The Impact of Superstar CEOs on Financial Reporting Practices and Firm Performance

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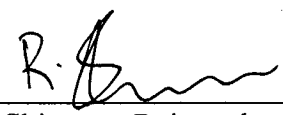

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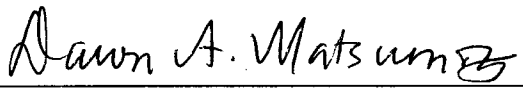

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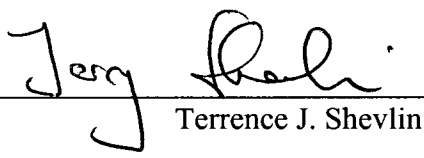

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Abstract

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The objective of this study is to examine the impact of managerial reputation on the financial reporting practices of firms and their operating performance. Using victory in high-profile CEO competitions as a proxy for managerial reputation, I compare within-firm changes in the timeliness of loss recognition, earnings management, and operating performance before and after CEOs win awards. The results indicate that, first, superstar CEOs (i.e. CEOs who win awards) improve the quality of financial reporting by reporting economic losses in a more timely fashion than before winning their award. Second, superstar CEOs are less likely to engage in opportunistic earnings management to meet short-term earnings benchmarks. Finally, firm performance, measured by indicators such as stock returns, return-on-assets, and operating cash flows, improve after superstar CEOs win awards. In contrast, no similar trends are observed for a control sample of non-superstar CEOs whose firms share similar characteristics to those managed by superstar CEOs prior to winning awards.

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DEDICATION

To the Koh family.

1.0 Introduction

The objective of this study is to examine the impact of superstar CEOs on financial reporting practices and firm performance. This paper is primarily motivated by the recent success that financial economics studies have had in documenting the links between managerial characteristics and corporate policies (Bertrand and Schoar 2003). Although this emerging literature provides credence to the view that managerial characteristics are important in providing a better understanding of firms' policies, accounting researchers have virtually ignored the impact of managerial characteristics on financial reporting practices. Therefore, I investigate how managerial characteristics, in particular CEO reputation, affect financial reporting practices and operating performance.

There are two perspectives on how reputable CEOs affect financial reporting practices and operating performance. Agency models (MacLeod and Malcomson 1988; Gibbons and Murphy 1992) argue that reputation serves as an effective mechanism for worker discipline because it provides information to potential employers about the quality of future employees. To preserve their reputations in the executive labor market, CEOs have career-related incentives to align their actions with stakeholders' interests (Fama 1980; Kreps 1990). As such, reputable CEOs would take actions to improve the quality of financial reporting and firm performance. Furthermore, reputable CEOs can afford not to engage in rent-seeking activities to meet stakeholders' short-term expectations because their established reputations can withstand short-term failures without major impact on

the value of their human capital. Thus, from an efficient contracting perspective, reputable CEOs would, at the minimum, not indulge in short-run games to please important stakeholders. In contrast, the rent extraction perspective argues that reputable CEOs over-emphasize their personal career by focusing on short-term personal gains (Malmendier and Tate 2005). Specifically, they are under constant pressure to meet the expectations of the capital markets because any negative news could be potentially viewed by the executive labor market as a sign of managerial failure (Graham, Harvey, and Rajgopal 2005). Thus, reputable CEOs are driven to take rent-seeking actions that ultimately reduce the quality of financial reporting and destroy firm value.

The rise of the superstar CEO phenomenon from the 1990s (Khurana 2002) provides a good setting to test the various conjectures regarding the implications of CEO reputation on financial reporting practices and firm performance. In this study, 'superstar CEOs' are defined as CEOs who receive high-profile awards, such as "CEO of the Year", as such accomplishments indicate that they have established a significantly positive reputation in the business community. Recent studies investigating the association between CEO reputation and various variables of interest (Milbourn 2003; Francis, Huang, Rajgopal, and Zang 2006; Rajgopal, Shevlin and Zamora 2006) measure CEO reputation using the number of CEO press citations.[1]

[1] For example, Milbourn (2003) find a positive relationship between CEO reputation and stock-based pay-sensitivities while Rajgopal et al. (2006) show that reputable CEOs face less relative performance evaluation.

However, measurement error arises because press references to a CEO's name do not necessarily reflect general beliefs about the CEO's reputation. Specifically, the press engages in sensationalism by reporting negative events about CEOs (Core, Guay, and Larcker 2006) and is biased towards covering high-visibility firms and firms with interesting cases of fraud (Miller 2006). An alternative measure that compensates for this bias is receiving high-profile awards. Winning such prizes better reflects a CEO's reputation because they provide a visible and public assessment of the CEO by a panel of prominent business experts, such as peer business leaders, financial analysts, and business journalists (Wade, Porac, Pollock, and Graffin 2006).

To investigate the impact of superstar CEOs on financial reporting practices and firm performance, I first hand-collect data on CEOs who win prestigious contests organized by the highly-regarded accounting firm, Ernst & Young, as well as those organized by large-circulation international business publications such as Business Week, Financial World, Forbes, Chief Executive, Fortune, and Time. In particular, I identify 189 superstar CEOs who won a total of 269 awards from 1987 to 2003. I then use a firm fixed effects approach to compare within-firm changes in asymmetric timely loss recognition, earnings management, and operating performance before and after each superstar CEO wins his first prestigious award.

Overall, I find evidence that superstar CEOs have a positive impact on the quality of financial reporting and firm performance. This broad finding arises out

of a variety of tests. First, I use Basu's (1997) returns-based and Ball and Shivakumar's (2005) accruals-based models to investigate whether superstar CEOs engage in more asymmetric timely loss recognition after winning awards. I find that superstar CEOs improve the quality of financial reporting by reporting economic losses in an even more timely fashion than before winning awards. Second, I examine whether superstar CEOs' earnings management practices, measured as the level of abnormal accruals and the propensity to achieve small earnings surprises, change after winning awards. Although I find no change in the levels of abnormal accruals, there is some evidence that firms managed by superstar CEOs are less likely to beat prior year's earnings by a small margin after their CEOs win awards. This provides support for the hypothesis that superstar CEOs do not engage in the opportunistic use of accounting discretion to meet short-term capital market expectations. Finally, I investigate whether superstar CEOs have an impact on operating performance. In particular, firms managed by superstar CEOs generate positive cumulative abnormal returns (CAR) of 11.7% for the three-year period after their CEOs win awards. In addition, accounting-based performance such as return-on-assets (ROA) and cash flows from operations (CFO) improve after superstar CEOs win awards.

To account for potential explanations that the documented trends are driven by endogenous firm-level characteristics, I perform sensitivity tests using a control sample of non-superstar CEOs who are predicted to win awards based on firm-specific characteristics. To obtain the control sample, I identify firms

managed by non-superstar CEOs that share a similar economic environment and achieve comparable operating performance to those managed by superstar CEOs prior to winning awards. Using a similar firm fixed effects approach, I compare within-firm changes in financial reporting practices and operating performance before and after non-superstar CEOs are predicted to win awards. There are no similar variations in asymmetric timely loss recognition, the propensity to exceed earnings benchmarks marginally, and operating performance, after non-superstar CEOs are predicted to win awards. As such, it is unlikely that self-selection bias, in the form of superstar CEOs choosing to manage firms which would have performed well without them, will be able to explain the results obtained.

This study has important implications for the accounting literature. Although recent studies (Bowen, Rajgopal, and Venkatachalam 2006; Larcker, Richardson, and Tuna 2007) document that firm-level characteristics do not substantially explain cross-sectional variation in firms' financial reporting practices, current research largely ignores the role of manager-specific attributes on financial reporting, continuing to focus primarily on firm-specific attributes, such as growth, leverage, operating risk, and corporate governance practices. An exception is a recent study by Francis et al. (2006) that uses levels regressions[2] to document an association between reputable CEOs and firms with lower accruals

[2] Studies using levels regressions are generally subjected to a common criticism of correlated omitted variables. The event-study methodology used in this study mitigates potential endogeneity issues because each firm is used as its own control when I use the firm fixed effects approach to compare within-firm changes in financial reporting practices before and after superstar CEOs win awards.

quality.[3] By examining the impact of superstar CEOs on a broader set of financial reporting practices, such as asymmetric timely loss recognition and earnings management, this study expands the limited accounting literature that investigates the effects of managerial characteristics on financial reporting practices. Specifically, I establish that superstar CEOs improve the quality of financial reporting by reporting economic losses in an even more timely fashion after winning awards. Furthermore, I provide evidence that superstar CEOs are less likely to engage in opportunistic earnings management to meet short-term capital market expectations, as indicated by their reduced propensity to report small increases from prior year's earnings.

This study also contributes to the strategic management literature by investigating two conflicting school of thoughts on whether managers affect firm performance. While the "leadership school" believes that managerial discretion to create and pursue strategic business opportunities is a critical factor in driving firm performance (Finkelstel and Hambrick 1996), the "constraints school" theorizes that environmental constraints, such as internal politics and competitive pressures, limit managers' ability to make any strategic impact on firm value (Carroll and Hannan 2000). As most of the evidence supporting either schools of thoughts comes from detailed comparative field studies and individual firm case studies (Wasserman, Nohria, and Anand 2001), this study provides archival

[3] Finding no evidence of reputable CEOs engaging in rent-extracting activities, Francis et al. (2006) attribute their results to firms with lower innate accruals quality requiring more talented CEOs to manage operations in a complex environment.

evidence that supports the "leadership school" of thought. Specifically, I document that superstar CEOs who win awards improve long-term firm performance.

Finally, this study promotes further understanding of the superstar CEO phenomenon. The two existing archival studies that investigate this phenomenon both focus on the effects of winning awards on superstar CEOs' personal outcomes, such as changes in compensation incentives. Malmendier and Tate (2005) find that, relative to the second-highest paid executive in the firm, award-winning CEOs gain an increase in total compensation. Wade et al. (2006) find that after winning high-profile awards, superstar CEOs face higher pay-performance sensitivities. In contrast, I examine the impact of superstar CEOs on financial reporting practices and firm performance.[4]

The remainder of the dissertation is as follows. Section 2 reviews the literature and develops my main hypotheses. Section 3 describes the data collection and research methods. In Section 4, I describe my sample data. In Section 5, I report my tests of how superstar CEOs impact financial reporting practices and firm performance. Section 6 discusses additional sensitivity tests and section 7 concludes.

[4] Contrary to my results that superstar CEOs have a positive impact on stock performance, Malmendier and Tate (2005) find that firms managed by superstar CEOs incur negative CAR after their CEOs win awards. Further analysis reveals that their results are specific to their expected returns model and are not robust to alternative methods of computing expected returns. See section 5.2 for more discussion.

