, and the performance of CEOs with celebrity status is found to be less consistent than that of non-celebrity CEOs (Adams, Alkmedia, and Ferreira, 2005). Mean reversion is also offered as a simpler reason for a decline in individual performance following outstanding success (Lazear, 2004). Beyond the realm of corporate executives, the 1970 Nobel Laureate in Economics refers to the decline in productivity of *Nobel Prize* winners as having vainglorious sterility due to the *Nobel Prize Disease* (Samuelson, 2002).

Conversely, achievement of CEO celebrity status may produce a positive impact on shareholder wealth. One such mechanism is based on the supposition that perks that accompany CEO celebrity may create value through signaling power and status within the company (Rajan and Wulf, 2006). Media exposure may also pressure celebrity CEOs to cease value-destroying behavior (Dyck, Volchkova, and Zingales, 2008). One study finds that after gaining celebrity status, CEOs are less likely to engage in earnings management, and cumulative average returns (CARs) are positive following CEO awards (Koh, 2011). Companies may also make adjustments to negate adverse performance trends pursuant to CEO celebrity status. CEO compensation may be realigned to market performance after CEO superstar status is attained to minimize the exploitation of agency opportunities (Bebchuk and Fried, 2003; Malmendier and Tate, 2009).

SAMPLE

The sample is based on the returns of the twenty-five corporations with CFOs included in the inaugural *Best CFO* list published by the *Wall Street Journal* on July 31, 2012. Returns of industrial-sector-matched iShares are also incorporated as a matched-pair control group. The inaugural *Best CFO* rankings published by the *Wall Street Journal* are cited as the result of a thorough analysis of both qualitative and quantitative factors to identify those financial managers who excel in the profession and offer major contributions to setting strategy of their respective corporations¹. In addition to a review of publicly available data, the *Wall Street Journal* notes that its analysis incorporated extensive interviews with finance recruiters and market analysts. Eligibility for the award requires that the CFO's company

have a minimum market capitalization of \$5 billion, and the CFO must have been in residency in the post for a minimum of three years.

The list of companies employing the *Best CFOs*, their chief financial officers (CFOs), and the corresponding iShare industrial sectors are displayed in Table 1. Some of the *Best CFO* companies also appear in other rankingsⁱⁱ.

Descriptive raw return characteristics of the *Best CFO* companies and their corresponding matched iShares are presented in Table 2. Panel A displays unadjusted returns for the portfolio of *Best CFO* companies and the portfolio of iShares for the estimation period ($t=-130, -11$). Panel B displays similar characteristics for three observation periods ($t=-1, 0, +1$), where $t=0$ is the publication date of the *Wall Street Journal* list of *Best CFOs*.

METHODOLOGY

The current study employs the *Wall Street Journal's* inaugural list of *Best CFOs* as a proxy of executive celebrity. The association between the achievement of executive celebrity and shareholder wealth is examined by observing post-announcement scaled, abnormal shareholder returns, for each *Best CFO* company versus its industrial-sector-matched iShare.

Daily returns are generated using the four-factor model prescribed by Fama and French (1996) and Carhart (1997), as follows:ⁱⁱⁱ

$$E(r_{i,t}) - R_{f,t} = \beta_i[E(R_{M,t}) - R_{f,t}] + s_i E(SMB_t) + h_i E(HML_t) + m_i E(MF_t) - \varepsilon_{f,t} \quad (1)$$

where $E(r_{i,t})$ is the expected daily return on company i for day t ,

β_i , s_i , h_i and m_i are the coefficients of the return model for company i for the 120-day estimation period ending eleven days prior to the announcement month of the *Best CFOs*,

$R_{f,t}$ is the Treasury Bill rate for day t ,

$R_{M,t}$ is the return on the market portfolio M for day t ,

SMB_t is the difference between the return on a portfolio of small stocks and the return on a portfolio of big stocks on day t ,

HML_t is the difference between the return on a portfolio of high book-to-market stocks and the return on a portfolio of low book-to-market stocks on day t ,

MF_t is the momentum factor found by the average return on two high prior return portfolios minus the average return on two low prior return portfolios, and

$\varepsilon_{f,t}$ is the error term.

