CEO COMPENSATION AROUND SPINOFFS

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ABSTRACT

This study examines whether CEO compensation decreases in response to the reduction in firm size after a corporate spinoff. Overall, CEO pay reduces after the spinoff, consistent with efficiency theory. However, the decrease is driven by the pay adjustment accompanying CEO turnover around the spinoff. New CEOs hired around the spinoff have little bargaining power regarding their compensation, and thus a decline in CEO compensation around these spinoff events is observed. The compensation of those CEOs who span the spinoff event does not decrease, consistent with the notion of CEO entrenchment.

INTRODUCTION

As a general rule, the bigger the corporation, the higher the CEO's pay (Murphy, 2012). For example, S&P 500 CEOs earned $12 million on average, compared with $3 million earned by mid-market CEOs in 2015 (Seidman, 2015). Bigger firms are more complex and, thus, harder to manage. Therefore, the CEOs of larger firms are compensated more than those of smaller and less complex firms (Custodio et al., 2010). Since bigger firms are harder to manage, they require a higher quality CEO vis-a-vis a smaller firm. Thus, it is no surprise that the best CEOs tend to run the largest firms (Gabaix & Landier, 2006).

The longer a CEO stays with a firm, the more entrenched they become (e.g., Boyd, 1994; Mace, 1986). This entrenchment often gives rise to the classic agency problem when CEOs use their influence on the compensation committee to obtain a more favorable total compensation package independent of their efforts to earn higher returns on shareholders' investments (Bebchuk & Fried, 2003).

The previously documented association between firm size and CEO compensation motivates us to consider how parent firm CEOs' compensation changes in a spinoff event. A spinoff distributes the shares of a subsidiary to the shareholders of the parent firm on a pro-rata basis. A corporate spinoff is one of several ways a firm can divest its assets. Unlike asset sell-offs or carve-outs that exchange the subsidiary for cash with another entity or in the public market and keep the parent firm assets at a similar level, spinoffs reduce parent firm size tremendously. On average, spinoffs lead to a 30% decrease in parent firm size (Eckbo, 2008).

We utilize spinoffs as an opportunity to disentangle the impacts of firm size and CEO power on CEO compensation to test competing theories of CEO compensation. The firm size always decreases after a spinoff. However, the CEO might stay after the spinoff or might

turnover and be replaced by a new CEO after the spinoff. Alternatively, a new CEO could be brought in to execute the spinoff. Because different theories predict different movement directions of CEO compensation regarding firm size and CEO power, we examine various scenarios of changes of CEO around spinoffs to contribute to the discussion on determinants of CEO compensation.

Over a sample period of 1994-2006, we find that about 50% of spinoffs accompany CEO turnover. In light of the entrenchment literature, we hypothesize the following relationships between CEO characteristics and CEO compensation around spinoffs. We predict a smaller drop in CEO compensation for a long-term CEO who initiates and completes a spinoff (and the CEO stays with the post-spinoff company) than for a newly hired CEO (who initiates and completes the spinoff and stays) or a CEO who leaves shortly after completing the spinoff. Accordingly, we classify the spinoff events in the sample into four categories: (1) Spanners, (2) Completers, (3) Initiators, and (4) Others. "Spanners" are those spinoff events in which the CEO, who has held their position with the parent firm for at least five years, initiates a spinoff, completes it, and then holds their position for at least another five years. "Completers" are those spinoff events in which the CEO, who has held their position with the parent firm for at least five years, initiates a spinoff and completes it, and then leaves their position within one year. "Initiators" are those spinoff events in which the CEO initiates a spinoff in their first year of tenure, completes it, and then stays with the firm for at least another five years. "Others" are those spinoff events that do not fall into the spanner, completer, or initiator categories.

The findings suggest that spinoffs with or without CEO turnover have significantly different effects on CEO compensation. In the whole sample, CEO compensation falls significantly following a spinoff event as hypothesized (controlling for other factors). However, this fall in total compensation is driven by the completer and initiator groups in the sample. The spanners do not see a drop in their total compensation surrounding the spinoff event. The spanners, by definition, are those longer-term CEOs who are more entrenched and, therefore, likely have more bargaining power and influence on their compensation committees. It is speculated that these CEOs agree to do the spinoff only upon the condition that their total compensation does not decline.

The contributions of this paper are twofold. First, this paper contributes to the CEO compensation literature by offering evidence regarding how CEO entrenchment affects CEO compensation in the context of spinoffs. To the best of our knowledge, this is the first paper to show that the change in parent firm CEO compensation around spinoffs is a function of whether or not the CEO is a spanner or completer/initiator. Second, this paper contributes to the CEO power literature by testing a new way of disentangling compounding factors pertinent to CEO power. We measured CEO power by both CEO tenure and CEO changes around spinoffs.

The remainder of the paper is organized as follows. The literature review section synthesizes the relevant related research, followed by hypothesis development. The following section summarizes the sample selection procedure and the data used to test the hypotheses. The results from the data analysis are then presented, followed by a discussion of the robustness tests. A summary of the conclusions is provided in the last section.