2.0 Background and Hypotheses Development

2.1 Managerial Impact on Firm Policies and Performance

Does leadership matter for firm decisions and outcomes? In the traditional economics and finance literature, researchers typically ignore the role of managerial characteristics in shaping corporate practices. Although agency theory, as developed by Jensen and Meckling (1976), recognizes the role of managerial discretion in firm decisions, agency models typically attribute firm decisions to the firm's ability to mitigate managerial incentives (i.e. cross-sectional variation in firm-specific characteristics such as corporate governance mechanisms). However, an emerging body of financial economics research documents associations between managerial characteristics and firms' corporate policies and operating performance.[5]

Using panel data that tracks the same top executives across different firms, Bertrand and Schoar (2003) show that managerial fixed effects explain a wide range of corporate finance decisions, such as investment policies, financial policies, and organizational strategies. Specifically, different managerial styles (e.g. an investment style of internal growth versus one of external acquisition) are systematically related to firm performance. For example, managers who make a large number of external acquisitions are associated with lower return-on-assets (ROA) values. Using a similar fixed effects methodology, Richardson, Tuna, and

[5] On a related note, macro-economics studies also find evidence supporting the "leadership school" of thought that leaders matter. For example, Jones and Olken (2005) find that national leaders play a critical role in shaping a nation's growth and are likely to affect monetary policy outcomes.

Wysocki (2003) show that firms with common directors pursue similar corporate policies. In a recent survey of CEOs and CFOs, Ben-David, Graham, and Harvey (2006) report that overconfident managers pursue aggressive corporate finance policies. Specifically, they invest more intensively, maintain higher debt ratios, and prefer debt with a longer maturity period.

The impact of managerial characteristics on firm performance has also been formalized in analytical models. In particular, Rotemberg and Saloner (2000) and Van den Steen (2005) explicitly model the role of visionary managers in aligning employees' decisions to select profitable investment projects. Besides case studies that document the links between CEO qualities, organizational decisions, and subsequent firm performance (Finkelstel and Hambrick 1996), Adams, Almeida, and Ferreira (2005) present archival evidence that powerful CEOs have greater influence on firm performance. In addition, studies that examine the stock market reaction around management turnover announcements suggest that investors perceive CEOs to have the ability to affect firm performance. In particular, Johnson, Magee, Nagarajan, and Newman (1985) find that the abnormal stock returns relating to unexpected executive deaths are associated with the status of the executive as a corporate founder, his decision-making responsibility, and other measures of the executive's talent. Huson, Malatesta, and Parrino (2004) also find positive abnormal returns when CEO turnover is triggered by deteriorating firm performance.

Under the "leadership school" view that managers can affect firm policies and outcomes, superstar CEOs are predicted to have an impact on financial reporting practices and operating performance. However, it is ambiguous as to whether superstar CEOs leverage their reputation to engage in efficient-contracting activities or rent-extracting activities. As such, the directional impact of superstar CEOs on financial reporting practices and operating performance remains an empirical question. The following section discusses the two competing perspectives of how superstar CEOs affect financial reporting practices and operating performance.

2.1 Efficient Contracting Perspective of Superstar CEOs

Analytical models that adopt an efficient contracting perspective (MacLeod and Malcomson 1988; Gibbons and Murphy 1992) propose that reputation serves as an effective mechanism for worker discipline because it provides information to potential employers about the quality of future employees. In particular, a CEO's reputation is established through the executive labor market's updated assessment of his abilities. Although the labor market initially does not know the true abilities of the CEO, it updates its beliefs about the CEO's abilities through the revelation of information related to firm performance. As more performance-related information is revealed, the market's estimation of the CEO's abilities becomes more precise and converges to the CEO's underlying abilities. Wade et al. (2006) argue that high-profile awards provide a visible and public assessment superstar CEOs by a panel of prominent

business experts, such as peer business leaders, financial analysts, and business journalists. The executive labor market will perceive high-profile award winners to be highly-talented managers because such awards provide a consensus of stakeholders' opinion of a CEO's true abilities. Thus, superstar CEOs can afford not to take any rent-seeking actions to meet short-term stakeholders' expectations because the executive labor market has already established a more precise estimate of their abilities. To preserve their established reputation, superstar CEOs have career-related incentives to align even more of their actions with stakeholders' interests after winning awards (Fama 1980; Kreps 1990).

Ball and Shivakumar (2005) argue that timely loss recognition is a desirable financial reporting practice for stakeholders because it enhances corporate governance and debt contracting efficiency. Timely loss recognition aligns managers with shareholders' interests because if managers ex-ante know that timely losses will be recognized during their reign, they are more likely to limit economic losses by abandoning negative-NPV investment projects quickly. In addition, timely loss recognition aligns managers with debt-holders' interests because it triggers debt covenant violations more quickly and thus, allows creditors more opportunities to restrict potential rent-extracting activities such as the excessive distribution of dividends. Furthermore, better financial reporting quality reduces the costs of capital for the firm (Francis, LaFond, Olsson, and Schipper 2004). Therefore, superstar CEOs will report economic losses in a timely fashion to enhance their human capital in the executive labor market.

H1a: Superstar CEOs are associated with more timely recognition of losses.

From an efficient contracting perspective, superstar CEOs will focus more on the long-term horizon of the firm and are thus less concerned about short-term stock price changes. Winning high-profile awards indicates that superstar CEOs have established their reputation of being highly talented managers in the executive labor market. As such, they can weather short-term fluctuations in firm performance without any major revisions of stakeholders' beliefs in their abilities. Therefore, superstar CEOs have fewer incentives to avoid negative earnings surprises and would, at the very least, not use income-increasing accruals to satisfy shareholders' demands for meeting short-term earnings benchmarks. In addition, superstar CEOs have incentives to not engage in opportunistic earnings management because they would suffer heavier human capital penalties in the executive labor market when their rent-seeking activities unravel. Hence, superstar CEOs engage in less earnings management and consequently, have a lower propensity to report small earnings surprises.[6]

H2a: Superstar CEOs are associated with a lower incidence of earnings management.

From the efficient contracting perspective, superstar CEOs will, in actual fact, be able to improve firm performance if high-profile awards accurately reflect

[6] The capital markets perceive firms that achieve small earnings surprises to have engaged in opportunistic earnings management because mangers would strategically manage earnings to beat earnings benchmarks by a small margin and preserve the remaining "cookie jar" reserves for future manipulation (Burgstahler and Dichev 1997). The three common benchmark proxies for earnings management are (i) small positive earnings, (ii) small increase from prior years' earnings, and (iii) just meeting consensus analysts' forecasts.

their underlying abilities. When firms employ superstar CEOs, they enhance their credibility to stakeholders by signaling that their CEOs are of better quality and thus, are likely to increase firm value (Wade et al. 2006). Hall (1992) argues that intangible resources like reputation contribute the most to the firm's operating success. For example, stakeholders' wide-spread deference to their celebrity status means that superstar CEOs can use their knowledge and skills more effectively to secure new markets or negotiate better terms of credit. Therefore, superstar CEOs will achieve better firm performance.

H3a: Superstar CEOs are associated with higher firm performance.

2.2 Rent Extraction Perspective of Superstar CEOs

The rent extraction perspective suggests that there is a "dark side" to superstar CEOs winning high-profile awards. Hayward, Rindova, and Pollock (2004) posit that the media tends to wrongly attribute positive firm performance to CEOs' ability by ignoring environmental factors. It often results in a culture in which stakeholders embrace the superstar CEOs' celebrity status as an intangible asset to the firm. Consequently, being publicly worshiped as a superstar carries the "burden of celebrity," especially since superstar CEOs have personal incentives to protect their reputation (Fombrun 1996).

To protect their reputation, rent-seeking superstar CEOs are less inclined to implement financial reporting policies that reflect badly on their competence. In particular, they would not report losses in a timely manner because any financial losses highlight their inability to successfully manage the firm.

Furthermore, timely loss recognition would draw attention to negative-NPV investment projects that were initially selected to increase their personal profile. For example, a superstar CEO with a reputation of acquiring profitable business targets would delay write-downs of goodwill for unprofitable acquisitions. Otherwise, he has to publicly acknowledge that he made a poor acquisition decision, which would damage his reputation of possessing the Midas touch in mergers and acquisitions.

H1b: Superstar CEOs are associated with less timely recognition of losses.

Due to the hype generated by the media about superstar CEOs' abilities to create value for the firm, superstar CEOs are held to unrealistically high performance expectations by the capital markets. In particular, superstar CEOs have incentives to avoid negative earnings surprises because any inability to meet earnings benchmarks is a potential signal of managerial failure to the executive labor market (Graham, Harvey, and Rajgopal 2005). Furthermore, they have equity incentives to prevent negative stock price reactions caused by not achieving earnings benchmarks because such misses would result in reductions in their personal wealth (Cheng and Warfield 2005). Thus, to avoid any repercussions from missing capital market expectations, rent-seeking superstar CEOs will use income-increasing accruals to deliver performance. Consequently, they will have a higher propensity to report earnings that marginally beat earnings benchmarks.

H2b: Superstar CEOs are associated with a higher incidence of earnings management.

Hayward and Hambrick (1997) argue that frequent adulation from the media results in CEOs being over-optimistic of their ability to make profitable strategic decisions. Therefore, superstar CEOs who are frequently termed by the media to be "corporate saviors" subsequently make suboptimal investment decisions that reduce firm value. Furthermore, rent-seeking superstar CEOs will overemphasize their personal career enhancements by engaging in distracting activities such as writing memoirs and sitting on numerous boards (Malmendier and Tate 2005). Hence, the rent-seeking behavior of superstar CEOs is detrimental to firm performance.

H3b: Superstar CEOs are associated with lower firm performance.

3.0 Research Methodology

This section describes the empirical methods used to test the implications of CEO reputation on financial reporting practices and firm performance. Specifically, I use a firm fixed effects approach to compare within-firm changes in timely loss recognition, earnings management, and operating performance before and after (ranging from one to three years) each superstar CEO win his first high-profile award. In this approach, firm and year dummy variables are included in my models to account for unobserved variations in the contracting environment (Himmelberg, Hubbard, and Palia 1999).

3.1 Award-Winning Superstar CEOs

To compile the list of superstar CEOs who acquire a positive reputation from winning prestigious awards, I hand-collect data on high-profile awards given to CEOs from 1987 to 2003.[7] The two main sources of data come from the publications Business Week and Financial World. Other sources include Chief Executive, Forbes, Fortune, and Time. Finally, I include national winners from the Entrepreneur of the Year contest organized by the accounting firm Ernst & Young. Appendix A provides additional descriptions about the awards. To avoid duplication of firm observations in my analyses, I only consider the first award superstar CEOs win. To be included in my test sample, the superstar CEO must continue to serve as the firm's CEO for another three years after winning awards.

