Research Statement

Felipe Cabezón **Ph.D. Candidate in Finance**

USC Marshall School of Business

My research focuses on the conflict of interest between a company's management and the company's stakeholders. Why do they exist, and how can we mitigate them. My work is centered on the board of directors' role, the effects of regulations, and the flow of information across firms, as the primary mechanisms to reduce these agency problems.

In my job market paper Executive Compensation: The Trend Toward One Size Fits All, I show that institutional shareholders, advisory services and regulators influence and standardize CEO pay. By standardizing CEO pay, they create a trend toward a "one-size-fits-all" pay package. I find that 25% of the variation in the way firms distribute total compensation across different components of pay –salary, bonus, stock awards, option awards, non-equity incentive plans, pensions, and perquisites– disappeared in the last ten years.

I show evidence that this convergence is partly an unintended consequence of recent regulations to get shareholders involved in the design of compensation plans. The adoption of shareholders' vote on executive compensation (Say-on-pay) increases convergence because shareholders rely on standardized recommendations from proxy advisory firms on how to vote. Using difference-in-difference and Regression Discontinuity Design estimations for close Say-on-Pay elections, I find that firms' compensation structures converge faster if the firm has Say-on-pay vote for frequently.

I also find that the standardization of compensation plans eliminates plans that are better fit for innovation. Specifically, I find that the convergence translates into less risk-taking behavior, less innovation, and, ultimately, into lower firm value. In particular, when a CEO compensation plan becomes more homogenous, that CEO gets higher pay, and this payment is less sensitive to the firm performance (delta) and the risk taken (vega). Additionally, the firm innovates less –invests less in R&D and is less likely to patent– and reduces its market value.

Agency conflicts also translate into a higher cost of external finance. Investors will be less likely to finance a firm if they cannot monitor managers' actions after the financing is provided. In my paper The Effect of Mandatory Information Disclosure on Financial Constraints

(R&R at *Journal of Accounting and Economics*; presented at AFA 2019), I show that by mandating disclosure, authorities can reduce those asymmetries and thus alleviate financial constraints. Specifically, in a difference-in-difference setting using the 2008 SEC regulation for smaller reporting companies, I find that firms moving from a voluntary use of the regime to a mandatory use increase debt issuance and investment in tangible assets, and reduce the level of discussion about difficulties in obtaining debt financing. However, I also find that they report higher difficulties obtaining external finance through equity. Even though the positive effect of mandatory disclosure prevails in my sample, the fact that firms lost their ability to signal suggests a potential unintended consequence of this regulation. Based on additional tests, my interpretation of these results is that mandatory disclosure provides a commitment device to future disclosure but shuts down the signaling value of voluntary disclosure.

The empirical results of firms being less debt constrained when mandatorily disclosing are in line with Jensen and Meckling (1976). Debt-holders are usually more concerned about exercising their control rights when necessary and about preventing managers from taking excessive risks that could potentially lead them to bankruptcy. By guaranteeing future disclosure, firms make it easier for debt-holders to monitor managers' behavior and thus reduce the agency cost of debt.

In my job market paper, I also show that overlapping directors across firms have an important role in explaining compensation plans' similarity. The flow of information across peer networks has been largely reported in the literature and presents a rich source of future research. In Overlapping Directors and Product-Market Strategies, a joint paper with Jerry Hoberg, we study how information flows across firms that share directors affects firms' product-market strategies.

We document that overlapping directors can be a relevant mechanism to share strategic information between firms without incurring the risk of unintended dissemination of sensitive information to competitors as is the case with public disclosure. We find that conditioning on each pair of firms' ex-ante product-market closeness, sharing a director increases product similarity if firms are close peers, but decreases it if they are far peers. These findings are robust to using exogenous variation motivated by the network econometrics literature. In particular, we consider more distant links in the network by considering director networks that are across peers of peers (2-degrees of separation).

These results are opposite to the standard finding of technology spillovers in the literature.

Most models predict that technology spillovers should increase product similarity due to technology complementarities. Indeed, we find that access to the public information about other firms' innovation strategies makes products more similar when information is shared across peers. We find the opposite effects when analyzing overlapping directors.

Our findings' main implication is that overlapping directors make the product market more stable, whereas public information makes the market more fluid. We are currently exploring two possible mechanisms of this effect. The results could be explained by firms using overlapping directors to collaborate in their product strategies. If they are far competitors, they avoid entering into the other firm's market. If they are already close competitors, they reduce competition by avoiding costly investment in product differentiation. Alternatively, the results could be consequences of the director's agency conflict. Because the director seeks to maximizes the joint values of the firms, she may avoid a beneficial strategy for one firm if it hurts the other. Even though the two hypothesis predict less fluid markets, they have opposite predictions related to shareholders value.

I am also interested in how to align the managers' incentives with environmental and social goals. Institutional investor claim to care about ESG in general and climate change in particular. Do institutional investors make any difference in firms' environmental policies? In my paper Green Incentives in Executive Compensation Plans and Firm Value –a joint project with AJ Chen, a Ph.D. student at Marshall–, we find evidence that they do. We use text analysis of compensation plans to identify if executives have explicit incentives to care about the environment. We find that the higher the institutional investors' ownership, the higher the probability of having green compensation incentives. Do these policies create value? We find that Tobin's Q increases only if the firm is in an industry with a high level of emissions, showing that the market values the effort only when environmentally relevant. To explore whether these policies are effective or not, we are obtaining data on firm-level emissions, ESG indexes, and climate risk exposure, and we will test whether the greenness of a compensation plan has any impact on them.