CEO Characteristics and Firm R&D Spending

Math Capstone PBL (Data Analysis) - Project #1

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Outline

1. Introduction
2. EDA
3. Correlation Analysis
4. Conclusion

Introduction

Topic and objective

Does the CEO's nature affect the company's R&D investment?

- What financial variables are relevant to the extent of the firm's R&D investment?
- Does the variable that characterizes the CEO lack explanatory power for R&D investments?
- If so, what characteristics correlate?

Data description

Dimension of raw data

1726 rows: U.S. S&P 1,500 + other Execucomp-reporting firms

27 columns: financial variables + CEO characteristics

Data source

Wharton Research Data Services (WRDS) Compustat Data / Execucomp [1] [2]

[1] http://wrds-www.wharton.upenn.edu.ssl.access.hanyang.ac.kr/

[2] https://lib.hanyang.ac.kr/#/er/web

Data description

Variables for identifying firms

`gvkey:` A firm's identifier used by S&P Capital IQ / Compustat / Execucomp

`sic:` A four-digit number that identifies a firm's primary industry of operation [3]

`state:` A two-letter code denoting the state in which the firm is headquartered

[3] Variables SIC2D and SIC3D denote the first two or three letters of the SIC code - the first two letters denote the broad classification, the third letter the middle classification

Data description

Financial variables (1)

`size:`	firm size (total assets)
`bm:`	book-to-market
`fcf:`	free cash flow (divided by total assets)
`hhi:`	Herfindhal-Hirschman Index [4]
`opperf:`	operating performance (divided by total assets)
`leverage:`	market value of a firm's leverage (divided by total mark-to-market assets)
`tobinsq:`	Tobin's Q
`rndmissing:`	a dummy variable that equals 1 if a firm's R&D expenditure is missing in the financial statement

[4] The more competitive the industry a firm operates in, the lower this number. It is always between 0 and 1.

Data description

Financial variables (2)

`rndratio:` a firm's R&D expenditure (divided by total assets)

`roa:` return on assets (divided by total assets)

`salesgrowth:` year on year growth rate of a firm's sales

`cashratio:` a firm's cash holdings (divided by total assets)

`divpay:` a dummy variable that equals 1 if and only if a firm has paid out dividends in the same fiscal year.

`intan:` intangibility measure. The higher this number, the more intangible a firm's assets [5]

`invest:` a firm's investment ratio [6]

[5] (total assets − property, plants, and equipments value)/total assets

[6] investment/(property, plants, and equipments value)

Data description

CEO characteristics

`ceoage:`	CEO's age
`ceocomp:`	CEO's total compensation, in $1000
`insiderceo:`	CEO who was promoted from inside the company (as opposed to an outsider)
`femaleceo:`	a dummy variable that equals 1 if the CEO is female
`ceopayslice:`	CEO's compensation divided by the firm's top 5 earning directors' total compensation [7]
`ceoequity:`	CEO's holdings of the firm's stock
`ceotenure:`	CEO's tenure in his or her current position, in years

[7] The higher this number, the more disproportionately highly a CEO is compensated within the top management team. Bebchuk, Cremers, and Peyer (2011) argue this is a good measure of how powerful a CEO is within the company.

EDA

Handling missing values

	#	%
gvkey	0	0
sic	0	0
sic2d	0	0
sic3d	0	0
state	56	3.24
size	1	0.06
bm	18	1.04
fcf	104	6.03
hhi	0	0
opperf	104	6.03
leverage	36	2.09
tobinsq	18	1.04
rndmissing	0	0
rndratio	779	45.13
roa	2	0.12
salesgrowth	5	0.29
divpay	0	0
cashratio	2	0.12
intan	101	5.85
invest	120	6.95
ceoage	1	0.06
ceocomp	1	0.06
insiderceo	0	0
femaleceo	0	0
ceopayslice	266	15.41
ceoequity	29	1.68
ceotenure	21	1.22

Table 1: Missing values of raw data

Mean groupby `sic`

3672: Printed Circuit Boards

↓

Mean groupby `sic3d`

(middle classification)

367: Electronic, Component and Accessories

↓

Mean groupby `sic2d`

(broad classification)