[7] The classification year is based on the year in which the CEO's competence is assessed. For example, Citigroup's Sanford Weil is honored as one of the Top Managers of the Year in the January 8, 2001 issue of Business Week . He would be classified as a superstar CEO in 2000, with the pre-award period for the empirical tests ranging from 1997 to 1999, and the post-award period ranging from 2001 to 2003.

This ensures that the changes in financial reporting practices and operating performance can be attributed to the superstar CEO.

3.2 Asymmetric Timely Loss Recognition in Financial Statements

The first set of tests examines the relationship between superstar CEOs receiving an award and timelier recognition of economic losses as compared to economic gains in financial statements. Basu (1997) uses the following piecewise-linear regression to identify the asymmetric timely recognition of losses and gains in financial statements:

$$NI_t = \alpha_0 + \alpha_1 DRET_t^- + \alpha_2 RET_t + \alpha_3 DRET_t^- * RET_t + \varepsilon_t \qquad (1)$$

where *NI* is net income per share scaled by beginning period price, *RET* is the contemporaneous 12-month returns less value-weighted market returns, and *DRET*$^-$ is a dummy variable set to 1 if *RET* < 0. In equation (1), stock returns (*RET*) proxy for contemporaneous economic events. The coefficient α_2 reflects the timeliness of economic gains being incorporated in earnings, while ($\alpha_2 + \alpha_3$) indicates the timeliness of economic losses being incorporated in earnings. A positive α_3 captures the incremental timeliness of economic losses being incorporated faster than economic gains in financial statements.

To investigate whether superstar CEOs recognize losses in an timelier fashion after winning awards, I estimate the following:

$$\begin{aligned} NI_t = {} & \alpha_0 + \alpha_1 DRET_t^- + \alpha_2 RET_t + \alpha_3 DRET_t^- * RET_t + \beta_0 POST \\ & + \beta_1 POST_t * DRET_t^- + \beta_2 POST_t * RET_t + \beta_3 POST_t * DRET_t^- * RET_t \\ & + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \end{aligned} \qquad (2)$$

where the dummy variable *POST* represents the post award-winning period. The co-efficient α_3 captures the asymmetric timely recognition of losses prior to superstar CEOs winning awards and β_3 reflects the change in asymmetric timely recognition of losses after superstar CEOs win awards. From an efficient contracting perspective, β_3 is expected to be positive because superstar CEOs will report economic losses faster to align themselves with stakeholders' interests. In contrast, the rent extraction perspective predicts that β_3 will be negative because superstar CEOs will delay reporting losses to prevent a reduction in their human capital and personal equity wealth.

Due to potential misspecifications of the Basu (1997) model (Dietrich, Muller, and Riedl 2006), I use an alternative model proposed by Ball and Shivakumar (2005) to estimate asymmetric timely loss recognition in financial statements. As a result of the role of mitigating noise in operating cash flows, accruals are generally negatively correlated to contemporaneous cash flows (Dechow 1994; Dechow, Kothari and Watts 1998). In a recent study, Ball and Shivakumar (2005) propose that when accruals are used for the purpose of timely gain and loss recognition, a positive correlation between accruals and contemporaneous cash flows attenuates their underlying negative correlation.[8] However, this positive correlation is stronger in cases of economic losses because

[8] In particular, Ball and Shivakumar (2005) argue that because cash flows from durable assets tend to be persistent over time, revisions in current period cash flows are positively correlated with current revisions in expected future cash flows. Since the concept of timely gain and loss recognition is based on expected future cash flows, accruals and contemporaneous cash flows will be positively correlated. For example, if an asset is impaired in the current period, the firm would (i) record lower current cash flows generated from the impaired asset and (ii) accrue charges against income for lower expected future cash flows.

economic losses are more likely to be recognized on a timelier basis as unrealized (non-cash) accrued charges against income, while economic gains are more likely to be recognized on a cash basis only when realized.

Adapting from Dechow, Kothari and Watts (1998), Ball and Shivakumar (2005) estimate the following piecewise-linear relationship between cash flows and accruals:

$$ACC_t = \alpha_0 + \alpha_1 DCFO_t^- + \alpha_2 CFO_t + \alpha_3 DCFO_t^- * CFO_t + \varepsilon_t \qquad (3)$$

where *ACC* is accruals, *CFO* is cash flows from operations, and $DCFO^-$ is a dummy variable set to 1 when *CFO* is negative. Both *ACC* and *CFO* are scaled by lagged total assets. α_2 is expected to be negative because accruals mitigate noise in operating cash flows (Dechow 1994; Dechow et al. 1998). A positive value for α_3 reflects incremental timely recognition of accrued losses in periods of economic losses, while a negative value for α_3 implies that accruals are used purely for the purpose of reducing earnings variability and not for timely recognition of losses.

To examine the effect of superstar CEOs on the asymmetric timely recognition of losses via accruals, I estimate the following model:

$$\begin{aligned} ACC_t = {} & \alpha_0 + \alpha_1 DCFO_t^- + \alpha_2 CFO_t + \alpha_3 DCFO_t^- * CFO_t + \beta_0 POST_t \\ & + \beta_1 POST_t * DCFO_t^- + \beta_2 POST_t * CFO_t + \beta_3 POST_t * DCFO_t^- * CFO_t \\ & + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \end{aligned} \qquad (4)$$

Under the efficient contracting perspective, superstar CEOs report economic losses in an timelier fashion after winning awards. Therefore, β_3 will be positive because a greater amount of accrued losses are charged against income in periods

of negative cash flow. Conversely, β_3 is predicted to be negative if rent-seeking superstar CEOs engage in less timely recognition of losses in financial statements via accruals after winning awards.

3.3 Earnings Management Practices

The second set of tests investigates the relationship between superstar CEOs receiving an award and earnings management, measured as the level of abnormal accruals and the propensity to achieve small earnings surprises. To test within-firm changes in the level of abnormal accruals before and after superstar CEOs win awards, I estimate the following regression:

$$ABACC_t = \alpha_0 + \alpha_1 POST_t + \beta_1 Leverage_t + \beta_2 BM_t + \beta_3 Size_t + \beta_4 STClaim_t + \beta_5 Capital_t + \beta_6 CFOVol_t + \beta_7 ROA_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (5)$$

where ABACC is the level of abnormal of accruals. Under the efficient contracting perspective, α_1 is predicted to be negative because superstars CEOs use less income-increasing accruals to manage earnings after winning awards. In contrast, α_1 would be positive because rent-seeking superstar CEOs satisfy shareholders' short-term demands for performance by using income-increasing accruals to temporarily boost earnings.

To compute abnormal accruals, I use the modified Jones (1991) model (Dechow, Sloan and Swenney 1995). Specifically, I estimate the following regression for each two-digit SIC code with at least 10 firms in each sample year:

$$TA_{i,t} / ASSET_{i,t-1} = \delta_0 1 / ASSET_{i,t-1} + \delta_1 \Delta REV_t / ASSET_{i,t-1} + \delta_2 PPE_{i,t} / ASSET_{i,t-1} + \varepsilon_{it} \quad (6)$$

where *TA* is total accruals, computed as earnings before extraordinary items less cash flows from operations adjusted for extraordinary items and discontinued items; *ASSET* is total assets at the beginning of year t; *ΔREV* is change in revenues; and *PPE* is gross value of property, plant and equipment. The industry- and year-specific parameter estimates obtained from equation (6) are used to estimate firm-specific abnormal accruals:

$$ABACC_{i,t} = TA_{i,t} / ASSET_{i,t-1} - [\hat{\delta}_0 1 / ASSET_{i,t-1} + \hat{\delta}_1(\Delta REV_{i,t} - \Delta AR_{i,t}) / ASSET_{i,t-1} + \hat{\delta}_2 PPE_{i,t} / ASSET_{i,t-1}] \quad (7)$$

where *ΔAR* is firm i's change in the level of accounts receivables.

To account for prior economic determinants of earnings management, I include the following control variables as identified by prior research. First, firms have incentives to manage earnings to avoid debt covenants violations or downgrading of debt ratings (Bowen, Noreen, and Lacey 1981; DeFond and Jiambalvo 1994). Therefore, I include *Leverage* as a proxy for debt-related incentives. Second, I include the book-to-market ratio (*BM*) to control for growth opportunities because growth firms have strong incentives to meet earnings benchmarks to avoid asymmetrically large negative stock price reaction (Skinner and Sloan 2002). Third, I include *Size* to control for political costs because larger firms have incentives to reduce political vulnerability by managing earnings (Watts and Zimmerman 1986).

Fourth, Bowen, DuCharme, and Shores (1995) document that firms choose income-increasing accounting methods to influence stakeholders'

assessment of a firms' ability to fulfill implicit claims. To measure implicit stakeholder claims (*STClaim),* I follow Matsumoto (2002) by extracting a common factor from the following variables using factor analysis: (i) membership in a durable goods industry as indicated by 2 digit SIC codes of 150-179, 245, 250-259, 283, 301, and 324-399; (ii) research and development scaled by lagged total assets; and (iii) labor intensity computed as one minus the ratio of property, plant, and equipment to total assets.

Fifth, I control for firms' demand for external capital because firms are more likely to engage in earnings management if they need frequent access to external financing (Frankel, McNichols, and Wilson 1995; Teoh, Welch and Wong 1998). Following Dechow, Sloan and Sweeney (1996), I measure a firm's ex-ante demand for external financing (*Capital*) in terms of the level of free cash flow, computed using the difference between year t-1 cash flow from operations and the average capital expenditure from years t-3 to t-1. I multiply the level of free cash flow by negative one so that a lower level of free cash flow reflects a higher demand for external capital.

To account for potential model misspecifications arising from omitted cross-sectional correlations between abnormal accruals and firms' operating environment (Hribar and Nichols 2006), I include the control variable cash flow volatility (*CFOVol*), computed using the standard deviation of operating cash flows from operations computed over the three-year period before the observation year. Finally, I include return-on-assets (*ROA*), computed as the income before

extraordinary items scaled by lagged total assets, to account for firm performance because Kothari, Leone, and Wasley (2005) show that empirical models of earnings management that do not control for firm performance are not well-specified.

To investigate the propensity of firms managed by superstar CEOs to marginally exceed earnings benchmarks, I estimate the following conditional logistic regression:

$$DBnMark_t = \alpha_0 + \alpha_1 POST_t + \beta_1 Leverage_t + \beta_2 BM_t + \beta_3 Size_t + \beta_4 STClaim_t + \beta_5 Capital_t + \beta_6 CFOVol_t + \beta_7 ROA_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (8)$$

where *DBnMark* is a dummy variable set to 1 if the firm reports a small positive surprise in annual earnings.[9] Following, Burgstahler and Dichev (1997), a small positive surprise occurs when the change in annual net income scaled by total assets at the end of year t-1 falls within the range of (0.00 to 0.01).