RELATED RESEARCH

CEO Compensation

Two theories exist in CEO compensation: efficiency theory and agency theory. Efficiency theory argues that compensation contracts are efficient in linking CEOs' motivation to shareholders' interests. The market equilibrium matches the best CEOs to the largest firms (Gabaix & Landier, 2006). Many prior studies (Lazear & Rosen, 1981; Lucas Jr., 1978; Rosen, 1982; Tervio, 2008) predict and find that CEO pay increases with firm size. Agency theory is motivated by CEO selfishness. CEOs are assumed to use all methods at their disposal to maximize their own compensation. For example, Bebchuk and Fried (2003) find that CEOs are not paid for performance. Specifically, their compensation contracts shield them from poor performance. Frydman and Jenter (2010) suggest that both competitive market forces and managerial power are principal determinants of CEO pay, but neither of them alone can explain the situation. The result of this study is consistent with their opinion. We find that when the agency problem is severe, it dominates CEO pay composition. However, the positive relationship between firm size and CEO compensation holds when a CEO is less entrenched and has less power (e.g., a newly hired CEO). Several studies recognize that CEOs undertake mergers and acquisitions as a way of empire-building (e.g., Jensen, 1986; Morck et al., 1990). Hartzell et al. (2004) study the benefits received by target CEOs in completed mergers and acquisitions. They find that target CEOs negotiate large cash bonuses and golden parachutes. The excess payment is negatively associated with the likelihood that the CEO will become the CEO of the acquiring firm. Darrough et al. (2014) investigate how goodwill impairment affects CEO compensation. Goodwill impairment is a signal of merger and acquisition failure and a major reason firm size falls. They find that CEO compensation decreases when the fair values of acquired business units are written down. Gilson and Vetsuypens (1993) find that in financially distressed firms that went bankrupt or private, CEOs experienced a 35% salary and bonus reduction. However, outside replacement CEOs are typically paid 36% more than their predecessors. Some scholars use employee numbers as the proxy of firm size. Hallock (1998) examined the association between layoffs and CEO pay. He found that CEOs are paid more in the year after the firm announces a layoff. Similarly, Chemmanur and He (2016) find that CEOs receive extra compensation in the year of a spinoff. It is interesting to see that in some contexts, when firm size decreases, CEO pay increases, while in other cases, CEOs have to accept the cut of their pay following a drop in firm size. This study examines what happens to CEO compensation around a spinoff, both in the presence and absence of CEO turnover. This study is also different than these previous studies in that it delineates categories of CEOs based on how long they have been with the firm and how long they stay post-spinoff. This classification helps capture their level of entrenchment and hopefully can delineate between the agency versus efficiency theories regarding a prediction of how their compensation will change.

Spinoffs

Prior studies document positive abnormal returns from 1.7% to 5.6% for parent firms around spinoff announcements (e.g., Eckbo, 2008; Hite & Owers, 1983; Miles & Rosenfeld, 1983) and positive post-spinoff long-run performance for both parents and spun-off subsidiaries (e.g., Ahn & Denis, 2004; Cusatis et al., 1993; Desai & Jain, 1999). Based on empirical research, potential sources of gains from spinoffs include: (1) improved focus, (2) elimination of negative synergies, (3) information asymmetry reduction, (4) tax and regulatory advantage, (5) wealth transfer from credit holders to stockholders, (6) a positive clientele effect, (7) better corporate governance, and (8) increased probability of takeover. Particularly, Desai and Jain (1999) find that abnormal returns around the announcement period and in the long run are both significantly higher for the focus-increasing spinoff parents than the non-focus-increasing spinoff parents. Allen et al. (1995) use the takeover loss as an indicator of negative synergy and find that spinoff gains can be explained by the shareholder value destroyed at the earlier time of acquisition. Krishnaswami and Subramaniam (1999) find that spinoff announcement returns are higher for firms with a higher level of information asymmetry, and the spinoff tends to reduce such information gap. Schipper and Smith (1983) argue that the gains to shareholders may partially arise from tax and regulatory advantages. They build a sub-sample of firms that change contracts with the Internal Revenue Service (IRS), labor unions, and rate regulators and find that those firms have positive abnormal returns around the spinoff, consistent with their proposition. Parrino (1997) employs a case study and documents a wealth transfer from bondholders to stockholders. Specifically, he observes a significant drop in bond values and a significant rise in stock prices concurrently. Chemmanur and He (2016) find large imbalanced tradings of institutional investors in the post-spinoff parent and subsidiary stocks, suggesting a clientele effect. Ahn and Denis (2007) view a spinoff decision to be associated with more effective corporate governance. A spinoff may also increase the probability of both parents and subsidiaries becoming takeover targets (Cusatis et al., 1993).

The literature has picked up spinoffs as a setup to study possible changes in CEO compensation around spinoffs. Parent CEOs get extra compensation in the year of undertaking a spinoff. (Chemmanur et al., 2014; Fich et al., 2014). Spun-off CEOs who were parent CEOs receive higher compensation than their peers (Pham, 2020). Feldman (2016) found that spinoffs better align management's incentive compensation with the spinoff firms' stock market performance, but not that of the parent firms.

The above-mentioned papers do not discuss the incentives of various-tenure CEOs around a spinoff. The CEO is very influential in a spinoff context, and if they know their compensation will fall due to a decline in their firm's size (there is less to manage), why would they ever agree to engage in a spinoff? This study indirectly examines this question by dividing a sample of spinoff events into four categories based on how long the CEO has been with the firm and how long they remain with the firm post-spinoff. The one category of CEOs who are expected to be more entrenched ("spanners") do not exhibit a fall in total compensation surrounding the spinoff, while the other CEOs who are less entrenched and do not have as much

bargaining power do see a significant decline in their total compensation post-spinoff controlling for other factors.

HYPOTHESIS AND METHODOLOGY

According to the characteristics of spinoffs and CEO turnover, this study categorizes four types of CEOs in the sample. "Spanners" are those spinoff events in which the CEO, who has held their position with the parent firm for at least five years, initiates a spinoff, completes it, and then holds their position for at least another five years. "Completers" are those spinoff events in which the CEO, who has held their position with the parent firm for at least five years, initiates a spinoff and completes it, and then leaves their position within one year. "Initiators" are those spinoff events in which the CEO initiates a spinoff in their first year of tenure, completes it, and then stays with the firm for at least five years. "Others" are those spinoff events that do not fall into the spanner, completer, or initiator categories.

As the previously discussed prior literature points out, a spinoff decreases the firm size, leading to a smaller and less complex firm to manage. The efficiency theory suggests that CEO compensation is aligned with the interests of shareholders through efficient contracting (Gabaix & Landier, 2006). Empirical studies have documented a direct correlation between CEO compensation and firm size (Lazear & Rosen, 1981; Lucas Jr., 1978; Rosen, 1982; Tervio, 2008). Firm size decreases after a spinoff. Based on the efficiency theory of CEO compensation and the decrease in firm size after a spinoff, the main hypothesis, in the alternative form, is:

H1: Parent-firm CEO compensation will decrease following a spinoff.

H1 is expected to hold for the entire sample and for each of the spinoff event sub-sample categories.