36: Electronic and Other Equipment

Data transformation

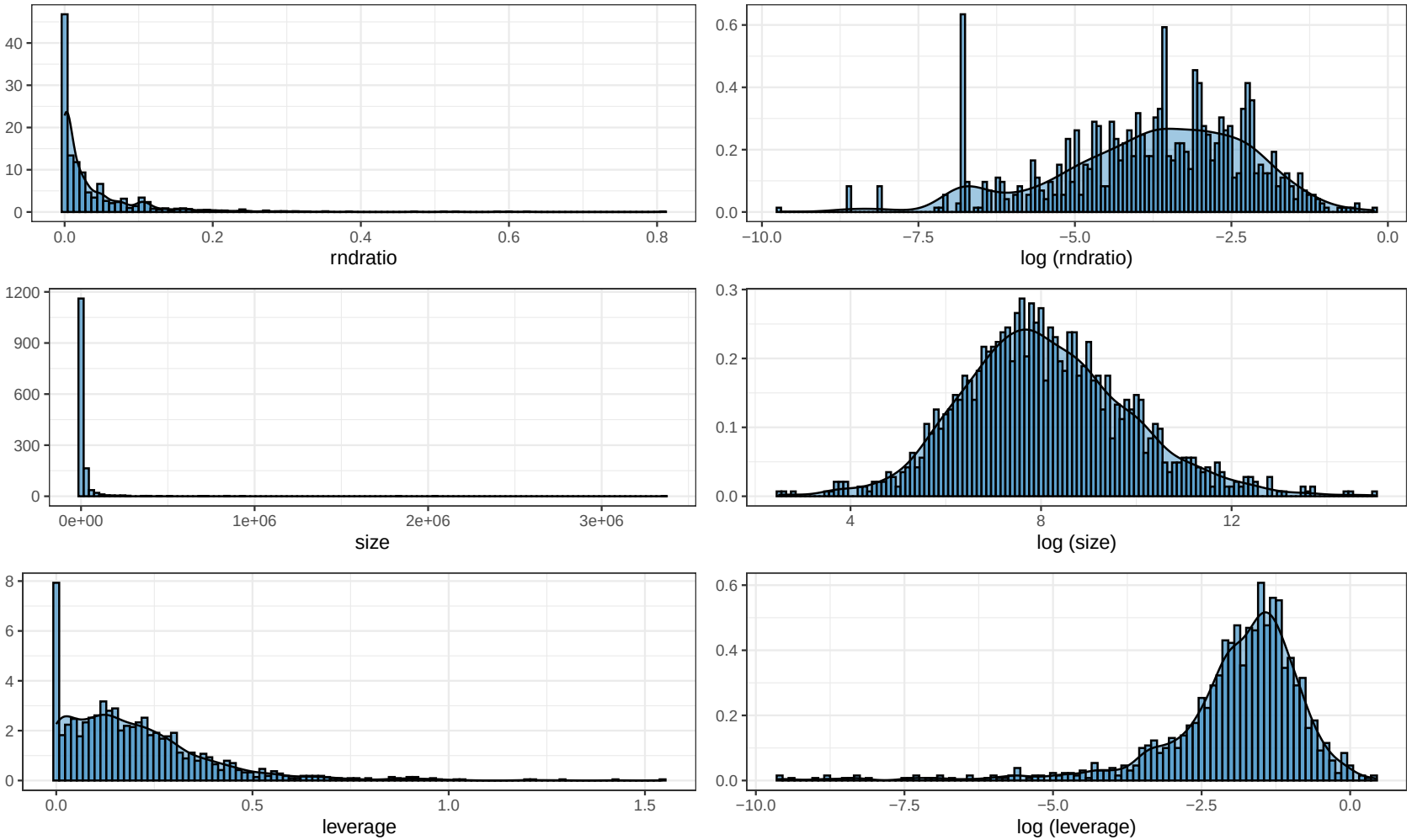

Figure 1: Log transformations of `rndratio`, `size`, `leverage`

Data transformation

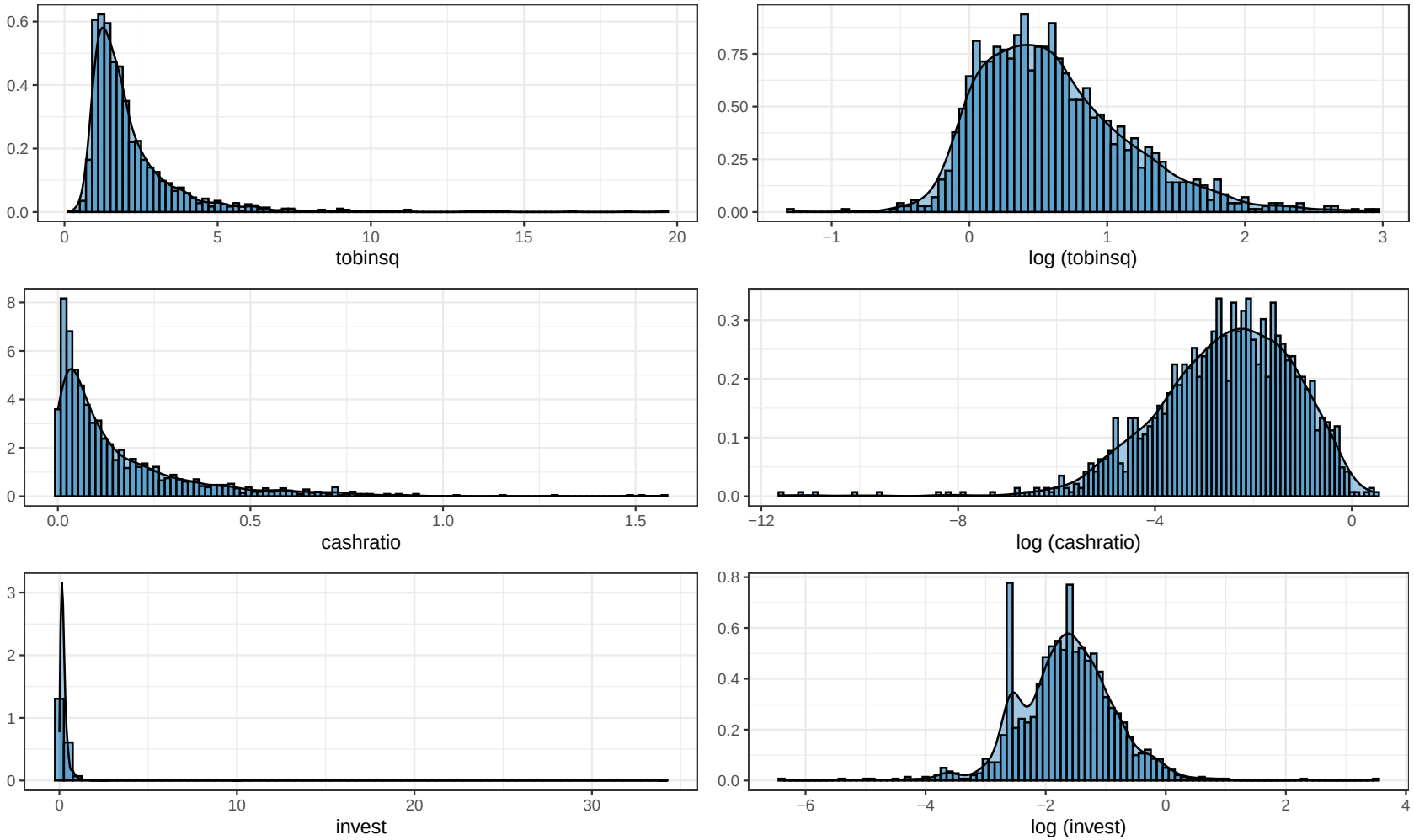

Figure 2: Log transformation of `tobinsq`, `cashratio` `invest`

Data transformation

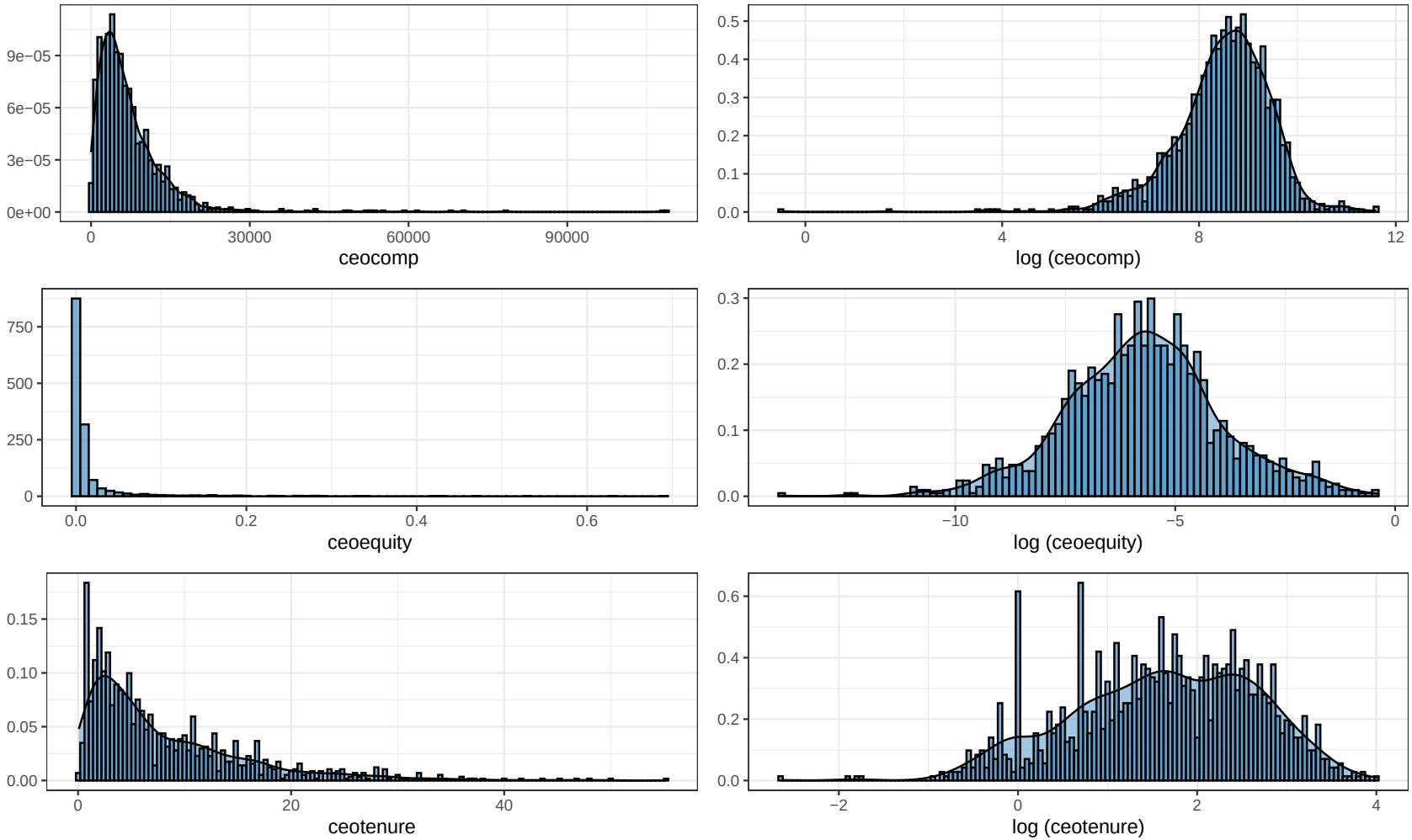

Figure 3: Log transformation of `ceocomp`, `ceoequity`, `ceotenure`

Data transformation