Under the efficient contracting perspective, α_1 will be negative because superstar CEOs focus on the long-term horizon of their firms and thus have fewer incentives to avoid negative earnings surprises. The rent extraction perspective suggests that superstar CEOs have more incentives to avoid capital market ramifications from missing earnings benchmarks. Therefore, α_1 is predicted to be

[9] I considered using the propensity to meet analysts' forecasts as a proxy for earnings management and find no changes after superstar CEOs win awards. However, it is difficult to interpret the results due to the potential confounding effects of analysts' forecasts. For example, due to heightened media coverage of superstar CEOs, analysts might have (i) overly-optimistic earnings expectations or (ii) more accurate earnings forecasts because they follow superstar CEOs more closely after they win awards.

positive because superstar CEOs intervene opportunistically to achieve small earnings increases.

3.4 Firm Performance

To test the impact of superstar CEOs on operating performance, I use stock returns and accounting-based indicators as measures of operating performance. For the returns-based test, I first compute the cumulative abnormal returns (CAR), adjusted by value-weighted market index, for the event window beginning from the month the superstar CEOs win an award and ending in the period ranging from one to three years after the award-winning month. A positive CAR implies that, after superstar CEOs win awards, they contribute to firm value. In contrast, a negative CAR suggests that superstar CEOs engage in rent-seeking activities that subsequently reduce firm value.

In addition, I use the calendar-time portfolio approach to estimate risk-adjusted abnormal returns of firms managed by superstar CEOs.[10] In this approach, a superstar CEO portfolio is formed in each calendar month over the entire sample period, comprising all firms whose CEO had won his first award in the previous period (ranging from one to three years).[11] Using the Fama-French

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[10] A time-calendar portfolio approach is used because recent literature (e.g. Mitchell and Stafford 2000) questions the validity of the common methodology to calculate buy-and-hold returns and form event-time portfolios. In particular, the positive cross-sectional correlation between event firms' returns biases results towards finding positive abnormal returns. See Kothari and Warner (2007) for a more detailed discussion.

[11] The number of firms included in the portfolio is not constant through time because the number of awards given to superstar CEOs varies across the sample period. As such, the portfolio is rebalanced on a monthly basis. Monthly equal-weighted portfolio returns are then computed based on the number of firms that enter and leave the portfolio each month.

(1993) three-factor model, modified with an additional short-run momentum factor (Carhart 1997), I estimate the following regression:

$$RET_m = \alpha_0 + \alpha_1 MKTRF_m + \alpha_2 SMB_m + \alpha_3 HML_m + \alpha_4 UMD_m + \varepsilon_m \quad (9)$$

where RET represents the monthly portfolio returns in excess of Treasury bill rate. *MKTRF* is the excess return on the market, *SMB* is the average return difference between small and big portfolios, *HML* is the average return difference between value and growth portfolios, and *UMD* is the average return differences between high and low return portfolios.[12] The intercept in equation (9) reveals the average monthly abnormal returns that firms managed by superstar CEOs generate after their CEOs win awards. A positive α_0 supports the efficient contracting view that superstar CEOs add value to the firm, while a negative α_0 implies that superstar CEOs extract rents from the firm.

For accounting-based performance measures, I estimate the following regressions to analyze within-firm changes in operating performance:

$$ROA_t = \alpha_0 + \alpha_1 POST_t + \alpha_2 ROA_{t-1} + \alpha_3 \sigma ROA_{t-1} + \alpha_4 Size_{t-1} + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (10)$$

$$CFO_t = \alpha_0 + \alpha_1 POST_t + \alpha_2 CFO_{t-1} + \alpha_3 \sigma CFO_{t-1} + \alpha_4 Size_{t-1} + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (11)$$

where prior year's performance measures (ROA_{t-1}, CFO_{t-1}) are included to control for potential mean-reversion effects in accounting performance measures (Barber and Lyon 1996). The standard deviation (σROA_{t-1}, σCFO_{t-1}) of each accounting

[12] Data is obtained from Professor Kenneth French's website (available at http://mba.tuck.dartmouth.edu/pages/faculty/ ken.french/data_library.html).

measure (three-years prior to each observation) and natural logarithm of total assets (*Size*) are included to control for the effects of risk and size on future operating performance. The efficient contracting perspective predicts that superstar CEOs leverage their reputation to improve firm performance after winning awards, thus α_1 is expected to be positive. Alternatively, operating performance would decline if superstar CEOs engage in rent-seeking activities. Therefore, α_1 will be negative under the rent extraction perspective of superstar CEOs.

4.0 Sample Description

Table 1 summarizes the superstar CEO data set. After merging it with available COMPUSTAT and CRSP data, a total of 269 award winners are identified from 1987 to 2003. The bulk of award winners come from the Business Week and Financial World magazines. There are only 189 individual superstar CEOs from the 269 awards because 52 of them won multiple-awards in different years. For example, the top superstar CEOs who won multiple awards came from well-known firms, such as Meg Whitman (EBay), Sanford Weil (Citigroup), Jack Welch (General Electric), Steve Jobs (Apple Computer), Jorma Ollila (Nokia), Scott McNealy (Sun Microsystems), Bill Gates (Microsoft), and Michael Eisner (Walt Disney).

Table 2 provides descriptive statistics of the firms managed by superstar CEOs when they win their first award. The declining trend in the book-to-market ratio in the years prior to superstar CEOs winning awards suggests that firms managed by superstar CEOs are growth firms. On average, performance, as measured by earnings per share, return-on-assets, and cash flows from operations, increases up to the year that superstar CEOs win awards. This suggests that a potential criterion that contest judges use to identify superstar CEOs is firm performance.[13]

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[13] In Section 6, I account for potential endogeneity issues by examining firm-level characteristics that are used by award organizers to select winners. For the year in which the CEO is assessed and recognized as winners, I find that the firm's economic environment (size and growth) and operating performance (return-on-assets and stock returns) are important criteria used to identify superstar CEOs.

Table 1: Summary Statistics of Awards and Superstar CEOs

Panel A: General Description of Awards

Source	Title of Award	From	To	Number of Winners
Business Week	Best Manager / Entrepreneur of the Year	1987	2003	163
Financial World	CEO of the Year	1987	1996	50
Forbes	Best Bosses of the Year	2001	2003	20
Time	Most Influential Global Business Executive	2001	2001	12
Fortune	Most Powerful People in Business	2003	2003	11
Chief Executive	CEO of the Year	1987	2003	8
Ernst & Young	Entrepreneur of the Year	1989	2003	5
Total		1987	2003	269

Panel B: Breakdown on Number of Awards Won by Each Superstar CEO

Number of Awards	Number of Superstar CEOs	Total Number of Awards
5 Awards	3	15
4 Awards	5	20
3 Awards	9	27
2 Awards	35	70
1 Award	137	137
Total	189	269

Notes: Panel A provides a breakdown of the number of award winners from the seven CEO contests held from 1987 to 2003. The classification year is based on the year in which the CEO's performance is based. To be included in the test sample, the superstar CEO must continue to serve as the company's CEO for the next three years after winning awards. If superstar CEOs win multiple awards in one year, only one award is considered. Panel B describes the number of awards won by each superstar CEO. For subsequent analyses, only the first award won by each superstar CEO is considered.

Table 2: Descriptive Statistics of Test Variables from Superstar CEOs Sample

Descriptive Statistics (Mean Values) of Test Sample
(No. of firm-year observations = 189)

Variable (Mean Values)	3 Years Before	2 Years Before	1 Year Before	Award Year	1 Year After	2 Years After	3 Years After
Market Capitalization	24,303	25,972	26,921	30,190	33,617	39,168	37,539
Total Assets	29,335	30,685	32,502	32,711	36,455	40,998	40,494
Sales	8.468	8.404	8.649	8.607	8.807	8.953	9.019
Book-to-Market	0.448	0.417	0.403	0.345	0.362	0.375	0.377
Leverage	0.169	0.177	0.168	0.160	0.155	0.155	0.151
EPS	0.023	0.037	0.041	0.057	0.051	0.035	0.031
ROA	0.053	0.058	0.059	0.083	0.076	0.063	0.068
CFO	0.121	0.127	0.133	0.132	0.131	0.121	0.120
DBnMark	0.149	0.116	0.189	0.197	0.170	0.156	0.200
Accruals	-0.060	-0.066	-0.074	-0.054	-0.061	-0.059	-0.053
Absolute Accruals	0.114	0.164	0.115	0.183	0.376	0.399	0.518
Stake	0.184	0.153	0.128	0.141	0.125	0.123	0.104
Capital	-0.095	-0.099	-0.108	-0.120	-0.125	-0.147	-0.108
CFOVol	0.051	0.046	0.051	0.055	0.047	0.048	0.041

Notes: Market Capitalization is the market value of equity, computed as stock price multiplied by number of shares outstanding. Total assets are the firms' assets net of liabilities and shareholders' equity. Sales are the natural logarithm of sales. Book-to-market is the book-to-market ratio. *Leverage* is the proportion of long-term debt to total assets. EPS is net income per share scaled by beginning period price. ROA is return-on-assets, computed as income before extraordinary items scaled by lagged total assets. CFO is cash flow from operations, scaled by lagged total assets. *DBnMark* is a dummy variable set to 1 if the firm reports a small positive surprise in annual earnings. A small positive surprise occurs when the change in lagged annual net income scaled by total assets at the end of year t-1 falls within the range of (0.00 to 0.01).
Accruals are the difference between income before extraordinary items and operating cash flows, adjusted for extraordinary items and discontinued operations. Absolute Accruals refer to the absolute value of accruals. *STClaim* is a factor score reflecting implicit stakeholder claims using durable industry membership, research and development expenses and labor intensity. *Capital* indicates the firm's ex-ante demand for external financing as reflected by the level of free cash flow multiplied by negative one, where free cash flow is computed using the difference between year t-1 cash flow from operations and the average capital expenditure from years t-3 to t-1. *CFOVol* is computed using the standard deviation of operating cash flow from operations computed over the three-year periods prior to sample year.

5.0 Results

5.1 Superstar CEOs' Impact on Financial Reporting Practices

Table 3 reports the impact of superstar CEOs on asymmetric timely loss recognition in the financial statements. Panel A shows the results when the Basu (1997) returns-based model is used. Across all three test periods, the coefficients on $DRET^{-}*RET$ is significant (t-statistic $\geq$ 2.28), implying that even before winning awards, superstar CEOs reported economic losses faster than gains. The positive coefficients on $POST*DRET^{-}*RET$ (t-statistic $\geq$ 1.93) reveal that superstar CEOs engage in even more asymmetric timely loss recognition after winning awards.

