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AN ANALYSIS OF FOUNDER-CEOS’ AND SALARIED CEOS’ SHORT-TERM INVESTMENT BEHAVIOR UNDER CONSIDERATION OF ASPIRATION LEVELS (SUMMARY)

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AN ANALYSIS OF FOUNDER-CEOS’ AND SALARIED CEOS’ SHORT-TERM INVESTMENT BEHAVIOR UNDER CONSIDERATION OF ASPIRATION LEVELS

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Principal Topic

Due to shorter CEO tenures, capital market pressure and highly frequented earnings reports, there are little incentives for salaried CEOs to pursue long-term strategies. In contrast to salaried CEOs, founder-CEOs normally have a longer decision horizon, higher ownership percentage and are more independent, e.g. in terms of their reputational status. According to their long-term personal affiliation to the company, they are intrinsically motivated and, likely, more emotionally attached. This raises the question whether founder-CEOs are more long-term- and value-oriented and, consequently, run companies less myopic than salaried CEOs.

“Managerial myopia” is regarded as the preference of managers to choose projects or strategies with immediate revenues over long-term oriented projects and strategies that will generate future earnings. It is mainly associated with cuts in R&D or other long-term related investments at the expense of the company’s future value. CEOs have different motivations to behave myopically, e.g. to pursue companies’ short-term goals or to maximize their own utility. In the latter, they have personal incentives to underinvest, e.g. signaling effects towards the job market, improvement of their negotiating position for salary, deterioration of the successor’s position or other opportunistic reasons. We are focusing on the case of CEOs trying to achieve the company’s earnings target by using last year’s earnings as “aspiration level”. Prior studies prove that managers try to avoid earnings decreases compared to last year.

Method

Over a period of twenty years and on the basis of Standard & Poor’s 1500, we analyze whether founder-CEOs invest less myopic compared to salaried CEOs. We use the databases Compustat for company financials and Execucomp for CEO and other company specific data. We hand-collect data on the CEO founder status. Of special interest for the analysis are cuts in R&D expenses whenever a company’s performance falls below its own “aspiration levels”. Following Bushee (1998), we divide the sample into three subsamples, depending on the relationship of earnings before taxes and R&D and prior R&D levels.

Results and Implications

Our findings show that CEOs exhibit myopic investment behavior by cutting R&D expenses to meet short-term earning’s goals. Founder-CEOs don’t seem to be fully immune to managerial myopia in the case of low R&D cuts and small earnings decreases. Further research will be conducted on whether founder-CEOs behave less myopically when it comes to deeper and value diminishing cuts. Settings with other motivations to behave myopically could shed more light on differences in investment behavior of founder- and non-founder-CEOs.

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