Scaled abnormal returns are then calculated for each company for the estimation period as:

$$AR_{it} = (R_{it} - \bar{R}_{it})/s_i \quad (2)$$

Where AR_{it} is the scaled abnormal (residual) return for company i on day t ,

\bar{R}_{it} is the predicted return for company i on day t ,

R_{it} is the observed return for company i on day t , and

s_i is the sample standard deviation of daily residual returns for company i over the estimation period.

A similar procedure is used to estimate the expected returns and scaled abnormal returns for each corresponding iShare.

Incremental scaled abnormal returns for the observation periods are defined as the difference between the scaled abnormal return for each *Best CFO* company and the scaled abnormal return for its paired iShare (based on the company's corresponding industrial sector), as follows:

$$\delta AR_{it} = AR_{it(BestCFO)} - AR_{it(iShare)} \quad (3)$$

Incremental scaled abnormal shareholder returns are examined for selected cumulative observation windows surrounding the publication date of the *Best CFOs*.

A standard t -statistic for testing scaled abnormal returns is introduced by Boehmer, Musumeci and Poulsen (1991), and referred to as the BMP t -statistic:

$$t_{AR} = \frac{\overline{\delta AR}_t \sqrt{n}}{s_{\delta AR}} \quad (4)$$

where

$s_{\delta AR}$ is the sample standard deviation of the daily incremental scaled abnormal returns for each company, and

$\overline{\delta AR}_t$ is the mean of incremental scaled abnormal returns of the sample over the estimation period.

Kolari and Pynnönen (2010), however, show that event-date clustering and associated cross-correlation effects can lead to an underestimation of the cross-sectional standard deviation of incremental scaled abnormal returns, leading to false rejection of the null hypotheses of zero average incremental scaled abnormal returns. Accordingly, the t -statistic is modified to correct for this bias as follows (Kolari and Pynnönen):

$$t_{AR} = \frac{\overline{\delta AR}_t \sqrt{n}}{s_{\delta AR}} \sqrt{\frac{1-\bar{r}}{1+(n-1)\bar{r}}} \quad (5)$$

where

\bar{r} is the average sample correlation of the daily incremental scaled abnormal returns for each company over the estimation period^{IV}.

Cumulative incremental scaled abnormal returns are then defined for selected observations periods ($t=-1, j$), where $t=0$ is the date of the *Wall Street Journal* publication of the *Best CFO* list as:

$$CAR_t = \sum_{t=-1}^j \delta AR_t \quad (6)$$

RESULTS AND ANALYSIS

Event window results based on the disclosure of the 25 *Best CFO* companies are displayed in Table 3. The reported cumulative incremental return measures control for each company's specific systematic market influences, each company's specific return variance, and industrial sector trends (based on the returns on paired industrial sector iShares). The t -statistic is also corrected for a potential bias associated with the common event date. Findings indicate a significant decrease in cumulative relative shareholder returns on the *Best CFO* announcement day that is marginally significant on the following day, but subsequently insignificant thereafter^V. The results are consistent with a market that exhibits a temporary lapse in efficiency.

The interesting aspect of the finding is the question of why there would be a temporary suspension of rational behavior by the market. Presumably, the *Wall Street Journal* ranking of *Best CFOs* is based on factors comparable to those employed by other market analysts. Consequently, a reaction by the market to the announcement of the *Best CFO* rankings would imply that the *Wall Street Journal* analysis captures information missed by other market analysts. This would be an unlikely occurrence in a market so actively driven by security analysts. More importantly, the CFO rankings produced by the *Wall Street Journal* do not constitute inside information, but rather an outside source's mosaic composite estimate of the quality of management. Consequently, the rankings do not involve the scrutiny that regulators would force to be assigned to inside information.

One potential confounding influence on the sample returns is associated with a possible contaminating influence of Humana, which posted a lowered fiscal year guidance for 2012 on January 31, experiencing a large price drop on that date. We address the importance of this effect by conducting a re-examination of the study based on a sample consisting of the other twenty-four companies (see Table 4). While the strength of the findings is somewhat diminished, the findings still reveal marginally significant negative returns for the announcement day and the prior day. In revising the findings for this potentially confounding influence, we still observe an inverse relationship between executive celebrity and shareholder wealth that is marginally significant.