Table 3 Panel B depicts the results when the Ball and Shivakumar (2005) accruals-based model is utilized. Consistent with prior literature that accruals are negatively correlated with cash flows from operations (Dechow 1994; Dechow, Kothari, and Watts 1998), the coefficient on *CFO* is negatively significant across all three test periods. For the two and three-year comparisons, the positive coefficients on $DCFO^{-}*CFO$ again indicate that superstar CEOs make timely recognition of losses even prior to winning awards. Similarly, the positive coefficients on $POST*DCFO^{-}*CFO$ positive (t-statistic $\geq$ 4.74) for the two and three-year comparisons reinforce the evidence that superstar CEOs report economic losses in an even more timely fashion after they win awards.[14] As such, the results are consistent with the efficient contracting perspective that superstar

[14] To test the sensitivity of the results, I include an additional variable to control for firm size for both models. My inferences remain the same.

CEOs improve the quality of financial reporting after winning high-profile awards.

Table 4 reports the impact of superstar CEOs on earnings management. In Panel A, *POST* represents the within-firm change in the level of abnormal accruals after superstar CEOs win awards. Across all three test periods, the coefficients on *POST* are insignificant, implying that there is no change in the level of abnormal accruals after superstar CEOs win awards.[15] Panel B reports the results from the conditional logistic regression testing the propensity of superstar CEOs to report small earnings increases.[16] For the two and three-year comparisons, the coefficient on *POST* is negative and significant (χ^2 statistics = 6.36 and 2.94, p-values = 0.01 and 0.09), suggesting that there is potentially less opportunistic managerial intervention by superstar CEOs to meet short-term capital market expectations. Overall, the results from Table 4 provide some evidence that there is a lower incidence of earnings management after superstar CEOs win awards, suggesting that superstar CEOs would, at minimum, not engage in short-term rent-seeking activities to meet stakeholders' expectations. In Section 6, I perform additional tests to ascertain that superstar CEOs do not engage in opportunistic earnings management.

5.2 Superstar CEOs' Impact on Firm Performance

Table 5 Panel A reports the market-adjusted cumulative abnormal returns

[15] I also estimate equation (5) using absolute abnormal accruals instead of signed abnormal accruals. Similarly, I do not find any significant change in the level of absolute abnormal accruals.
[16] I am unable to estimate within-firm changes using the fixed effects approach for the one-year period because there are insufficient observations to estimate fixed effects in a conditional logistic regression. For completeness, I report the logistic regression results without fixed effects.

(CAR) for the one to three-year periods after superstar CEOs win awards. For all three test periods, firms managed by superstar CEOs achieve positive CAR, ranging from 5.7% (t-statistic = 1.74) for the one-year period to 11.7% (t-statistic = 2.64) for the three-year period. These results suggest that the capital markets view firms' long-term performance favorably after superstar CEOs win awards.[17]

In contrast, Malmendier and Tate (2005) document that firms managed by superstar CEOs incur negative CAR for the one to three-year periods after their CEOs win awards. Further analysis reveals that the difference between my results and theirs potentially arises from different methods of computing abnormal returns. To compute abnormal returns in the test periods, Malmendier and Tate (2005) first estimate the current expected returns using the three-year period returns prior to the event of superstar CEOs winning awards. In this approach, abnormally high prior returns would overstate the expected returns in the test periods and hence create a bias towards finding negative abnormal returns. Such a bias can be seen from my data because firms in my test sample have a 66.18% CAR for the three-year period prior to the event of their superstar CEOs winning awards. Using the approach by Malmendier and Tate (2005) would subsequently lead to wrong inferences arising from the bias towards finding negative abnormal returns in the test periods. I compute abnormal returns by adjusting current period

[17] I considered investigating the short-window market reaction to the event of superstar CEOs winning awards but have no confidence in the inferences due to inaccuracies of the event dates. The event dates are based on the magazines' official publication dates and are usually later than the actual dates when the magazines are circulated to the public. I do not find any significant market reaction in the three to five-day event window surrounding the announcement of superstar CEOs winning awards.

returns with the contemporaneous value-weighted market returns. This approach is more suitable because other alternative methods of computing abnormal returns in my test sample also yield positive CAR.[18]

Table 5 Panel B reports the results of estimating risk-adjusted abnormal returns from the calendar-time portfolio approach. The intercept in equation (9) reveals the monthly abnormal returns generated by firms managed by superstar CEOs after their CEOs win awards. The intercepts are all positive (t-statistics ≥ 2.16), indicating that firms managed by superstar CEOs generate CAR ranging from approximately 6.0% for the one-year period to 18.0% for the three-year period after their CEOs win awards.

Table 6 presents the impact of superstar CEOs on accounting-based performance. In Panel A, the coefficients on *POST,* representing within-firm changes in ROA after superstar CEOs win awards, are all positive (t-statistics ≥ 3.19). In Panel B, only the three-year period comparison reveals a significant coefficient on *POST* (coefficient = 0.010 and t-statistic = 2.04). Consistent with prior research (Minton, Schrand, and Walther 2002), the negative impact of

[18] Different test samples of superstar CEOs could also potentially account for the difference between my results and Malmendier and Tate (2005). Using my test sample, I am able to replicate Malmendier and Tate's (2005) results of negative CAR using their approach. Specifically, they first estimate the α and β of the standard market model using the three-year returns prior to the event of superstar CEOs winning awards. They then compute current abnormal returns using the estimated α and β from the prior period and find negative CAR for the one to three-year periods after superstar CEOs win awards. When they drop α from the standard market model, they find a positive 0.8% CAR for the one-year period after superstar CEOs win awards. Similarly, I find significantly positive CAR for all three test periods when I drop α from the standard market model to estimate expected returns. This provides additional support that computing expected returns with the standard market model using both α and β is a biased approach.

operating risk on future operating performance could be inferred from the negative coefficients on σROA_{t-1} and σCFO_{t-1}.

In general, the results are consistent with the "leadership school" of thought that managers are associated with firm performance. Coupled with the findings that, after winning awards, superstar CEOs report economic losses in an even more timely fashion and are less likely to engage in opportunistic actions to achieve small earnings surprises, the overall evidence gives credence to the efficient-contracting view that superstar CEOs enhance the quality of financial reporting and add firm value.

Table 3: The Impact of Superstar CEOs on Asymmetric Timely Loss Recognition

Panel A: Within-firm changes using Basu (1997) returns-based model

$$NI_t = \alpha_0 + \alpha_1 DRET_t^- + \alpha_2 RET_t + \alpha_3 DRET_t^- * RET_t + \beta_0 POST + \beta_1 POST_t * DRET_t^- + \beta_2 POST_t * RET_t + \beta_3 POST_t * DRET_t^- * RET_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (2)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	(t-stat)	Coeff	(t-stat)	Coeff	(t-stat)
DRET⁻	0.003	(0.22)	0.010	(1.00)	0.014	(1.61)
RET	0.031	(2.28)	0.032	(3.22)	0.034	(3.04)
DRET⁻*RET	0.109	(2.61)	0.089	(2.96)	0.053	(2.20)
POST	0.000	(-0.05)	-0.002	(-0.21)	0.006	(0.79)
POST*DRET⁻	-0.006	(-0.31)	-0.009	(-0.74)	0.000	(0.01)
POST*RET	0.008	(0.41)	-0.002	(-0.15)	-0.026	(-1.38)
POST*DRET⁻*RET	0.158	(2.48)	0.101	(2.90)	0.060	(1.93)
No. of firm-year obs	352		632		856	
Adj. R^2(%)	0.775		0.566		0.489	

Panel B: Within-firm changes using Ball and Shivakumar (2005) accruals-based model

$$ACC_t = \alpha_0 + \alpha_1 DCFO_t^- + \alpha_2 CFO_t + \alpha_3 DCFO_t^- * CFO_t + \beta_0 POST_t + \beta_1 POST_t * DCFO_t^- + \beta_2 POST_t * CFO_t + \beta_3 POST_t * DCFO_t^- * CFO_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (4)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
DCFO⁻	0.092	(1.37)	0.082	(3.18)	0.074	(3.72)
CFO	-0.341	(-2.07)	-0.351	(-5.94)	-0.483	(-10.72)
DCFO⁻*CFO	0.026	(0.15)	0.050	(2.96)	0.032	(2.19)
POST	0.055	(1.66)	0.035	(2.41)	0.033	(2.96)
POST* DCFO⁻	0.005	(0.05)	0.003	(0.07)	-0.034	(-1.32)
POST*CFO	-0.195	(-1.11)	-0.164	(-2.09)	-0.142	(-2.55)
POST* DCFO⁻*CFO	0.148	(1.62)	0.187	(4.74)	0.189	(5.61)
No. of firm-year obs	340		580		770	
Adj. R^2(%)	0.835		0.649		0.631	

Table 3 (continued):
The Impact of Superstar CEOs on Timely Loss Recognition

Notes: Panel A reports the within-firm change in asymmetric timely loss recognition in financial statements before and after superstar CEOs win awards using Basu (1997) model. *RET* is the contemporaneous 12-month returns less value-weighted market returns. *DRET*⁻ is a dummy variable set to 1 if $RET < 0$ to reflect bad economic events. Panel B reports the within-firm change in asymmetric timely loss recognition in financial statements before and after superstar CEOs win awards using Ball and Shivakumar (2005) model. *ACC* is accruals and *CFO* is cash from operations. Both *ACC* and *CFO* are scaled by lagged total assets. DCFO⁻ a dummy variable set to 1 when *CFO* is negative to reflect bad economic events. The firm and year dummy variables to account for firm and year fixed effects are not reported for the sake of brevity.