A competing alternative to the efficiency theory is the agency theory of CEO compensation. The agency theory posits that CEOs are selfish individuals who maximize their own pay at the expense of shareholder interests (Boyd, 1994; Tosi & Gomez-Mejia, 1989). CEOs use their power to extract greater compensation for themselves through their influence over the compensation committee and the compensation contracts (Bebchuk & Fried, 2003). Spanners are more entrenched and have more power than completers and initiators. Since spanners are more likely to influence the board and the CEO compensation committee, their compensation may be less affected by the spinoff event than the compensation for completers or initiators. Thus, the second hypothesis, stated in the alternative form, is:

H2: Parent-firm spanner CEO compensation will decrease less than completer and initiator CEO compensation following a spinoff.

The following model is employed to test the hypotheses:

$$\begin{aligned}\text{TotalComp} &= \beta_0 + \beta_1\text{Spinoff} + \beta_2\text{Post} + \beta_3\text{Post} * \text{Spinoff} + \beta_4\text{Post} * \text{Size} \\ &+ \beta_5\text{Post} * \text{Size} * \text{Spinoff} + \beta_6\,\text{Size} + \beta_7\text{MV} + \beta_8\text{MB} + \beta_9\text{ROA} + \beta_{10}\text{DebtRatio} \\ &+ \beta_{11}\text{Tenure} + \beta_{12}\text{Age} + \beta_{13}\text{FirmAge} + \beta_{14}\text{Herf} + \varepsilon \qquad (1)\end{aligned}$$

Where *TotalComp* is the total compensation of the CEO in either the year before the spinoff announcement date or in the year after the spinoff effective date. *Post* is an indicator variable equal to one if the other variables are measured one year post-spinoff and zero if they are measured one year pre-spinoff. *Spinoff* is an indicator variable equal to one if the firm is a spinoff firm and zero if it is a control firm. The other variables are control variables and are defined in Table A1 in Appendix A. The coefficient of interest in equation (1) is β_3. H1 hypothesizes $\beta_3 < 0$. That is, relative to a control group matched in size and total compensation of the CEO (see description in the next section), the total compensation of CEOs is expected to fall after a spinoff. H2 hypothesizes that the β_3 from estimating equation (1) with the completer and initiator sub-samples should be smaller than that from estimating equation (1) with the spanner sub-sample. Size is controlled in equation (1) because the spinoff reduces the parent firm size by definition, and total compensation should fall accordingly. We are interested in comparing the relative drop in total compensation between the subgroups while controlling for size.

Sample Selection and Data Description

The initial spinoff sample was drawn from the Security Data Corporation's (SDC) Mergers and Acquisitions (M&A) database. Each spinoff observation from SDC was compared with those in the US Securities & Exchange Commission's (SEC) Electronic Data Gathering, Analysis and Retrieval (EDGAR) database or with those in the Center for Research in Security Prices (CRSP) event database. This comparison helps verify the occurrence of each spinoff and the incentive to spinoff if managers mention the reason in 10-K, 8-K, or S-1/3 filings. If the corresponding spinoff event was not found in EDGAR or CRSP, we employed a Google search to determine how the media reports the spinoff motive when quoting the managers' statements. We only kept those spinoffs listed in the SDC and shown at least once among SEC, CRSP, and Google searches. All sample firms' and control firms' characteristics (e.g., total assets) were obtained from COMPUSTAT. Companies' segment information came from the COMPUSTAT historical segments database. Firms' market performance was obtained from CRSP. We collected CEO compensation and tenure information from EXECUCOMP.

We started with 1,029 completed spinoffs in SDC over the sample time period 1994-2006. We stopped in 2006 because FAS 123R took effect in 2006, which requires companies to expense share-based equity compensation to employees. The literature (e.g., Hayes et al., 2012) suggests that firms significantly reduced their usage of stock options in CEO compensations after the adoption of FAS 123R. More specifically, Skantz (2012) found evidence that the reduction in CEO pay was greater for CEOs who had less power after FAS123R. FAS 123R was a significant exogenous shock on CEO compensation and the relation between CEO power and CEO compensation, so the relation between CEO power and CEO compensation may not be comparable before and after FAS 123R. We then matched these spinoff events with the CRSP event database. If a spinoff was also included in CRSP with a distribution code of 3762, 3763, 3764, or 3765, the spinoff should be considered an effective one. If the spinoff event was not found in CRSP, we then searched EDGAR. If a related 8-K, 10-Q, or 10-K proves the existence

of the spinoff, the observation is kept. If the spinoff was not found in EDGAR, a Google search of "spinoff" was performed with the firm name and spinoff year given by SDC. If Google results showed clearly that such a spinoff was actually an asset sale, the observation was excluded. We found that the SDC database had 222 mistakes in recording a "spinoff."[23] We then excluded private parent firms as they are neither in CRSP nor COMPUSTAT. SDC considers over-the-counter firms as public firms (e.g., pink sheet firms), but we also removed those. Then the remaining sample was merged with EXECUCOMP. Two-thirds of the sample was lost here since EXECUCOMP only contains S&P500 CEO compensation information. The final sample consisted of 244 completed spinoffs over the period 1994-2006.[24] Table 1 summarizes the sample selection procedure.

Table 1
Sample Selection

Sample Selection Step	**# of Spinoff Event**
SDC (Completed spinoffs from 1994-2006)	1029
Minus: SDC mistakes (e.g., asset sales classified as spinoffs.)	(222)
Clean Data in SDC	807
Minus: Parent firms not public (merge with CRSP)	(106)
SDC/CRSP	701
Minus: Missing in Compustat (merge with Compustat)	(6)
SDC/CRSP/COMPUSTAT	695
Minus: Missing in Execucomp	(451)
SDC/CRSP/COMPUSTAT/EXECUCOMP	244

The spinoff event samples were divided into four categories by parent firm CEO type as described earlier. These categories are summarized in Table 2. Table 3 summarizes the CEO's tenure at the announcement date and after the spinoff, as well as the spinoff processing time. The average pre-spinoff tenure of the spanners in the sample was 12.14 years versus 8.03 years for the completers and 0.61 years for the initiators. Also, spanners are with the firm 11.65 years after completing the spinoff on average versus 0.81 years for completers and 7.07 years for initiators.