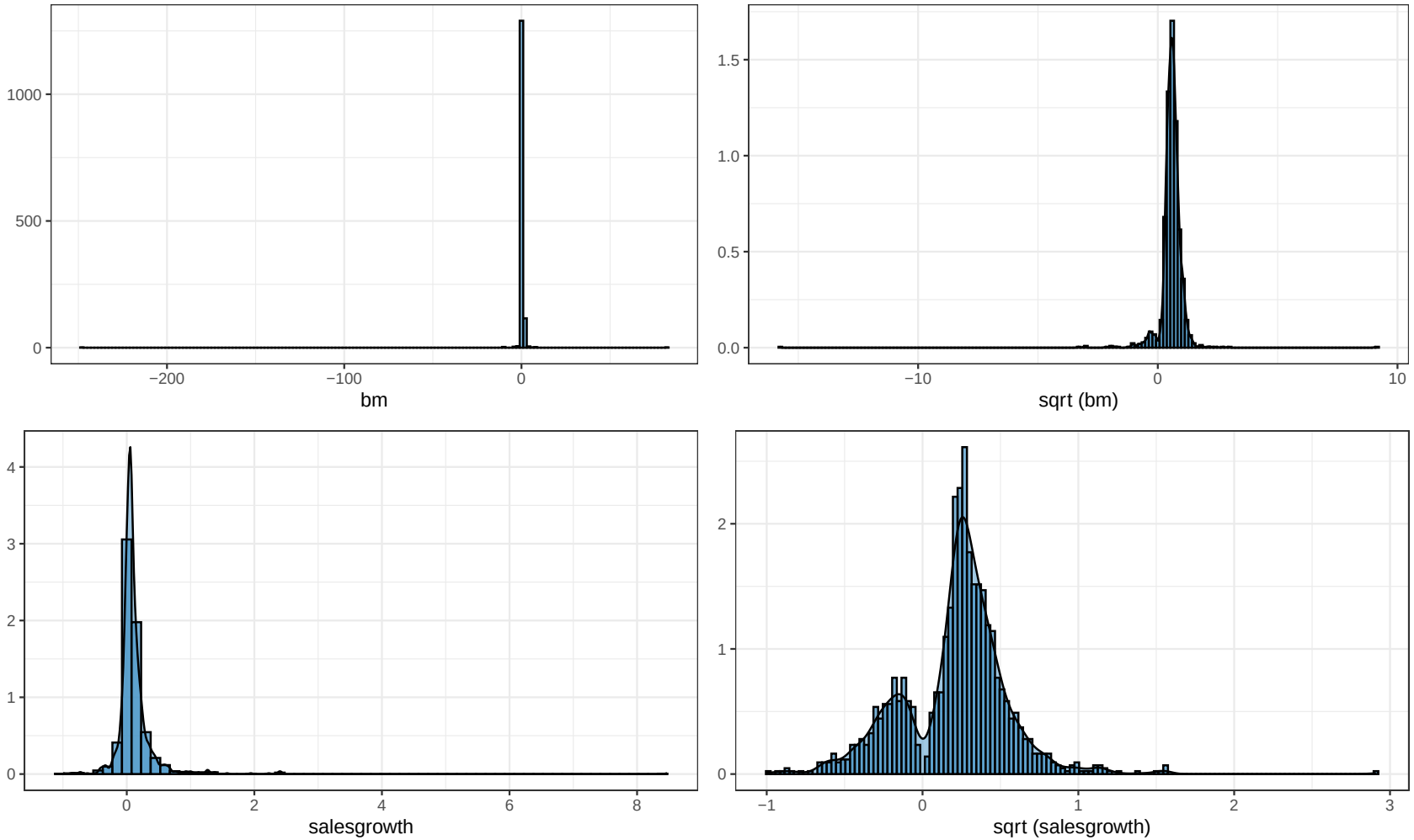

Figure 4: Square-root transformation (with sign) of `bm`, `salesgrowth`

Data transformation

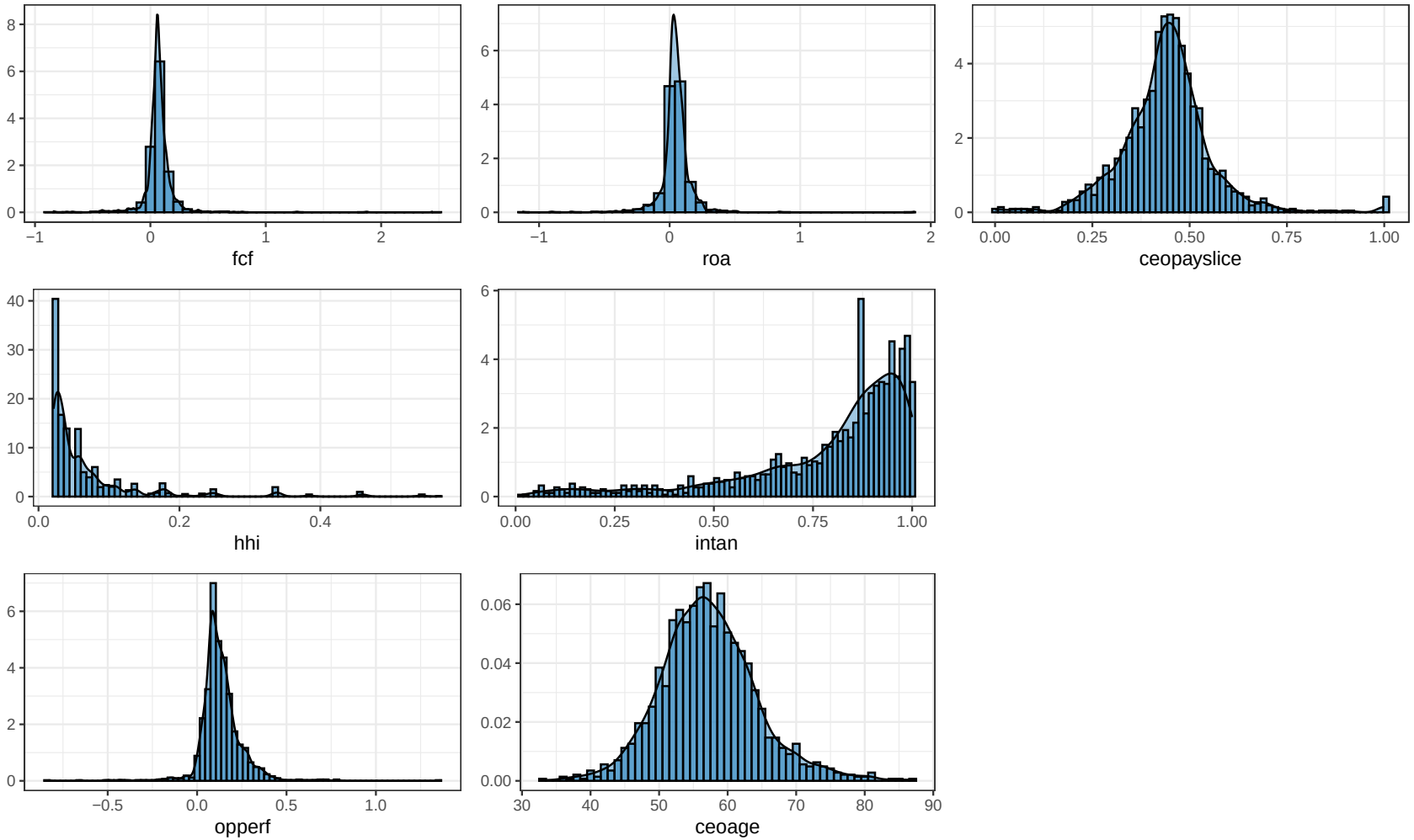

Figure 5: Not transformed

Summary statistics

	mean	sd	Q1	Q3	max	min	kurtosis	skewness
log size	8.098	1.745	6.941	9.163	15.023	2.483	0.470	0.333
log leverage	-1.951	1.266	-2.319	-1.217	0.435	-9.648	8.524	-2.336
log tobinsq	0.613	0.544	0.212	0.914	2.973	-1.281	1.105	0.869