Table 4: The Impact of Superstar CEOs on Earnings Management Practices

Panel A: Within-firm Changes using OLS Regression on the level of Abnormal Accruals

$$ABACC_t = \alpha_0 + \alpha_1 POST_t + \beta_1 Leverage_t + \beta_2 BM_t + \beta_3 Size_t + \beta_4 STClaim_t + \beta_5 Capital_t + \beta_6 CFOVol_t + \beta_7 ROA_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (5)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
POST	-0.371	(-1.50)	-0.274	(-1.08)	-0.297	(-1.14)
Leverage	0.503	(0.27)	0.531	(0.35)	2.346	(1.73)
BM	-0.374	(-0.34)	-0.555	(-0.72)	-0.534	(-0.78)
Size	0.561	(1.79)	0.373	(1.44)	0.559	(2.24)
STClaim	-0.246	(-0.27)	-0.267	(-0.35)	-0.197	(-0.26)
Capital	0.826	(0.65)	2.022	(1.97)	0.976	(1.07)
CFOVol	7.031	(1.01)	6.999	(1.41)	7.498	(1.40)
ROA	1.396	(1.61)	1.316	(1.84)	1.419	(1.86)
No. of firm-year obs	242		404		540	
Adj. R^2(%)	0.771		0.383		0.303	

Panel B: Within-firm Changes using Conditional Logistic Regression of Achieving Earnings Benchmark

$$DBnMark_t = \alpha_0 + \alpha_1 POST_t + \beta_1 Leverage_t + \beta_2 BM_t + \beta_3 Size_t + \beta_4 STClaim_t + \beta_5 Capital_t + \beta_6 CFOVol_t + \beta_7 ROA_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (8)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	χ^2-stat	Coeff	χ^2-stat	Coeff	χ^2-stat
POST	-1.559	(0.56)	-3.890	(6.36)	-6.338	(2.94)
Leverage	0.305	(0.46)	0.140	(0.15)	0.731	(1.67)
BM	-0.910	(1.08)	-0.113	(0.02)	-3.111	(2.06)
Size	0.335	(3.86)	0.271	(4.80)	1.280	(2.64)
STClaim	-1.258	(1.01)	-1.192	(1.26)	0.807	(0.29)
Capital	0.366	(3.15)	0.356	(3.62)	3.570	(2.03)
CFOVol	-14.872	(2.44)	-17.868	(5.11)	-31.866	(2.04)
ROA	-1.381	(4.67)	-1.740	(1.91)	-2.307	(0.31)
No. of firm-year obs	242		404		540	
Pseudo R^2(%)	0.152		0.308		0.227	

Table 4 (continued):
The Impact of Superstar CEOs on Earnings Management Practices

Notes: Panel A reports the within-firm change in the level of abnormal accruals (*ABACC*) before and after superstar CEOs win awards. *ABACC* is computed using the modified Jones (1991) model. The firm and year dummy variables to account for firm and year fixed effects are not reported for brevity. Panel B reports the within-firm change in the propensity to achieve small earnings benchmark (*DBnMark*) before and after superstar CEOs win awards. *DBnMark* is a dummy variable set to 1 if the firm reports a small positive surprise in annual earnings. A small positive surprise occurs when the change in lagged annual net income scaled by total assets at the end of year t-1 falls within the range of (0.00 to 0.01). For the one-year comparison, firm and year fixed effects are not estimated because of insufficient observations required by the conditional logistic regression approach to estimate fixed effects. For the two and three-year periods, firm and year fixed effects are not reported for the sake of brevity. *POST* is a dummy variable set to 1 to indicate the period after superstar CEOs win awards. *Leverage* is the proportion of long-term debt to total assets. BM is the book-to-market ratio. Size is measured as the natural logarithm of firm's total assets. *STClaim* is a factor score reflecting implicit stakeholder claims using durable industry membership, research and development expenses and labor intensity. *Capital* indicates the firm's ex-ante demand for external financing in terms of the level of free cash flow multiplied by negative one, where free cash flow is computed using the difference between year t-1 cash flow from operations and the average capital expenditure from years t-3 to t-1. *CFOVol* is computed using the standard deviation of operating cash flow from operations computed over the three-year periods prior to sample year. ROA is return-on-assets, computed as income before extraordinary items scaled by lagged total assets.

Table 5: The Impact of Superstar CEOs on Stock Performance

Panel A: Cumulative Abnormal Returns (CAR) after winning Awards

Variable	1 Year (No. of firm-years = 165)		2 Years (No. of firm-years = 165)		3 Years (No. of firm-years = 162)	
	Coeff	(t-stat)	Coeff	(t-stat)	Coeff	(t-stat)
CAR	0.057	(1.74)	0.089	(2.22)	0.117	(2.64)

Panel B: Fama-French Factor Returns Model after winning Awards

$$RET_m = \alpha_0 + \alpha_1 MKTRF_m + \alpha_2 SMB_m + \alpha_3 HML_m + \alpha_4 UMD_m + \varepsilon_m \qquad (9)$$

Variable	1 Year		2 Years		3 Years	
	Coeff	(t-stat)	Coeff	(t-stat)	Coeff	(t-stat)
Intercept	0.005	(2.16)	0.004	(2.18)	0.005	(2.75)
MKTRF	1.053	(17.91)	1.075	(21.03)	1.085	(23.38)
SMB	-0.028	(-0.41)	0.062	(1.03)	0.099	(1.82)
HML	0.075	(0.87)	-0.409	(-5.51)	-0.337	(-4.99)
UMD	-0.079	(-1.61)	-0.071	(-1.67)	-0.144	(-3.70)
No. of months	214		222		222	
Adj. R^2(%)	0.724		0.792		0.822	

Notes: Panel A reports the cumulative abnormal returns (CAR) that is adjusted by value-weighted market index, for the event window beginning from the month superstar CEOs win an award. Panel B reports the calendar-time portfolio approach to estimate risk-adjusted abnormal returns of superstar CEOs after winning awards. *RET* is the monthly portfolio returns in excess of Treasury bill rate. *MKTRF* is the excess return on the market. *SMB* is the average return difference between small and big portfolios. *HML* is the average return difference between value and growth portfolios. *UMD* is the average return differences between high and low return portfolios. Treasury bill rate and factors are obtained from Professor Kenneth French's website (available at http://mba.tuck.dartmouth.edu/pages/faculty/ ken.french/data_library.html).

Table 6: The Impact of Superstar CEOs on Accounting-Based Performance

Panel A: Within-firm Changes in Returns-on-Assets (ROA)

$$ROA_t = \alpha_0 + \alpha_1 POST_t + \alpha_2 ROA_{t-1} + \alpha_3 \sigma ROA_{t-1} + \alpha_4 Size_{t-1} + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (10)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
POST	0.037	(3.19)	0.021	(3.50)	0.019	(3.92)
ROA_{t-1}	0.789	(4.15)	0.199	(4.86)	0.277	(8.68)
σROA	-0.176	(-1.45)	-0.092	(-1.94)	-0.199	(-5.88)
Size	-0.024	(-1.51)	-0.035	(-5.25)	-0.029	(-5.24)
No. of firm-year obs	298		502		684	
Adj. R^2(%)	0.812		0.698		0.685	

Panel B: Within-firm Changes in Cash Flows from Operations (CFO)

$$CFO_t = \alpha_0 + \alpha_1 POST_t + \alpha_2 CFO_{t-1} + \alpha_3 \sigma CFO_{t-1} + \alpha_4 Size_{t-1} + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (11)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
POST	0.000	(0.05)	0.008	(1.43)	0.010	(2.04)
CFO_{t-1}	0.262	(5.28)	0.173	(5.13)	0.179	(5.86)
σCFO	-0.063	(-5.16)	-0.206	(-3.67)	-0.230	(-4.78)
Size	-0.135	(-1.43)	-0.040	(-5.80)	-0.043	(-7.29)
No. of firm-year obs	248		434		598	
Adj. R^2(%)	0.925		0.782		0.762	

Notes: Panel A and Panel B reports the within-firm changes in return-on-assets (ROA) and cash flows from operations (CFO) before and after superstar CEOs win awards. *POST* indicates the period after superstar CEOs win awards. Lagged ROA and CFO are included to control for mean-reversion effects. The standard deviation (σROA_{t-1}, σCFO_{t-1}) of each measure is computed based on the three-years prior to each observation to control for risk. Size is measured using the natural logarithm of total assets to control for the effects size on future operating performance. The firm and year dummy variables to account for firm and year fixed effects are not reported for the sake of brevity.

6.0 Sensitivity Analysis

A potential concern with inferences made in the previous section is that endogenous firm-level characteristics are driving the results. As such, I perform sensitivity tests using a control sample of non-superstar CEOs. These CEOs were chosen based on the similarity of their firms' economic environment and operating performance to those managed by superstar CEOs prior to winning awards. Using a similar firm fixed effects approach, I compare within-firm changes in financial reporting practices and operating performance before and after non-superstar CEOs are predicted to win awards to determine whether the trends documented earlier exist for this sample.

6.1 Identifying a Control Sample of Non-Superstar CEOs

To identify a control sample of non-superstar CEOs who are predicted to win awards, I compare all S&P 500 firms to firms that are managed by superstar CEOs by estimating the following model:

$$DAward_i = \alpha_0 + \alpha_1 Size_i + \beta_1 BM_i + \beta_2 ROA_i + \beta_3 RET_i + \beta_4 RETVol_i + \gamma IndustryEffects_i + \delta YearEffects_i + \varepsilon_i \quad (12)$$

where *DAward* is a dummy variable set to 1 for the year in which the CEO's performance is assessed and recognized by the award-organizers as winners. To account for similar pre-event (i.e. winning an award) economic environment (Barber and Lyon 1996), I include *Size* and book-to-market ratio (*BM*). Johnson et al. (1993) find that both accounting and stock markets measures of performance affect the perception of CEOs' reputation to win awards. Therefore, I include

ROA to control for accounting performance. For stock market performance, I include the contemporaneous 12-month value-weighted adjusted returns (*RET*) and the standard deviation of the returns (*RETVol*) based on the year when the CEO's performance is assessed.

Table 7 Panel A reports the characteristics of firms whose CEOs are likely to win awards. The prediction model has a pseudo R-squared of 26.6% and the significant coefficients on *Size, BM, ROA,* and *RET* suggest that firm size, growth, ROA, and stock returns are good predictors of whether a firm's CEO is likely to win an award. To obtain a control sample of non-superstar CEOs who are predicted to win awards, firms without superstar CEOs are matched to each award-winning superstar CEO firm-year observation based on the following criteria: (i) same industry; (ii) same year; and (iii) closest predicted probabilities estimated from equation (12). This procedure yields a control sample of 172 firms whose non-superstar CEOs are predicted to win awards. Table 7 Panel B compares the characteristics between firms managed by superstar CEOs and those managed by non-superstar CEOs who are predicted to win awards. There are no differences in all five predictors of CEOs winning awards, suggesting that the control firms share a similar economic environment and have comparable firm performance to those managed by superstar CEOs.

6.2 Within-Firm Tests of Non-Superstar CEOs

I perform similar tests of within-firm changes in financial reporting practices and operating performance before and after non-superstar CEOs are

predicted to win awards in the control sample. Table 8 summarizes the impact of non-superstar CEOs on financial reporting practices. Panel A presents the asymmetric timely loss recognition test using Basu's (1997) returns-based model. The coefficients on *POST*DRET*RET* suggest no evidence that non-superstar CEOs report economic losses in a timelier fashion after they are predicted to awards. In untabulated analysis, the results also showed no change in asymmetric timely loss recognition when I use Ball and Shivakumar's (1997) returns-based model. Panel B reports the tests of within-firm changes in the level of abnormal accruals after non-superstar CEOs are predicted to win awards. The coefficients on *POST* are insignificant across all three test periods, indicating no change in the level of abnormal accruals after non-superstar CEOs are predicted to win awards. Similarly, untabulated analysis finds no change in the non-superstar CEOs' propensity to report small earnings increases.