[23] We cross-checked all 1,029 initial spinoff events from SDC and found 222 cases where an event was coded as a `spinoff` by SDC but really was not a spinoff event. Some of these cases were an asset sale, some of these were duplicates of actual spinoff events, some were exchange offers, etc.

[24] Execucomp provides data on a three-year lagged rolling window. Thus, when merged with Execucomp (for the compensation data), the Execucomp data ended in 2009.

Table 2 Spinoff Event Categorization		
Type	**Sample Size**	**Description**
Spanners	73	CEOs who have held their position for at least five years before the spinoff (-5 years) and stay at least five years after the spinoff (+5 years)
Completers	62	CEOs who have held their position for at least five years before the spinoff year (-5 years) and leave within a year post-spinoff (+1 year)
Initiators	34	New CEOs who initiate a spinoff in their first year of tenure (-1 year) and stay at least five years after the spinoff (+5 years)
Others	75	CEOs who do not fit into the above three categories. Some examples are: (1) Former CEOs announced the spinoffs, but new CEOs processed the events. (2) The board hired an outsider CEO to turn around the company, and the CEO left the company very soon. A turnaround CEO usually works for the company in a very short period.
Total	244	

Table 3 CEO Tenure around Spinoffs			
Type	**Tenure at the Spinoff Announcement Date**	**Spinoff Processing Time (Effective Date – Announcement Date)**	**Tenure after the spinoff**
Spanners	12.14 years	0.57 years	11.65 years
Completers	8.03 years	0.67 years	0.81 years
Initiators	0.61 years	0.64 years	7.07 years
Others	2.81 years	0.56 years	6.14 years

The largest group of spinoff CEOs are spanners (long-term CEOs), which include 73 individuals. Completers (old CEOs) finish the spinoff, leave the firms, and represent 62 of the spinoff events. Only 34 initiators (newly hired CEOs) spin off a subsidiary in the first year of their tenure with the parent firm. Analyzing the 75 other spinoff events, we find that many are parent firm CEOs who spin off a firm within the first 2-4 years of their tenure but do not leave within a year following the spinoff effective date. Also, several of the spinoff events are spinoffs that occur during CEO transit, in which the old CEO announces the spinoff but then leaves before the spinoff effective date, and the new CEO completes the spinoff. It is difficult to decide whether to attribute these spinoffs to the new or old CEO. In addition, several spinoff events classified in the other category have interim CEOs surrounding the spinoff announcement and effective dates.

Table 4 reports descriptive statistics for the variables that are used in the study for both the spinoff event parent firms and the matched forms in testing the hypotheses. For each spinoff event parent firm, we choose a control firm that is within +/-10% in size (total assets) in the year prior to the spinoff event and with the closest total CEO compensation to the parent firm. Table 4 Panel A reports descriptive statistics before the spinoff. The mean firm size in the year before the spinoff for the spinoff event (control) firms was $16.7($16.2) billion, and the mean total compensation for the spinoff event (control) firms was $6.34($5.97) million. Neither difference

was statistically significant. The pre-spinoff differences in the mean descriptive statistics between the spinoff and control firms for the other control variables are largely insignificant as well, indicating a well-matched treatment and control group. Some exceptions exist between the completer group and its control group regarding CEO tenure and age, the return on assets between the initial group and the control group, and the firm age of the other group and its control group.

Table 4 Panel B reports descriptive statistics after the spinoff. As expected, the size of the spinoff firms is significantly smaller than the size of the matched control firm post-spinoff. Total compensation insignificantly differs between spinoff firms and their matched firms.[25] Initiators have much shorter tenure than matched control firms by construction, as we define these as newly hired CEOs. Initiators are also younger than CEOs in their control group. As expected, the tenure of CEOs in the completer group is significantly shorter than that of CEOs in the control group, as completer CEOs left the firm within one year after the effective date of the spinoff. The firm age of the firms in the other group is smaller than firms in the control group.

[25] The total compensation of spinoff event sample of CEOs during the spinoff year is excluded to avoid additional noise.

Table 4
Descriptive Statistics[26]

Panel A: Descriptive Statistics for Spinoff Firms and Control Firms in the pre-spinoff Years										
Variable	**Spanner (N=73)**	**Control (N=73)**	**Completer (N=62)**	**Control (N=62)**	**Initiator (N=34)**	**Control (N=34)**	**Others (N=75)**	**Control (N=75)**	**Whole (N=244)**	**Control (N=244)**
TotalComp	6,696	6,343	6,999	6,641	4,122	4,283	6,437	5,773	6,337	5,965
Size	19,248	19,353	21,117	19,762	10,350	9,992	12,902	12,610	16,650	16,195
MV	19,567	28,339	17,442	19,657	10,458	14,158	12,002	10,490	15,636	18,929
MB	1.7	1.93	1.96	1.93	1.94	2.05	2	2.19	1.89	2.02
ROA	0.052	0.041	0.054	0.061	0.000*	0.053*	0.039	0.053	0.035	0.051
DebtRatio	0.24	0.23	0.28	0.26	0.23	0.22	0.27	0.28	0.26	0.25
Tenure×	8.52	7.64	7.54*	4.19*	3.86	5.65	3.28*	6.05*	6.04	5.91
Age	57.5	57.45	58.33*	55.94*	59.44	54.88	55.27	56.43	57.28	56.39
FirmAge	28.41	28.80	32.70	29.13	29.75	31.21	32.77*	26.61*	30.14	29.72
Herf	0.56	0.52	0.61	0.51	0.6	0.45	0.59	0.48	0.59	0.5
Panel B: Descriptive Statistics for Spinoff Firms and Control Firms in the post-spinoff Years										
Variable	**Spanner (N=73)**	**Control (N=73)**	**Completer (N=62)**	**Control (N=62)**	**Initiator (N=34)**	**Control (N=34)**	**Others (N=75)**	**Control (N=75)**	**Whole (N=244)**	**Control (N=244)**
TotalComp	7,514	8,110	5,185	8,626	4,598	8,676	7,366	6,856	6,454	7,979
Size	14,020	25,534	12,088	25,144	8,872	10,535	11,112	16,674	11,951*	20,836*
MV	15,045	36,393	5,593	21,673	9,650	13,818	7,169	10,870	9,540	22,169
MB	1.77	1.92	1.82	1.92	1.86	1.98	2.05	1.79	1.88	1.89
ROA	0.024	0.027	0.023	0.018	-0.034	0.045	0.028	0.013	0.004	0.030
DebtRatio	0.24	0.24	0.32*	0.25*	0.25	0.2	0.31	0.27	0.28	0.25
Tenure××	10.98	7.02	0.85*	4.91*	2.81*	7.54*	3.75*	5.66*	4.81*	5.98*
Age	59.35	56.98	53.51	55.38	54.73*	56.05*	55.6	54.9	55.98	55.88
FirmAge	30.93	31.85	35.34	31.74	32.30	36.30	35.23*	29.08*	32.72	33.24
Herf	0.58	0.58	0.61	0.63	0.67	0.64	0.57	0.62	0.6	0.61