The reason for the temporary decrease in returns can only be speculated, given the design limits of the current study. One possibility, however, is that the temporary drop in returns may have been driven by the plethora of studies that suggest executive celebrity has a negative impact on shareholder wealth associated with earnings management (DeGeorge, Patel, and Zeckhauser, 1999), CEO disease (Byrne, Symonds, and Siler, 1991), mean reversal (Lazear, 2004), or CEO entrenchment (Gompers, Ishii, and Metrick, 2003; and Morck, Shleifer, and Vishny, 1989).

CONCLUSIONS

The current study examines the impact of executive celebrity on shareholder wealth surrounding the announcement of the July 2012, *Wall Street Journal* rankings of the *Best CFOs* of SP500 corporations. The results show a significant decrease in shareholder wealth on the day of the rankings announcement, but an effect that is quickly reversed. The decrease in shareholder returns is consistent with the findings of several prior studies on the relationship between executive celebrity and shareholder wealth, although the decrease in the current study is very short-lived.

The market's reaction to the *Best CFOs* announcement implies that the rankings, which were based on the efforts of *Wall Street Journal* analysts, disclosed additional information to investors. The quick reversal of the wealth loss, however, is consistent with a temporarily inefficient market surrounding the announcement.

ENDNOTES

- i. Wall Street Journal, July 31, 2012, Best CFOs.
- ii. For example, see: <https://www.iiresearch.net/customerService/VoterGiveBack/2012All-AmericaExecutiveTeamLeadersTable.pdf>
- iii. Returns are derived from daily closing prices, adjusted for splits and dividends, through the Wall Street Journal online website at: <http://quotes.wsj.com>. The 120-day estimation period ends eleven days prior to the announcement date with parameter estimates based on a four-factor model based on the three systematic factors introduced by Fama-French (1996) and Carhart's (1997) momentum factor. Factor data are publicly available from the Kenneth French Data Library at: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.
- iv. The value for $\hat{\rho}$ is determined as the average bivariate Pearson correlation of incremental scaled abnormal returns for the 120-day estimation period for all possible unique pairs of Best CFO companies. The average sample correlation is found to be 0.0301.

- v. All subsequent event windows (after $t=-1,+1$) ranging up to a year after the Best CFO announcement day produce an insignificant change in cumulative shareholder returns (not reported).

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TABLE 1
SAMPLE COMPANIES

| Best CFOs* | | | |
|------------|---------------------|------------------------|-----------------------------------|
| Rank | CFO Name | Ranked Company | Industrial Sector (iShare ticker) |
| 1 | Mark Loughridge | IBM | U.S. Technology (IYW) |
| 2 | Carol Tome | Home Depot | U.S. Home Construction (ITB) |
| 3 | Karen Hoguet | Macy's | U.S. Consumer Goods (IYK) |
| 4 | Stacy Smith | Intel | U.S. Technology (IYW) |
| 5 | Paul Clancy | Biogen Idec | U.S. Healthcare (IYH) |
| 6 | Kim Foster | FMC | U.S. Basic Materials (IYM) |
| 7 | James Sawyer | Praxair | Global Industries (EXI) |
| 8 | Daniel Comas | Danaher | Global Industries (EXI) |
| 9 | Dan Florness | Fastenal | U.S. Basic Materials (IYM) |
| 10 | Richard Galanti | Costco Wholesale | U.S. Consumer Goods (IYK) |
| 11 | Neil Williams | Intuit | U.S. Technology (IYW) |
| 12 | Jack Hartung | Chipotle Mexican Grill | U.S. Consumer Services (IYC) |
| 13 | Jeff Edwards | Allergan | U.S. Healthcare (IYH) |
| 14 | Patricia Yarrington | Chevron | U.S. Oil & Gas Explor Prod (IEO) |
| 15 | Rob Knight | Union Pacific | Transportation Average (IYT) |
| 16 | Ann Marie Petach | BlackRock | U.S. Financial Services (IYG) |
| 17 | Byron Pollitt | Visa | U.S. Financial Services (IYG) |
| 18 | Bill Giles | AutoZone | U.S. Consumer Goods (IYK) |
| 19 | James Bloem | Humana | U.S. Healthcare Providers (IHF) |
| 20 | Ted Crandall | Rockwell Automation | Global Industries (EXI) |
| 21 | Judy Brown | Perrigo | U.S. Healthcare (IYH) |
| 22 | Patricia Bedient | Weyerhaeuser | U.S. Basic Materials (IYM) |
| 23 | David Wajsgras | Raytheon | U.S. Aerospace & Defense (ITA) |
| 24 | David Goulden | EMC | U.S. Technology (IYW) |
| 25 | Mark Dentinger | KLA-Tencor | U.S. Technology (IYW) |