log cashratio	-2.568	1.421	-3.418	-1.543	0.458	-11.645	3.454	-1.068
log invest	-1.649	0.798	-2.129	-1.171	3.530	-6.430	3.174	-0.060
$\sqrt{\text{bm}}$	0.569	0.643	0.435	0.765	9.096	-15.762	313.873	-10.471
$\sqrt{\text{salesgrowth}}$	0.213	0.339	0.068	0.391	2.910	-1.000	3.755	0.187
fcf	0.073	0.140	0.329	0.106	2.447	-0.844	85.110	4.820
hhi	0.068	0.077	0.026	0.073	0.566	0.021	12.951	3.296
opperf	0.133	0.120	0.080	0.178	1.363	-0.832	16.421	0.656
roa	0.045	0.120	0.010	0.087	1.878	-1.128	50.972	1.169
intan	0.796	0.212	0.722	0.946	1.000	0.015	2.230	-1.631
rndratio	0.039	0.069	0.000	0.050	0.809	0.000	25.756	4.033
ceoage	33.000	7.060	53.000	61.000	87.000	33.000	0.996	0.407
log ceocomp	8.489	1.003	7.994	9.135	11.596	-0.453	7.256	-1.380
log ceoequity	-5.725	1.774	-6.858	-4.699	-0.377	-13.999	0.671	-0.061
log ceotenure	1.625	1.023	0.916	2.418	4.009	-2.643	-0.339	-0.328
ceopayslice	0.440	0.116	0.381	0.494	1.000	0.001	4.312	0.520