Note: × Tenure of CEO at one year before the spinoff (-1 year); ×× Tenure of CEO at one year after the spinoff (+1) year. * Indicates significant differences between the spinoff group and the control group at the P-value <.05 level.

RESULTS

A preliminary spinoff event test is executed to calculate the cumulative abnormal returns (CAR) over a three-day window (-1, +1) surrounding the spinoff announcement date (day 0). Table 5 summarises the results. We employ the standard single-factor return model to calculate the beta for each parent firm by regressing the parent firm's most recent 250 trading days of returns prior to the spinoff announcement date on the daily market returns over this same time

[26] We run a series of t-tests to compare the four different groups in pairs of both pre and post-spinoffs. Most of the results are not statistically significant. By definition, the tenures of CEOs are different around the spinoffs. Spanner CEOs are significantly older than completer CEOs. The debt ratios of the completer groups are significantly greater than the initiator group.

period. We then use the fitted coefficients, the estimated beta, and the actual daily market return to estimate the expected return for the parent firm over each of the three days surrounding the spinoff announcement (-1, 0, +1). Next, we calculate the abnormal return for each of the three days by subtracting the expected return from the actual return. Then we sum these abnormal returns to arrive at the CAR for the three-day window (-1,+1) for each parent firm spinoff event. Finally, we calculate the mean and median of the parent firm spinoff event three-day CARs for the four categories of spinoff events. T-statistics for two-tailed hypothesis tests of mean difference from zero are reported below their respective means. In the second part of the table, we tabulate the difference in means and medians for each unique pair of spinoff event categories. T-statistics for two-tailed hypothesis tests of the difference in means for each unique pair of spinoff event categories are reported below their respective differences, and ***(**) (*) represent statistical significance at the 1% (5%) (10%) levels, respectively.

Table 5
Spinoff Announcement Abnormal Returns

Spinoff Event Category	**Sample Size**	**Mean CAR**	**Median CAR**
Whole	244	2.75%***	2.51%
		(5.25)	
Spanners	73	2.39%***	2.30%
		(2.99)	
Completers	62	4.68%***	3.59%
		(4.24)	
Initiators	34	4.08%***	3.56%
		(4.14)	
Others	75	0.84%	1.96%
		(0.77)	
		Diff. in Means	Diff. in Medians
Spanners vs. Completers		-2.29%*	-1.29%
		(1.68)	
Spanners vs. Initiators		-1.69%	-1.26%
		(-1.25)	
Spanners vs. Others		1.55%	0.34%
		(-1.15)	
Completers vs. Initiators		0.61%	0.03%
		(-0.41)	
Completers vs. Others		3.84%**	1.63%
		(-2.47)	
Initiators vs. Others		3.24%**	0.60%
		(-1.86)	

Notice that the market reaction to a spinoff announcement is a positive 2.75% in the whole sample.[27] The spanners, completers, and initiators all have significantly positive market reactions when broken down by subgroup. However, results in Table 5 show a significantly more positive market reaction to the completer subgroup (4.68%) than the spanner subgroup (2.39%). This indicates that the market might view a CEO change surrounding a spinoff event more favorably than a long-term CEO who initiates and completes a spinoff and then stays with the firm. The market reaction to a spinoff by the initiator subgroup (4.08%) is also economically higher relative to the spanner subgroup, but the difference is not statistically significant.

Table 6 reports the coefficient estimates from estimating our regression equation (1):

$$\begin{aligned} \text{TotalComp} &= \beta_0 + \beta_1\text{Spinoff} + \beta_2\text{Post} + \beta_3\text{Post} * \text{Spinoff} + \beta_4\text{Post} * \text{Size} \\ &+ \beta_5\text{Post} * \text{Size} * \text{Spinoff} + \beta_6\,\text{Size} + \beta_7\text{MV} + \beta_8\text{MB} + \beta_9\text{ROA} + \beta_{10}\text{DebtRatio} \\ &+ \beta_{11}\text{Tenure} + \beta_{12}\text{Age} + \beta_{13}\text{FirmAge} + \beta_{14}\text{Herf} + \varepsilon \end{aligned} \quad (1)$$

The coefficient of interest is β_3. A matched spinoff/control firm sample is used. Thus, β_3 represents the change in CEO total compensation for a spinoff firm from pre to post-spinoff relative to the average control firm. The regression is estimated for the entire spinoff sample as well as for each of the four categories defined in Table 2. T-statistics from two-tailed hypothesis tests of difference from zero are reported in Table 6, with their respective coefficients and ***(**) (*) representing statistical significance at the 1% (5%) (10%) levels, respectively.

Test results of H1 and H2 are reported in Table 6. Notice that the coefficient on Post*Spinoff is strongly statistically negative for the whole sample. This provides support for H1 that, relative to a control group of firms, CEO total compensation decreases after a spinoff. Also, notice that the coefficient on Post*Spinoff is not statistically different from zero for the spanner sub-sample but is statistically negative for the completer and initiator sub-samples. This provides support for H2 that, relative to a control group of firms, the decrease in CEO total compensation for spanner CEOs is smaller than that for completer and initiator CEOs.[28] In fact, statistically speaking, the total compensation of the spanner CEOs does not fall (controlling for other factors). This is probably due to spanner CEOs being more entrenched than completer and initiator CEOs and thus exerting a greater influence on their respective firms' boards of directors and compensation committees. The regression results in Table 6 report relatively high adjusted R Square values, indicating the relatively high explanatory power of the variables included in the regression model. However, additional variables could have been included in the regression, such as CEO ownership in the parent company and the spinoff subsidiary.

