



University of Zurich
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Executive Summary – Master Thesis

Perks and Headquarter Location

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1 Problem

There is an ongoing academic discussion whether perks lead to an increase in company value as an efficient way to pay executive officers, or whether firm performance suffers from the presence of perquisites. The main focus of this master thesis lays on the influence of headquarter locations of companies. In the more specific CEO compensation, a social circle premium can be explained with this geographical measure: a CEO working for a company with its headquarters located among many others demands for more compensation than a CEO sitting in a headquarter located in an area with low firm density.

2 Research objective

The core part of the paper focuses on social circle premia for perk consumption. Does a CEO of a company with its headquarter in New York ask automatically for more personal aircraft use because he compares his social status by this measure to 20 other CEOs located in a radius of 100 kilometers? Subparts concern the effect perks have on company performance and the role of SEC's new disclosure rules for perquisites. Three hypotheses are stated:

1. **Hypothesis 1:** *There exists a social circle premium in NEOs' perk consumption. This social circle premium increases with the size of the social circle of the NEOs.*
2. **Hypothesis 2:** *More frequent perquisite disclosure leads to a smaller effect of perk consumption on firm performance in 2009.*
3. **Hypothesis 3:** *Stronger SEC disclosure rules lead to a higher and more frequent perk disclosure, plus the negative effect of perk consumption on firm performance increases.*

3 Proceeding

The paper studies perquisite consumption by NEOs in all 100 S&P 100 major companies and in a sample of 103 S&P Small Cap 600 companies with their headquarters located in the New-York area. It focuses on the effect that headquarter location has on perk consumption behaviour by taking firm density (the number of similar headquarters located in a circle with radius of 100 kilometers around a firm's own headquarter) as primary measure. To measure firm density I use the number of similar company headquarters located around the firms own headquarter as the primary proxy. More detailed questions arise out of this hypothesis, for instance are there differences region by region in perk consumption, and – if yes – what are the inter- and intracorrelations of these data. Firstly, I test the 25% of companies disclosing the highest values of perk consumption and the 25% of companies

with the lowest disclosed perk values in separate regressions (Q_3 versus Q_1), to check for possible differences between those clusters. By the use of regional dummy variables I then control for regional differences in perk consumption in the big four regions of the USA, the New York, Mid–West, West–Coast and South areas. Using again the dummies–method I study clusters of industry sectors to test, for instance, if financial companies show characteristics of a social circle premium and other industries do not. The paper splits perks in six subcategories, ranging from firm paid club memberships, relocation expenses, security systems or financial planning services up to car allowances including chauffer services and the personal use of corporate airplanes. The tests in this study are set up for every single category of perquisite, and findings differ rather significantly between those categories. Tests concerning headquarter location’s influence are made for the S&P Small Cap 600 companies with headquarters located in the New York area, as well. I choose New York area companies, only, because of regional differences in perk consumption. The tests should be consistent for a region, no reliable results could be obtained, otherwise.

Most similar papers to this work are [Ang, Nagel, and Yang \(2008\)](#), [Kress \(2009\)](#) and [Yermack \(2006\)](#).

4 Results

The most striking results of the paper for S&P 100 firms concern a social circle premium in car allowances (US\$ 5’796 more per additional HQ located in the 100 kilometers radius) and a social circle discount in relocation expenses (US\$ 10’954 less per additional HQ located in the 100 kilometers radius), meaning, on average, a firm in a location with lots of comparison possibilities spends more money on its NEOs cars and chauffer services than a company located with no similar headquarters around. Companies located in a rural area invest more into the relocation of their NEOs, what possibly arises from the fact, that managers mostly live in urban areas and have to be – once if hired – relocated to work for a rural located firm. Upper and lower quantile regressions confirm this tendency for car allowance. Additional tests show large differences in perk consumption for different areas: in the New–York and the West–Coast areas, nearly twice the value of the Mid–West region in total perks are consumed. Personal aircraft use and car allowance have their peaks in New York, while financial planning services, security costs and relocation expenses are maximized on the West–Coast, club membership dues have their highest level in the South area. Regression analysis shows a significant higher perk consumption in the New–York area compared to the others. Further differences are explored across industry sectors, where the IT (US\$ 1’046’292 total perks) and the financial sectors (US\$ 782’001) are identified as the largest perk consumers, for example compared to the healthcare industry (US\$ 289’591). Regression analysis clearly confirms premia for financial companies in car and relocation perks, a premium for IT firms in security costs, and a discount for IT

companies in car allowances. These results are stated, as well, by a fixed effect regression including industry dummies. The stated **Hypothesis 1** has to be rejected concerning results about total perks, and can be accepted in special cases like car allowances.

Tests based upon the possible effect of perks on company performance elaborate non-significant, extremely small coefficients for perquisites, **Hypothesis 2** is accepted. The result predicts a stock price drop of 0.002% for additional perk consumption of US\$ 1'000'000; in other words, stock price is assumed to drop by 1% if a company spends US\$ 500 million more for perks than the average firm, which is a rather senseless result (maximum value of total perk consumption for S&P 100 firms lies at US\$ 4'149'843 in 2009).

Studying the role of the change of SEC's disclosure rules for perks in August 2006 indicate – given higher means of perquisites in the first annual proxy statements of S&P 100 companies after, compared to the last proxy statements before the adoption of new SEC's rules – an opposite result than **Hypothesis 3**. The effect of perks on company performance becomes significant at the 10%-level and gets stronger, but the sign of the coefficient switches from a negative effect to a positive one (a 0.007% stock drop in late 2005/early 2006 versus a 0.019% stock boost in late 2006/early 2007 for an additional expenditure of US\$ 1 million in perks). This finding coincides with the thesis, that more frequent perk disclosure weakens the exotic, negative note perks used to have under a more rare disclosure in earlier times.

Finally, summary statistics of the small cap firms show, as expected, clearly lower values of perks compared to the large caps, and, therefore, regression analysis of headquarters' location effect on perk consumption indicates neglectable (and statistically non-significant, most of the times) differences of a few hundreds of dollars for an additional small cap HQ located in the 100-km-radius. Values differ stronger across industry sectors, but only car allowance shows significant results in a fixed effect regression with industry dummies. Last but not at least, neither one of the tests for perk consumption's effect on company performance obtains perk-coefficients of a sufficient statistical level for a reliable interpretation.

References

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