Table 2: Summary statistics for continuous variables

Summary statistics

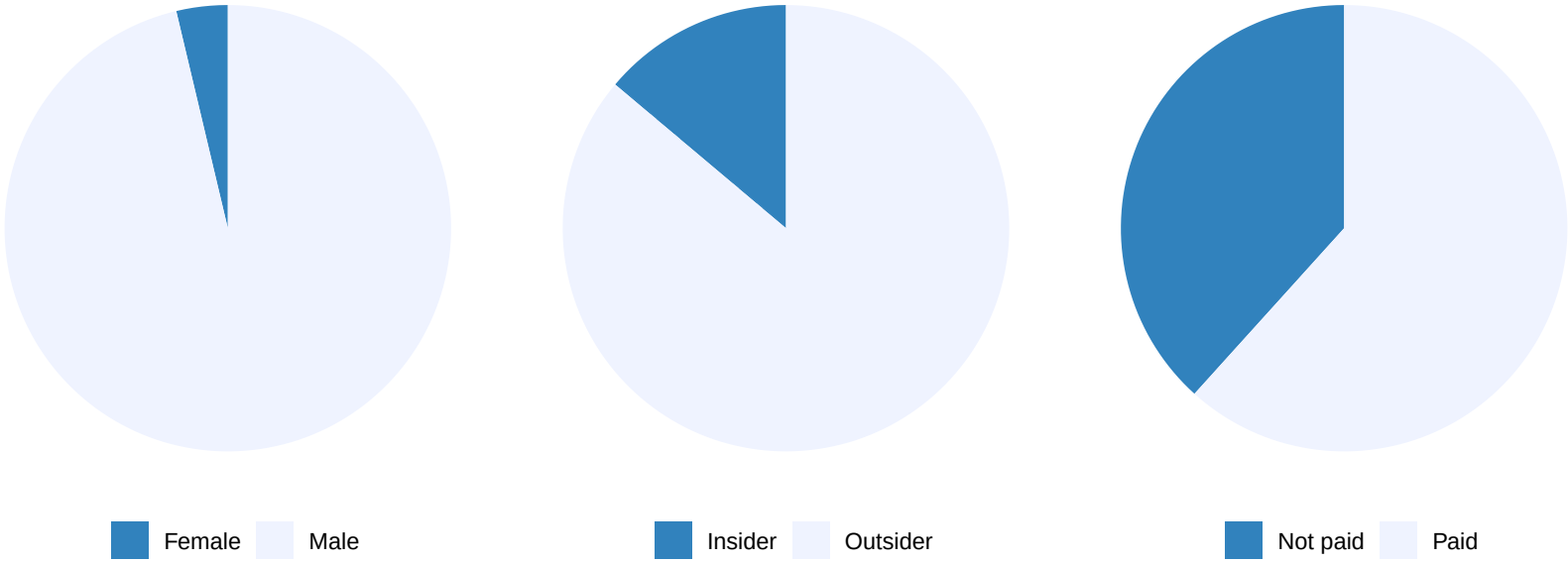

Figure 6: Pie chart of `femaleceo`, `insiderceo`, `divpay`

Summary statistics

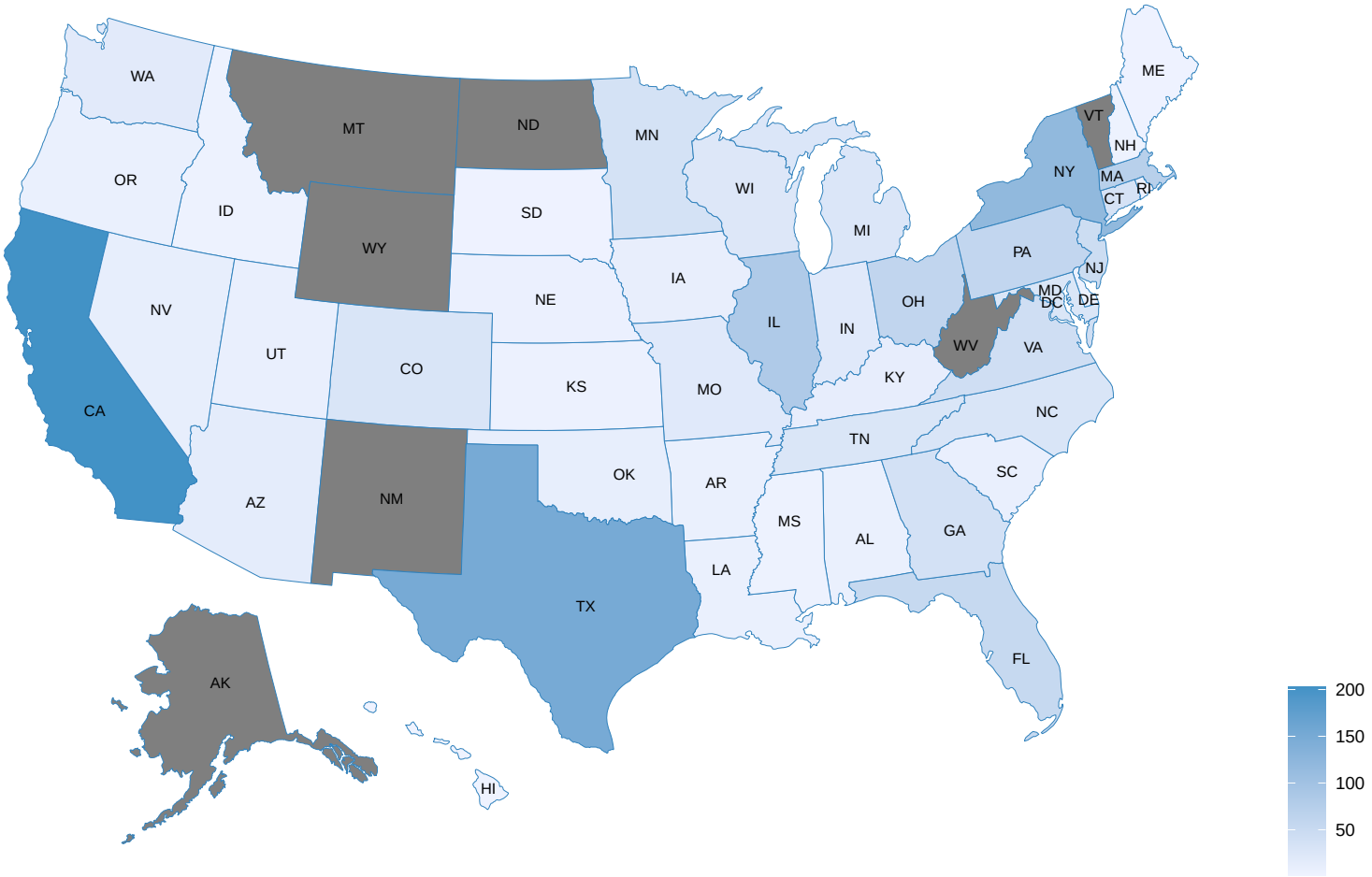

Figure 7: # of firms by `state`

Correlation Analysis

rndratio — continuous variable

	τ	p-value
roa	0.025	0.174
log ceocomp	−0.004	0.842
log ceoquity	0.012	0.493
log ceotenure	0.028	0.122
ceopayslice	−0.027	0.144