[27] This result is similar to prior research that finds an average market reaction of around 3% surrounding a spinoff event (e.g., Hite & Owers, 1983; Kothari & Warner, 1997).

[28] The results for the "other" category are difficult to interpret as these include spinoff events for which the hypotheses are hard to apply. These results are reported for completeness' sake.

Table 6 Main Regression Results					
Variable	**Whole**	**Spanners**	**Completers**	**Initiators**	**Others**
Intercept	8409.07**	9054.01*	11030*	13494	12426***
	3.22	1.89	1.74	1.34	3.74
Spinoff	18.44	-788.41	-164.76	887.77	-109.92
	0.03	-0.91	-0.12	0.5	-0.13
Post	262.64	-824.72	596.96	2017.57	-14.00
	0.45	-0.96	0.43	1.17	-0.02
Post*Spinoff	-1343.89*	1250.18	-2961.74*	-4517.38*	-881.48
	-1.68	1.11	-1.68	-1.72	-0.75
Post*Size	-0.024**	-0.023	0.014	-0.048	-0.048**
	-2.04	-0.72	0.6	-1.69	-2.3
Post*Spinoff*Size	0.055***	-0.047	0.150***	0.201*	0.031
	2.38	-0.8	3.25	1.94	1.04
Size	0.046***	0.026	0.020	0.061*	0.087***
	4.47	0.62	0.8	1.89	5.18
MV	0.12***	0.136***	0.054	0.075	0.119***
	8.66	3.09	1.38	0.94	8.11
MB	-49.77	-198.44	-235.23	-792.05	-327.24
	-0.23	-0.62	-0.32	-0.79	-0.87
ROA	620.66	-3247.08	212.69	491.61	806.92
	0.42	-0.96	0.04	0.16	0.23
DebtRatio	1474.21	-2539.45	-386.47	3691.35	-1657.67
	1.29	-1.15	-0.11	0.59	-1.05
Tenure	93.71***	-0.42	-38.61	96.00	114.25**
	3.09	-0.01	-0.44	0.81	2
Age	-90.85*	-14.84	66.16	-62.71	-108.58**
	-3	-0.24	0.88	-0.53	-2.53
FirmAge	36.45***	25.20	82.78**	26.38	6.14
	2.86	1.2	2.17	0.59	0.3
Herf	-1494.96	-185.22	-4632.01	-5039.70	-3186.89
	-1.14	-0.1	-1.49	-1.06	-1.42
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
N	736	228	192	104	212
Adj. R^2	36.75%	47.30%	46.50%	35.80%	61.15%

Robustness

We performed four robustness exams. In the first robustness check, we tested whether the audit fees of spinoff firms and matched firms changed around spinoffs. Audit fees reflect the effort and labor of the auditors. We expect audit fees to decrease after a spinoff, similar to the decrease in CEO compensation after a spinoff, as predicted by the efficiency theory.

We merged Audit Analytics with the spinoff final sample. The final sample consists of 108 spinoff events with audit fees and covers a period from 2000 to 2006.[29] We matched each of these spinoff event firms with a control firm according to the matching procedure described in the sample selection section. Table 7 reports the mean change in size from pre-spinoff to post-spinoff (as measured by total assets) as well as the mean change in audit fees for a sample of spinoff event firms as well as their matched control firms both in the aggregate and when broken down into 'spanner,' 'completer,' 'initiator' and 'other' sub-samples. Change in size is measured in $billions, while the change in audit fees is measured in $millions. T-statistics from two-tailed hypothesis tests of difference from zero are reported below their respective means, and ***(**) (*) represent statistical significance at the 1% (5%) (10%) levels, respectively.

Table 7
Audit Fee Changes Around Spinoff Events

Variable	Whole	Spanner	Completer	Initiator	Other
Sample Size	108	47	27	17	17
Change in Size	-5,806***	-5,758***	-9,976***	-8,014**	-1,568***
	(-4.96)	(-2.94)	(-3.25)	(-2.10)	(-2.96)
Change in Audit Fees	-1,913***	-2,993**	-2,189***	-2,955**	1,013
	(-3.24)	(-2.35)	(-2.94)	(-2.40)	(0.80)
Change in Size of Matched Firms	1,071*	963	1,281	1,575	1,387*
	-1.87	-0.99	-1.5	-0.52	-1.85
Change in audit Fees of Matched Firms	3,644	2,861	6,888*	-992	798**
	-1.52	-0.84	-2.02	(-0.90)	-2.14

Table 7 reports the results from the first robustness test. Notice that the change in audit fees around the spinoff events for the spanners, completers, and initiators sub-samples as well as for the whole sample, is statistically negative at the p-value <.05 level or greater. This makes sense in light of the statistically negative change in size and complexity (as measured by total assets) documented for each sub-sample as well as the whole spinoff event sample. The matched firms do not experience the drop in size (they didn't undergo a spinoff) nor the corresponding decrease in audit fees.

[29] Audit Analytics began in 2000.

It is interesting that the total compensation of the spanner sub-group does not fall after a spinoff despite the reduction in firm size and complexity, while their audit fee does fall. This provides some indirect evidence that entrenched spanners have bargaining power with their compensation committees to ensure that their total compensation does not fall post-spinoff when efficiency theory says that it should, due to the reduction in firm size and hence CEO effort.

In the second robustness check, we tested our hypotheses with a different sample, namely spinoffs from 2007 to 2019, after FAS 123R. We expect both hypotheses to be supported by the data, although FAS 123R might attenuate the strength of some relations.

