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Impact of Internal Governance on a CEO's Investment Cycle

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Date/Time: 9/25/2019 at 1:00
Location: Leir Conference Room, CAB 3052

Abstract: Agency theory tells us that unless CEO owns 100% of the firm, the motive of CEO will deviate from maximizing shareholders wealth. Furthermore, we would expect that conflict of interest between CEO and shareholders escalates as the CEO grows older because the CEO horizon is much shorter than the shareholder. To mitigate the agency problem and the horizon issue, the literature suggests and examines various forms of corporate governance provisions such as compensation package design, board governance and external regulations. In this paper, we focus on the impact of internal governance, the monitoring of the CEO from within the top management, upon the investment policy of the firm around the CEO turnover period. Previous literature has found that there is a substantial change in the firms investment policy around the turnover event. The mechanism of internal governance is conceptualized in Acharya, Myers and Rajan (2011), and we modify the empirical proxy in Aggarwal, Fu and Pan (2017) whereby using the text mining technique, REGEX, in R. We demonstrate that the change in investment policy for myopic old CEO is less likely to occur during the transition period if the firm prior to the CEO turnover event had effective internal governance. Moreover, the empirical evidence implies that the asset disposal that happens at the beginning of a CEOs tenure is more likely due to skill set mismatch. We further find that good governance helps incoming CEOs get rid of less profitable investments previously made by older and myopic predecessors at less loss or perhaps even a gain.

Speaker Bio: Professor Ivan E. Brick joined Rutgers Business School at Newark and New Brunswick in 1978. He has been the Chair of the Finance and Economics department since 1996. Professor Brick has published widely in several leading finance and economics journals. His research interests include corporate finance, optimal security design and corporate governance. Currently, he is an associate editor for the Review of Quantitative Finance and Accounting. Previously, he has served as an Associate Editor of Financial Management and Multinational Finance Journal. Professor Brick has received several teaching awards at the Rutgers Business School. He received the Outstanding Educator Award by the 1995 Executive MBA Class. Professor Brick was awarded the Farrokh Langdana Excellence in Teaching Award by the 2011 MBA Class. In 2012, the Newark Undergraduate Program awarded him the Deans Advisory Council Award for the Most Knowledgeable Finance Professor, The Most Caring Finance Professor, as well as The Most Motivational Finance Professor. In September 2016, Professor Brick was given the Deans Professor of Business designation.