Finally, Table 9 summarizes the impact of non-superstar CEOs on operating performance. Both panels find no evidence of an increase in stock returns[19] or return-on-assets after non-superstar CEOs are predicted win awards. As such, these results provide assurance that the inferences on superstar CEOs discussed in the previous section are not driven by endogenous firm-level characteristics used to identify superstar CEOs.

[19] In untabluated analysis, I also form a balanced portfolio that take long positions on firms managed by superstar CEOs and short positions that are managed by non-superstar CEO firms to estimate equation (9). I continue to find significant positive two and three-year abnormal returns for the balanced portfolio.

6.3 Superstar CEOs' Propensity to Restate Earnings

The results from the earnings management tests suggest that that superstar CEOs would, at the very least, not engage in short-term rent-seeking activities to meet stakeholders' expectations. As aggressive accounting practices will likely lead to a higher incidence of earnings restatement in the future periods, I use the ex-post event of an earnings restatement to ascertain whether superstar CEOs engage in opportunistic earnings management after winning awards.[20] Using a pooled sample of firms managed by both superstar CEOs and non-superstar CEOs, I examine the likelihood that firms managed by superstar CEOs will restate their earnings within three years after their CEOs win awards:

$$DRestate_i = \alpha_0 + \alpha_1 SUPER_i + \beta_1 Leverage_i + \beta_2 BM_i + \beta_3 Size_i + \beta_4 STClaim_i + \beta_5 Capital_i + \beta_6 CFOVol_i + \beta_7 ROA_i + \varepsilon_i \quad (13)$$

where *SUPER* is a dummy variable set to 1 to indicate that the firm is managed by a superstar CEO. *DRestate* is a dummy set to 1 if the firm restates its earnings within three years after its CEO win (or predicted to win) awards. Restatement data from 1997 to 2005 is gathered using reports provided by the General Accounting Office (GAO) [2002, 2005]. The efficient contracting perspective predicts a non-positive α_1 because superstar CEOs do not have career-related incentives to engage in aggressive accounting techniques that subsequently result in regulatory demands to restate earnings. In contrast, the rent extraction

[20] I considered using the event of audit qualifications as ex-post indication of CEOs' aggressive accounting behavior. However, none of the firms managed by superstar CEOs or non-superstar CEOs receives a qualified audit opinion within three years after their CEOs win (predicted to win) their first awards.

perspective predicts a positive α_1 because superstar CEOs have career-related incentives to use aggressive accounting techniques to meet short-term stakeholders' expectations.

As earnings restatement data is available only from 1997, the total number of firm-year observations is reduced to 233. There are 14 earnings restatements among the firms managed by superstar CEOs. In contrast, there are 22 earnings restatements for the control sample firms. Table 10 reports univariate and multivariate analyses of the differences between firms managed by superstar CEOs and non-superstar CEOs in their propensity to restate earnings. The insignificant coefficients on *SUPER* in both column 1 (χ^2 statistic= 1.84, p-value = 0.17) and column 2 (χ^2 statistic = 0.68, p-value = 0.41) indicate that superstar CEOs do not have a higher propensity to restate earnings. Therefore, the results are consistent with the efficient contracting perspective that superstar CEOs do not engage in aggressive financial reporting practices.

Table 7: Sample of Non-Superstar CEOs who are predicted to win Awards

Panel A: Predicting Firm Characteristics of Superstar CEOs

$$DAward_i = \alpha_0 + \alpha_1 Size_i + \beta_1 BM_i + \beta_2 ROA_i + \beta_3 RET_i + \beta_4 RETVol_i + \gamma IndustryEffects_i + \delta YearEffects_i + \varepsilon_i \quad (12)$$

Variable	Coeff	(χ^2-stat)
Size	0.842	(419.46)
BM	-2.994	(66.57)
ROA	1.487	(5.21)
RET	1.095	(37.01)
RETVol	-0.983	(0.54)
Firm Year Observations	19,229	
Pseudo R^2(%)	0.266	

Panel B: Differences between Superstar CEO firms and Non-Superstar CEO firms

Award-Winning Year	Superstar CEO Firms (n = 187)	Non-Superstar CEO Firms (n = 175)	Difference	(t-stat)
Size	8.847	8.580	0.267	(1.29)
BM	0.339	0.351	-0.012	(-0.52)
ROA	0.085	0.089	-0.004	(-0.39)
RET	0.299	0.277	0.021	(0.47)
RETVol	0.108	0.101	0.007	(1.14)

Notes: Panel A estimates the firm characteristics of superstar CEOs. The industry and year dummy variables to account for firm and year fixed effects are not reported for the sake of brevity. To obtain a control sample of non-superstar CEOs who are predicted to win awards, firms without superstar CEOs are matched to award-winning superstar CEO firm-year observation based: (i) same industry; (ii) same year; and (iii) closes predicted probabilities estimated from equation (12). *DAward* is a dummy variable set to 1 if the firm's CEO receives an award. *Size* is measured using the natural logarithm of total assets. *BM* is the book-to-market ratio. *ROA* is return-on-assets, computed as income before extraordinary items scaled by lagged total assets. *RET* is the contemporaneous 12-month returns less value-weighted market returns based on the year when the CEO's performance is assessed. *RETVol* is the standard deviation of the contemporaneous 12-month abnormal returns based on the year when the CEO's performance is assessed. Panel B compares the firm characteristics between superstar CEOs and non-superstar CEOs who are predicted to win awards.

Table 8: Non-Superstar CEOs and Financial Reporting Practices

Panel A: Asymmetric Timely Loss Recognition using Basu (1997) model

$$NI_t = \alpha_0 + \alpha_1 DRET_t^- + \alpha_2 RET_t + \alpha_3 DRET_t^- * RET_t + \beta_0 POST + \beta_1 POST_t * DRET_t^- + \beta_2 POST_t * RET_t + \beta_3 POST_t * DRET_t^- * RET_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (2)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	(t-stat)	Coeff	(t-stat)	Coeff	(t-stat)
DRET⁻	0.008	(0.70)	0.008	(1.09)	0.005	(0.67)
RET	0.028	(1.92)	0.014	(1.75)	0.066	(3.04)
DRET⁻*RET	0.040	(1.10)	0.086	(3.48)	0.012	(1.66)
POST	-0.005	(-0.43)	0.010	(0.80)	0.007	(0.62)
POST*DRET⁻	0.006	(0.32)	-0.001	(-0.07)	0.001	(0.13)
POST*RET⁻	0.005	(0.11)	0.040	(1.41)	0.017	(0.73)
POST*DRET⁻*RET	-0.045	(-0.56)	-0.112	(-2.28)	-0.026	(-0.61)
No. of firm-year obs	342		616		826	
Adj. R^2(%)	0.632		0.503		0.471	

Panel B: Earnings Management using OLS Regression of Abnormal Accruals

$$ABACC_t = \alpha_0 + \alpha_1 POST_t + \beta_1 Leverage_t + \beta_2 BM_t + \beta_3 Size_t + \beta_4 STClaim_t + \beta_5 Capital_t + \beta_6 CFOVol_t + \beta_7 ROA_t + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (5)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
POST	-0.050	(-0.80)	-0.031	(-0.42)	0.005	(0.05)
Leverage	0.010	(0.01)	0.757	(1.15)	0.348	(0.50)
BM	-0.044	(-0.15)	-0.119	(-0.50)	-0.104	(-0.37)
Size	0.230	(2.32)	0.091	(0.90)	0.055	(0.50)
STClaim	-0.226	(-1.02)	0.009	(0.04)	-0.100	(-0.35)
Capital	0.405	(1.32)	0.637	(2.00)	0.581	(1.68)
Risk	2.356	(0.92)	-0.651	(-0.26)	-3.312	(-1.15)
ROA	0.412	(0.62)	0.157	(0.23)	0.314	(0.42)
No. of firm-year obs	238		404		542	
Adj. R^2(%)	0.518		0.285		0.254	

Table 8 (continued):
Non-Superstar CEOs and Financial Reporting Practices

Notes: Panel A reports within-firm change in asymmetric timely loss recognition in financial statements before and after non-superstar CEOs win awards using Basu (1997) model. *RET* is the contemporaneous 12-month returns less value-weighted market returns. *DRET* is a dummy variable set to 1 if $RET < 0$ to reflect bad economic events. Panel B reports the within-firm change in the level of abnormal accruals (*ABACC*) before and after non-superstar CEOs supposedly win awards. *ABACC* is computed using the modified Jones (1991) model. *POST* is a dummy variable set to 1 to indicate the period after superstar CEOs win awards. *Leverage* is the proportion of long-term debt to total assets. BM is the book-to-market ratio. Size is measured as the natural logarithm of firm's total assets. *STClaim* is a factor score reflecting implicit stakeholder claims using durable industry membership, research and development expenses and labor intensity. *Capital* indicates the firm's ex-ante demand for external financing in terms of the level of free cash flow multiplied by negative one, where free cash flow is computed using the difference between year t-1 cash flow from operations and the average capital expenditure from years t-3 to t-1. *CFOVol* is computed using the standard deviation of operating cash flow from operations computed over the three-year periods prior to sample year. ROA is return-on-assets, computed as income before extraordinary items scaled by lagged total assets. The firm and year dummy variables to account for firm and year fixed effects are not reported for the sake of brevity.