We followed the same sample selection procedure as in the main analysis and selected 90 spinoff event firms as well as 90 control firms after FAS 123R, expanding from 2007 to 2019. Based on the main findings of this study, we employed a simplified regression model as follows.

$$\begin{aligned} \text{TotalComp} &= \beta_0 + \beta_1\text{Spinoff} + \beta_2\text{Post} + \beta_3\text{Post} * \text{Spinoff} + \beta_4\text{Post} * \text{Size} \\ &+ \beta_5\text{Post} * \text{Size} * \text{Spinoff} + \beta_6\ \text{Size} + \beta_7\text{MV} + \beta_8\text{MB} + \beta_9\text{ROA} + \beta_{10}\text{DebtRatio} \\ &+ \beta_{11}\text{Tenure} + \beta_{12}\text{Age} + \beta_{13}\text{FirmAge} + \beta_{14}\text{Herf} + \varepsilon \end{aligned} \quad (2)$$

The descriptive statistics are summarized in Table 8. The results of the regression analysis are reported in Table 9. T-statistics from two-tailed hypothesis tests of difference from zero are reported, with their respective coefficients and ***(**) (*) representing statistical significance at the 1% (5%) (10%) levels, respectively. The coefficient on Post*Spinoff is positive for spanner CEOs and negative for completer and initiator CEOs. More notably, the coefficient on Post*Spinoff is significantly negative for completer CEOs. This result provides some evidence that spanner CEOs are able to avoid a pay cut after a spinoff in the post-FAS 123R era.

Table 8
Descriptive Statistics of Robust Test #2

Panel A: Descriptive Statistics for Spinoff Firms and Control Firms in the pre-spinoff Years						
Variable	**Spanner (N=30)**	**Control (N=30)**	**Completer (N=37)**	**Control (N=37)**	**Initiator (N=23)**	**Control (N=23)**
TotalComp	8405.6	8806.8	12864.8	9368.9	58595	57728
Size	18975.2	19082	29663.7	29509	8484.1	8055.5
MV	22153.7	19330	29086.4	21311	22451	20565
MB	1.738	1.554	1.592	1.553	1.595	1.711
ROA	0.045	0.042	0.037	0.002	0.040	0.054
DebtRatio	0.324	0.296	0.352	0.308	0.240	0.260
Tenure×	9.5	9.07	7.71	6.37	5	7
Age	56.67	58.67	57.79	55.42	58.92	56.29
FirmAge	32.63	33.47	40.32	38.74	31.63	29.58
Herf	0.776	0.732	0.787	0.755	0.778	0.837
Panel B: Descriptive Statistics for Spinoff Firms and Control Firms in the post-spinoff Years						
Variable	**Spanner (N=30)**	**Control (N=30)**	**Completer (N=37)**	**Control (N=37)**	**Initiator (N=23)**	**Control (N=23)**
TotalComp	8367.2	8137.2	7356.4	9345.2	51003	66419
Size	17086	21850	17023.7	41129	10884	10359
MV	23183.6	21401	17214.1	29666	25302	23727
MB	1.726	1.593	1.716	1.585	1.772	1.579
ROA	0.046	0.021	0.028	0.024	0.054	0.030
DebtRatio	0.317	0.337	0.472*	0.318*	0.246	0.273
Tenure××	11.3	7.50	1.41*	7.82*	2.17*	8.09*
Age	58.53	59.70	54.03	56.50	55.91	58.04
FirmAge	35.20	36.53	41.47	40.65	35.35	31.65
Herf	0.765	0.751	0.807	0.741	0.787	0.862

Note: × Tenure of CEO at one year before the spinoff (-1 year); ×× Tenure of CEO at one year after the spinoff (+1) year. * indicates significance at the level of P-value<.05.

Table 9 Main Regression Results of Robustness Test #2			
Variable	**Spanners**	**Completers**	**Initiators**
Intercept	-2674.09	2297.96	171.09
	-0.42	0.25	0.03
Spinoff	-1208.41	2826.45*	28.3
	-0.98	1.67	0.02
Post	-1188.99	-1510.26	2800.68*
	-0.74	-0.8	1.66
Post*Spinoff	2084.21	-3895.41*	433.37
	1.14	-1.75	0.26
Post*Size	-0.005	0.011	0.04***
	-0.09	0.23	2.59
Post*Spinoff*Size	0.041	-0.031	-0.043
	0.88	-1.2	-1.39
Size	0.326***	0.103***	0.13***
	6.39	3.07	3.87
MV	-0.138***	1.44	0.07**
	-5.48	0.15	2.15
MB	2003.48**	-1713.65	-275.3
	2.26	-1.09	-0.24
ROA	24873***	-7359.72*	7490.3
	2.79	-1.91	0.69
DebtRatio	7540.86***	1548.99	-5117.27
	2.6	0.48	-0.96
Tenure	69.239	-103.69	115.03
	0.63	-0.86	0.88
Age	15.923	12.14	129.58
	0.18	0.11	1.26
FirmAge	-22.19	7.92	-18.82
	-0.58	0.16	-0.72
Herf	1723.96	-8297.31**	-2579.21
	0.61	-1.96	-0.79
Industry Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
N	120	148	88
Adj. R^2	62%	61.9%	74.57%

The third robustness test employs a different measurement of CEO compensation. For the period of 2007-2019, we used a different variable, "TOTAL_SEC," from EXECUCOMP, instead of TDC1, to measure CEO compensation. We expect to find similar support for the hypotheses.

TOTAL_SEC includes the amount of stock and option awards charged to the income statement under FAS 123R instead of their grant day fair value. TOTAL_SEC became available after 2006 and has been used as an alternative measurement of CEO total compensation in the literature (e.g., Conyon et al., 2009). The regression analysis follows the same regression model as expressed in Regression Model (2), with all the independent variables remaining the same.

The results are summarized in Table 10, and ***(**) (*) represent statistical significance at the 1% (5%) (10%) levels, respectively.

The coefficient on Post*Spinoff is positive for spanner CEOs and initiator CEOs but negative for completer CEOs. Consistent with the results of the second robustness test, the coefficient on Post*Spinoff is significantly negative for completer CEOs. Completer CEOs suffered significant pay cuts after the spinoff. This finding provides some additional evidence that spanner CEOs are able to maintain their total compensation after a spinoff in the post-FAS 123R era.