Table 3: Kendall correlation test of variables that can't reject H_0

rndratio — continuous variable

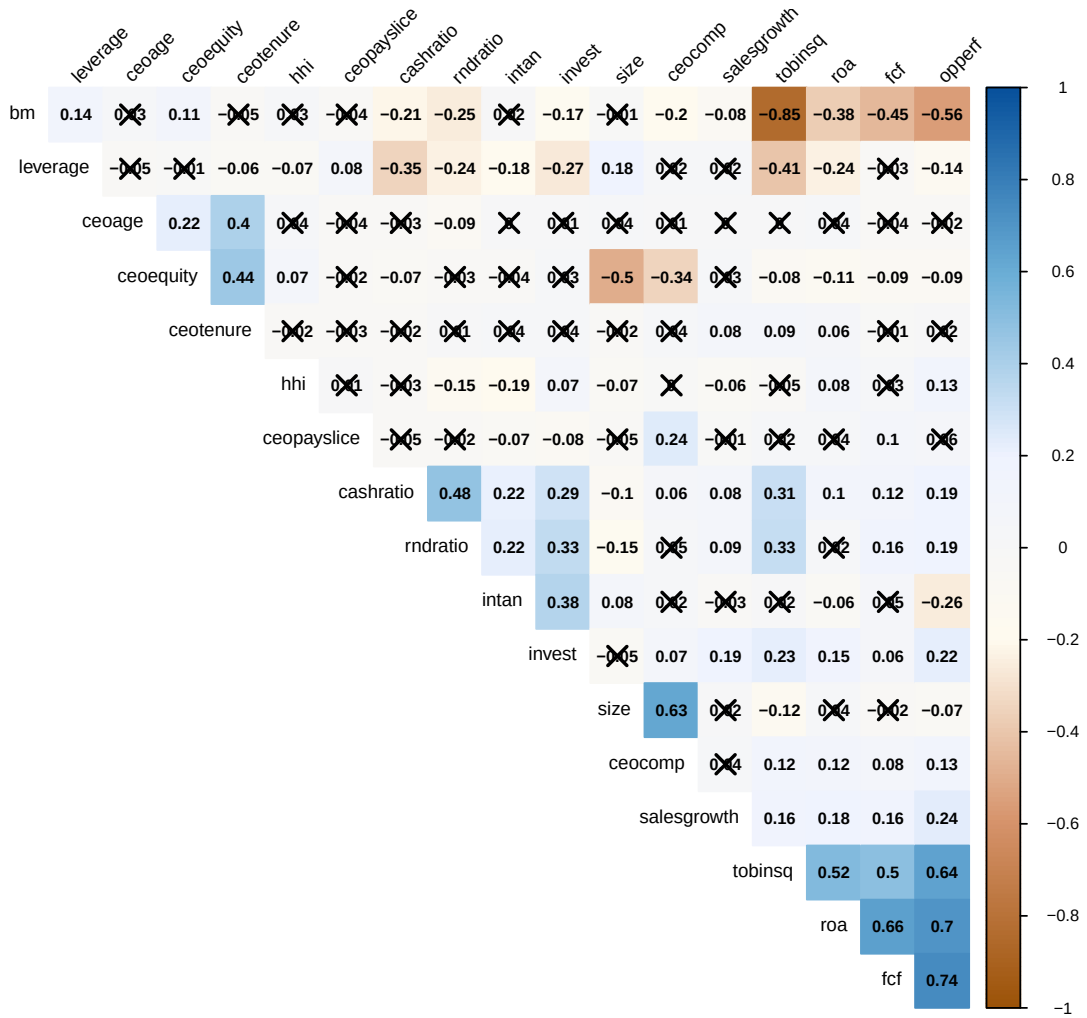

Figure 8: Spearman correlogram with significance test

rndratio — continuous variable

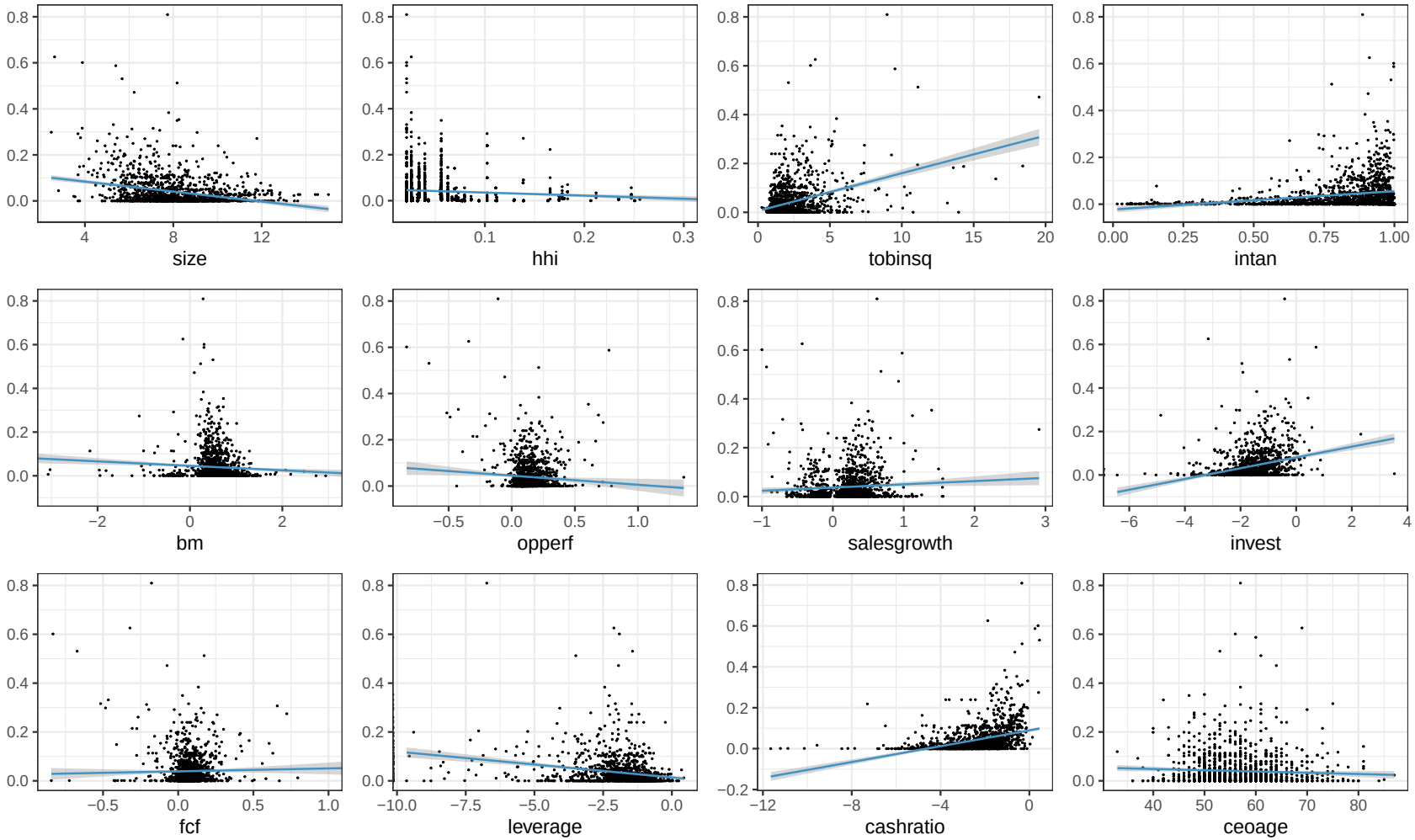

Figure 9: Scatter plot and regression line

rndratio — continuous variable

	Dependent variable: rndratio					
	(1)	(2)	(3)	(4)	(5)	(6)
log size	−0.011***					
	(0.001)					
log leverage		−0.011***				
		(0.001)				
log tobinsq			0.015***			
			(0.001)			
log cashratio				0.019***		
				(0.001)		
log invest					0.025***	
					(0.002)	
ceoage						−0.001**
						(0.0003)
Constant	0.127***	0.014***	0.006**	0.089***	0.081***	0.069***
	(0.008)	(0.003)	(0.003)	(0.003)	(0.004)	(0.015)
Observations	1,429	1,301	1,429	1,426	1,402	1,429
R^2	0.074	0.043	0.147	0.157	0.084	0.003
Adjusted R^2	0.074	0.043	0.147	0.157	0.083	0.002
Residual Std. Error	0.067	0.063	0.064	0.064	0.065	0.069
	(df = 1427)	(df = 1299)	(df = 1427)	(df = 1424)	(df = 1400)	(df = 1427)
F Statistic	114.643***	59.035***	246.718***	266.045***	128.159***	3.897**