Table 9: Non-Superstar CEOs and Firm Performance

Panel A: Stock Performance after Non-Superstar CEOs supposedly win awards

$$RET_m = \alpha_0 + \alpha_1 MKTRF_m + \alpha_2 SMB_m + \alpha_3 HML_m + \alpha_4 UMD_m + \varepsilon_m \quad (9)$$

Variable	1 Year		2 Years		3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
Intercept	0.001	(0.56)	0.001	(0.62)	0.001	(0.80)
MKTRF	1.137	(17.31)	1.002	(20.77)	1.026	(25.46)
SMB	0.061	(0.79)	0.003	(0.05)	0.054	(1.15)
HML	-0.417	(-4.37)	-0.034	(-0.49)	-0.056	(-0.96)
UMD	0.183	(3.33)	-0.155	(-3.84)	-0.264	(-7.82)
No. of months	214		222		222	
Adj. R^2(%)	0.663		0.742		0.826	

Panel B: Within-firm change in ROA after Non-Superstar CEOs supposedly win awards

$$ROA_t = \alpha_0 + \alpha_1 POST_t + \alpha_2 ROA_{t-1} + \alpha_3 \sigma ROA_{t-1} + \alpha_4 Size_{t-1} + \gamma FirmEffects + \delta YearEffects + \varepsilon_t \quad (10)$$

Variable	Pre / Post 1 Year		Pre / Post 2 Years		Pre / Post 3 Years	
	Coeff	t-stat	Coeff	t-stat	Coeff	t-stat
POST	0.012	(1.56)	0.006	(1.10)	0.004	(0.78)
ROA_{t-1}	0.193	(3.29)	0.287	(6.97)	0.335	(9.39)
σROA	-0.206	(-3.73)	-0.048	(-3.87)	-0.044	(-5.22)
Size	-0.037	(-1.62)	-0.026	(-0.67)	-0.028	(-0.57)
No. of firm-year obs	274		476		643	
Adj. R^2(%)	0.798		0.708		0.716	

Notes: Panel A reports the calendar-time portfolio approach to estimate risk-adjusted abnormal returns of non-superstar CEOs after supposedly winning awards. RET is the monthly portfolio returns in excess of Treasury bill rate. MKTRF is the excess return on the market. SMB is the average return difference between small and big portfolios. HML is the average return difference between value and growth portfolios. UMD is the average return differences between high and low return portfolios. Treasury bill rate and factors are obtained from Professor Kenneth French's website (available at http://mba.tuck.dartmouth.edu/pages/faculty/ ken.french/data_library.html). Panel B reports the within-firm change in return-on-assets (ROA) before and after non-superstar CEOs supposedly win awards. *POST* indicates the period after superstar CEOs win awards. Lagged ROA is included to control for mean-reversion effects. σROA_{t-1} is the standard deviation ROA, computed based on the three-years prior to each observation to control for risk. Sales are measured using the natural logarithm of sales to control for the effects size on future operating performance. The firm and year dummy variables to account for firm and year fixed effects are not reported for the sake of brevity.

Table 10:
Propensity to Restate Earnings within 3 years after Superstar CEOs win Awards

$$DRestate_i = \alpha_0 + \alpha_1 SUPER_i + \beta_1 Leverage_i + \beta_2 BM_i + \beta_3 Size_i + \beta_4 STClaim_i + \beta_5 Capital_i + \beta_6 CFOVol_i + \beta_7 ROA_i + \varepsilon_i \quad (13)$$

Variable	Coeff	(χ^2-stat)	Coeff	(χ^2-stat)
Intercept	-1.976	(48.01)	-1.440	(0.91)
SUPER	0.503	(1.84)	0.432	(0.68)
Leverage			-1.310	(0.43)
BM			1.182	(1.01)
Size			-0.149	(1.03)
STClaim			1.383	(0.55)
Capital			-0.229	(0.85)
Risk			11.345	(1.35)
ROA			1.600	(0.37)
Firm Year Observations	233		181	
Pseudo R^2(%)	0.014		0.109	

Notes: Table 10 compares the propensity of superstar CEO firms and non-superstar CEO firms to restate earnings within three years after winning (or supposedly winning) awards. *DRestate* is a dummy set to 1 f the firm experiences a subsequent earnings restatement event within 3 years after the superstar CEOs (or non-superstar CEOs supposedly) win an award. *SUPER* is a dummy variable set to 1 to indicate that the firm is managed by a superstar CEO. *Leverage* is the proportion of long-term debt to total assets. BM is the book-to-market ratio. Size is measured as the natural logarithm of firm's total assets. *STClaim* is a factor score reflecting implicit stakeholder claims using durable industry membership, research and development expenses and labor intensity. *Capital* indicates the firm's ex-ante demand for external financing in terms of the level of free cash flow multiplied by negative one, where free cash flow is computed using the difference between year t-1 cash flow from operations and the average capital expenditure from years t-3 to t-1. *CFOVol* is computed using the standard deviation of operating cash flow from operations computed over the three-year periods prior to sample year. ROA is return-on-assets, computed as income before extraordinary items scaled by lagged total assets.

7.0 Summary and Conclusions

Motivated by the recent success that financial economics research has had in relating corporate investment and financing policies to managerial traits, the objective of this study is to investigate the impact of managerial reputation on financial reporting practices and firm performance. As managerial reputation is difficult to measure, I exploit the event of CEOs winning high-profile awards to proxy for managerial reputation. Using a sample of 269 awards given to 189 superstar CEOs by various organizations from 1987 to 2003, I compare within-firm changes in asymmetric timely loss recognition, earnings management, and operating performance before and after each superstar CEO wins his first award.

This study has important implications for the accounting literature. In particular, the evidence suggests that managerial characteristics play a role in financial reporting practices. First, superstar CEOs align their actions with stakeholders' interests by reporting economic losses in an even more timely fashion after they win awards. In addition, there is no change in the level of abnormal accruals after superstar CEOs win awards, suggesting that they do not use income-increasing accruals to opportunistically manage earnings. Firms managed by superstar CEOs show a reduced propensity to beat prior year's earnings by a small margin, supporting the argument that reputable CEOs are less likely to succumb to short-term capital market pressures to deliver performance.

This study also contributes to the debate in the strategic management literature on whether managers matter for firm performance. The evidence

supports the "leadership school" of thought that reputable managers have an ability to affect firm performance. Firms managed by superstar CEOs generate long-term positive abnormal returns after their CEOs win awards. In addition, accounting-based measures such as return-on-assets and cash flows from operations improve. In contrast, no similar trends exist in a control sample of firms managed by non-superstar CEOs, suggesting that the documented results are not driven by endogenous firm-level characteristics used to identify superstar CEOs.

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Appendix A: Description of Awards Given to Superstar CEOs

Business Week confers two main types of awards to business executives: Best Managers of the Year and Best Entrepreneurs of the Year. From 1987 to 1990, an average of five executives were awarded the title of Best Managers. For the next four years, the magazine increased the number of Best Manager winners to about 15 per year. From 1994 to 2005, a consistent editorial format of naming 25 top business managers was implemented. In contrast, the number of Best Entrepreneurs awarded each year is sporadic, ranging from zero to ten. I include all available Best Managers and Best Entrepreneurs winners as superstar CEOs.

Up till its cessation of publication in 1997, Financial World surveyed CEOs and business analysts from various industries to compile an annual list of admired CEOs and awarded three types of medals: bronze, silver, and gold. From 1987 to 1996, the magazine chose a single gold medal winner and bestowed the winner with the "CEO of the Year" title. There were about ten to twelve silver medal winners from 1987 to 1993. However, the number increased to 70 in 1994 and 1995 and then decreased to five in 1996. For each industry surveyed (42 major industries with sub-categories), between one and three bronze medals were awarded each year. Given this study's focus on superstar CEOs who acquire a reputation by winning prestigious awards, I consider the more exclusive winners to be superstar CEOs. As such, only gold and silver medal winners from 1987 to 1996 (with the exception of silver medalists) are included in my superstar CEOs sample.

The two other publications that regularly organize CEO contests are Forbes and Chief Executive. Since 2001, Forbes magazine use a consistent methodology to compile its annual Best and Worst Bosses list. Using various criteria such as shareholder returns (absolute and relative to S&P 500) and the amount of executive compensation, the editorial team identifies ten best performing CEOs each year, all of whom I consider to be superstar CEOs. Beginning in 1986, Chief Executive magazine organizes an annual CEO of the Year contest and announces the winner in its July issue. The magazine accepts nominations exclusively from top business executives holding top management positions such as CEOs, chairmen, presidents, and board directors. A selection committee comprising of top business leaders makes the final decision to name one superstar CEO as the contest winner.

Since 1989, the accounting firm Ernst & Young recognizes outstanding business managers through its Entrepreneur of the Year program. Nominations are accepted from top active business executives and various categories of regional winners are selected by an independent panel of judges consisting of past winners, educators, business and community leaders. In November each year, Ernst & Young announces a national winner (or winners from the same company) whom I consider to be a superstar CEO.

Finally, I include two ad-hoc rankings of influential business executives. In its December 10, 2001 issue, Time magazine published a Time/CNN 25 Most Influential Global Business Executive list. In collaboration with CNN journalists,

Time magazine journalists use criteria such as the ability to create new industries, reshape markets, and leadership styles to identify business executives who have boarder influence beyond their firm. Similarly, Fortune magazine published a list of the 25 Most Powerful People in Business in 2003. This list is based on the editorial team's perception of the winners' ability to exert influence in their company and industry.

Curriculum Vitae

Whee Ling Kevin Koh

Academic Experience:

June 2002 to June 2007	Senior Tutor, Division of Accounting Nanyang Technology University, Singapore

Education:

September 2003 to June 2007	University of Washington Ph.D. in Business Administration (Accounting)
July 1998 to June 2001	Nanyang Technological University, Singapore Bachelor of Accountancy (First Class Honors) -- Fulfilled requirements for a minor in Business Law

Professional Experience:

September 2001 to May 2002	Global Corporate Sales Executive Singapore Airlines Limited

Research Interests:

Financial reporting issues, Corporate Governance, and Executive Compensation

Working Papers:

"The Impact of Superstar CEOs on Financial Reporting Practices and Firm Performance" -- dissertation.

"Meeting Analyst Forecasts in the Post-Enron World: Early Evidence on Stock Market Rewards and Managerial Actions" coauthored with Dawn Matsumoto and Shiva Rajgopal (University of Washington).

"Non-Audit Services and Auditor Independence: Evidence from 1978-1981" coauthored with Shiva Rajgopal (University of Washington) and Suraj Srinivasan (University of Chicago)

Invited Presentation:

2007
American Accounting Association (AAA) Annual Conference in Chicago, IL. (Concurrent Research Session) -- "The Impact of Superstar CEOs on Financial Reporting Practices and Firm Performance"

2006
American Accounting Association (AAA) Annual Conference in Washington DC (Concurrent Research Session) -- "Meeting Analyst Forecasts in the Post-Enron World: Early Evidence on Stock Market Rewards and Managerial Actions"

Invited Conference Participation:

2007
Joint research conference by University of British Columbia, University of Oregon, and University of Washington (UBCOW) -- Feb 2007

2006
Global Issues in Accounting Conference and Doctoral Consortium by University of North Carolina at Chapel Hill – Jun 2006

Pac-10 Plus Doctoral Consortium held at University of Utah, Salt Lake City – Feb 2006

2005
Joint research conference by University of British Columbia, University of Oregon, and University of Washington (UBCOW) -- Feb 2005

2004
Joint research conference by University of British Columbia, University of Oregon, and University of Washington (UBCOW) -- Feb 2004

Media / Popular Press / Practitioner Citation:

April 2006 Fortune Magazine, Pages 40 and 41. "Why so short-sighted? It's time for executives, analysts and investors to get wise to the earnings game" by Justin Fox, FORTUNE Magazine editor at large

Awards and Honors:

April 2006 Dean's Achievement Award at University of Washington

July 2001 KPMG Gold Medal at Nanyang Technological University, Singapore