*Source: *Wall Street Journal*, July 31, 2012.

TABLE 2
SAMPLE CHARACTERISTICS

Panel A displays descriptive sample characteristics for the 120-day estimation period ending eleven days prior to the publication of the *Wall Street Journal Best CFOs*. The characteristics reflect raw daily returns (r) for the twenty-five stock portfolio comprised of *Best CFO* companies and the corresponding measures for the portfolio comprised of industrial-sector-matched iShares (in percent).

Panel B presents similar characteristics for each of three observation periods ($t=-1, 0, +1$), where $t=0$ represents the publication date of the *Best CFOs* by the *Wall Street Journal*.

Portfolio mean / (portfolio standard deviation)

Panel A: Estimation period returns

| t | $r_{BestCFOs}$ | $r_{iShares}$ |
|------------|-----------------|-----------------|
| (-130,-11) | 0.037 / (0.951) | 0.016 / (0.991) |

Panel B: Observation period returns

| t | $r_{BestCFOs}$ | $r_{iShares}$ |
|------|------------------|------------------|
| (-1) | -0.268 / (0.776) | -0.228 / (0.407) |
| (0) | -1.350 / (2.579) | -0.448 / (0.686) |
| (+1) | -0.550 / (1.869) | -0.485 / (0.467) |

TABLE 3
EVENT PERIOD RETURN RESULTS: FULL SAMPLE

CAR_{it} is the cumulative incremental scaled abnormal returns for the portfolio of each *Best CFOs* companies less that of its industrial-sector-matched iShare (CAR_{it}). The date the *Best CFOs* are announced by the *Wall Street Journal* is $t=0$. The t -statistic is corrected for cross-correlation bias associated with the common event date (average Pearson $r = .0301$).

Mean / (Standard Deviation)

n = 25 company vs iShare matched pairs

| Event Window | $CAR_{it} / (S_{CAR})$ | t -statistic |
|--------------|------------------------|----------------|
| $t=-1,-1$ | -0.206 / (1.286) | -0.593 |
| $t=-1,0$ | -1.201 / (2.112) | -2.095 * |
| $t=-1,+1$ | -1.352 / (2.440) | -2.047 # |
| $t=-1,+2$ | -0.730 / (3.250) | -0.830 |

**p<.01

*p<.05

#p<.10

TABLE 4
EVENT PERIOD RETURN RESULTS: SAMPLE EXCLUDING HUMANA CORP

CAR_{it} is the cumulative incremental scaled abnormal returns for the portfolio of each *Best CFOs* companies less that of its industrial-sector-matched iShare (CAR_{it}) with Humana Corp. excluded. The date the *Best CFOs* are announced by the *Wall Street Journal* is $t=0$. The t -statistic is corrected for cross-correlation bias associated with the common event date (average Pearson $r = .0315$).

| Mean / (Standard Deviation) | | |
|--|------------------------|----------------|
| n = 25 company vs iShare matched pairs | | |
| Event Window | $CAR_{it} / (S_{CAR})$ | t -statistic |
| $t=-1,-1$ | -0.225 / (1.310) | -0.608 |
| $t=-1,0$ | -1.000 / (1.906) | -1.857 # |
| $t=-1,+1$ | -1.262 / (2.450) | -1.822 # |
| $t=-1,+2$ | -0.580 / (3.230) | -0.635 |

**p<.01 *p<.05 #p<.10