Table 10
Main Regression Results of Robustness Test #3

Variable	**Spanners**	**Completers**	**Initiators**
Intercept	-1262.51	3079.66	1029.51
	-0.15	0.36	0.12
Spinoff	-1420.84	2716.19*	-1459.84
	-0.85	1.76	-0.8
Post	-2503.63	-781.10	336.61
	-1.16	-0.45	0.14
Post*Spinoff	3921.84	-5452.47***	977.71
	1.62	-2.68	0.41
Post*Size	-0.03	0.04	0.05**
	-0.48	0.98	2.34
Post*Spinoff*Size	0.03	-0.05**	-0.04
	0.48	-1.99	-0.83
Size	0.35***	0.11***	0.17***
	5.17	3.6	3.66
MV	-0.09**	0.08**	0.05
	-2.48	2.26	1.11
MB	2233.24*	-1025.40	-212.66
	1.89	-0.72	-0.13
ROA	18504.00	-5880.94*	6788.47
	1.51	-1.67	0.44
DebtRatio	4328.38	1547.67	-8411.71
	1.12	0.53	-1.12
Tenure	105.04	-83.15	103.65
	0.91	-0.75	0.57
Age	-10.70	47.95	246.28*
	-0.1	0.46	1.7
FirmAge	21.75	32.94	-27.99
	0.43	0.75	-0.76
Herf	4455.24	-10060.00**	-3385.02
	1.17	-2.61	-0.74
Industry Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
N	120	140	92
Adj. R^2	58.19%	75.31%	61.74%

The fourth robustness test investigates the changes in CEO Pay Slice (CPS) before and after the spinoff among three groups of CEOs. Instead of measuring CEO compensation in dollars, we use a relative measure of CEO compensation, CPS, to test our research hypotheses. CPS is a relative gauge that provides an alternative perspective to investigate CEO compensation, CEO power, and CEO deal-making (e.g., Chintrakarn et al., 2014). Although CPS might catch numerous observable and unobservable firm and executive characteristics (Bebchuk et al., 2011), we compute the changes in CPS before and after the spinoff, which might reduce the impacts of variant firm characteristics. We expect the relative share of CEO compensation to move similarly to the absolute amount predicted in our research hypotheses.

CPS represents the portion of the total compensation of the top-five executive team obtained by the CEO (Bebchuk et al., 2011). We calculate the CPS by dividing the CEO's total compensation (EXECUCOMP item TDC1) by the total compensation of the top-five executives of the same firm. The period is 1994-2006, the same as the main regression reported in Table 6. The results are reported in Table 11, and ***(**) (*) represent statistical significance at the 1% (5%) (10%) levels, respectively.

The results show that spanner CEOs' CPS significantly increases after the spinoff, while completer CEOs' CPS remains the same. In addition, initiator CEOs' CPS also significantly increases. Together with the main regression results reported in Table 6, the findings in Table 11 suggest that although CEO pay declines after a spinoff, CEOs' relative share of total top executives' pay increases after a spinoff, which provides some evidence of CEO bargaining power. Between the two groups of incumbent CEOs, spanner CEOs are able to capture a bigger share of the total compensation of the top executive team than completer CEOs do, providing some additional evidence that entrenched CEOs have more power over the board.

Table 11
CEO Pay Slice Pre- and Post-Spinoff

Spanners (N=73)			**Completers(N=62)**			**Initiators(N=34)**			**Whole(N=169)**		
Pre-Spinoff	Post-Spinoff	Difference	Pre-Spinoff	Post-Spinoff	Difference	Pre-Spinoff	Post-Spinoff	Difference	Pre-Spinoff	Post-Spinoff	Difference
35.75	39.41	+3.66*	37.06	37.42	+0.36	32.88	38.70	+5.82**	35.39	37.28	+1.89*

CONCLUSION

Using a sample of parent-firm spinoff events, we hypothesize and find that CEO total compensation decreases after a spinoff relative to a control group of firms. Upon dividing this sample into spanner, completer, and initiator CEO spinoff events, we find that spanner CEOs experience no statistically significant decline in their total compensation relative to a control group of firms, unlike completer and initiator CEOs. It is hypothesized that spanner CEOs are more entrenched and thus can exert greater influence on the board of directors and, specifically, the compensation committees of their respective firms.

We employ four robustness tests. In the first robustness test, we examine a variable that is also expected to decline with the firm size and complexity decrease necessitated by a spinoff:

audit fees. Audit fees fall for the spinoff event sample as a whole as well as for each sub-sample (including spanners). This provides some indirect evidence that entrenched spanner CEOs have bargaining power with their compensation committees to ensure that their total compensation does not fall post-spinoff when efficiency theory predicts a decline thanks to the reduction in firm size and complexity. In the second and third robustness tests, we examine a different set of spinoff events after FAS 123R, covering 2007 – 2019, with two different measurements of CEO compensation. We find some evidence that spanner CEOs are able to avoid a pay cut after a spinoff in the post-FAS 123R era. In the last robustness test, we investigate the changes in CEO Pay Slice before and after a spinoff. The results provide some additional evidence of CEO power and CEO entrenchment.

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APPENDIX A

This table defines all variables used in our study. COMPUSTAT and CRSP variable names are given in parentheses after the variable definitions.

Table A1
Variable Definitions

CEO Pay	**Definition**
TotalComp	TDC1 TOTAL compensation in EXECUCOMP
CEO Characteristics	
Tenure	Current year minus the year the CEO was hired.
Age	Age of the CEO.
Firm Characteristics	
Spinoff	Dummy variable equals one if the firm-year is a spinoff event and zero for a control firm year.
Size	Firm total assets (AT).
MV	Market value calculated as fiscal year-end closing price (PRCC F) multiplied by the number of common shares of stock outstanding (CSHO).
MB	Market-to-book ratio calculated as (AT - CEQ + MV)/AT.
ROA	Return on assets calculated as operating income before depreciation (OIBDP) scaled by total assets (AT).
DebtRatio	Calculated as long-term debt plus current liabilities scaled by total assets (DLTT +DLC)/AT.
FirmAge	Age of the parent firm.
Herf	Herfindahl Index for an industry-year calculated as (1 - $\sum_{i=1}^{N} s_i^2$) where s_i firm i's share of total sales of a given industry segment in a given year.