	(df = 1; 1427)	(df = 1; 1299)	(df = 1; 1427)	(df = 1; 1424)	(df = 1; 1400)	(df = 1; 1427)
Note:						*p<0.1; **p<0.05; ***p<0.01

Table 4: Stargazer for simple linear regression (1)

rndratio — continuous variable

	Dependent variable: rndratio					
	(1)	(2)	(3)	(4)	(5)	(6)
$\sqrt{\texttt{bm}}$	−0.010***					
	(0.003)					
$\sqrt{\texttt{salesgrowth}}$		0.013**				
		(0.005)				
fcf			0.012			
			(0.013)			
hhi				−0.134***		
				(0.024)		
opperf					−0.039***	
					(0.015)	
intan						0.078***
						(0.008)
Constant	0.045***	0.037***	0.039***	0.049***	0.045***	−0.023***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.003)	(0.007)
Observations	1,429	1,429	1,429	1,429	1,429	1,429
R^2	0.009	0.004	0.001	0.022	0.005	0.057
Adjusted R^2	0.008	0.004	-0.0001	0.021	0.004	0.057
Residual Std. Error (df = 1427)	0.069	0.069	0.069	0.069	0.069	0.067
F Statistic (df = 1; 1427)	12.984***	6.020**	0.846	32.064***	6.706***	86.702***
Note:						*p<0.1; **p<0.05; ***p<0.01

Table 5: Stargazer for simple linear regression (2)

rndratio — categorical variable

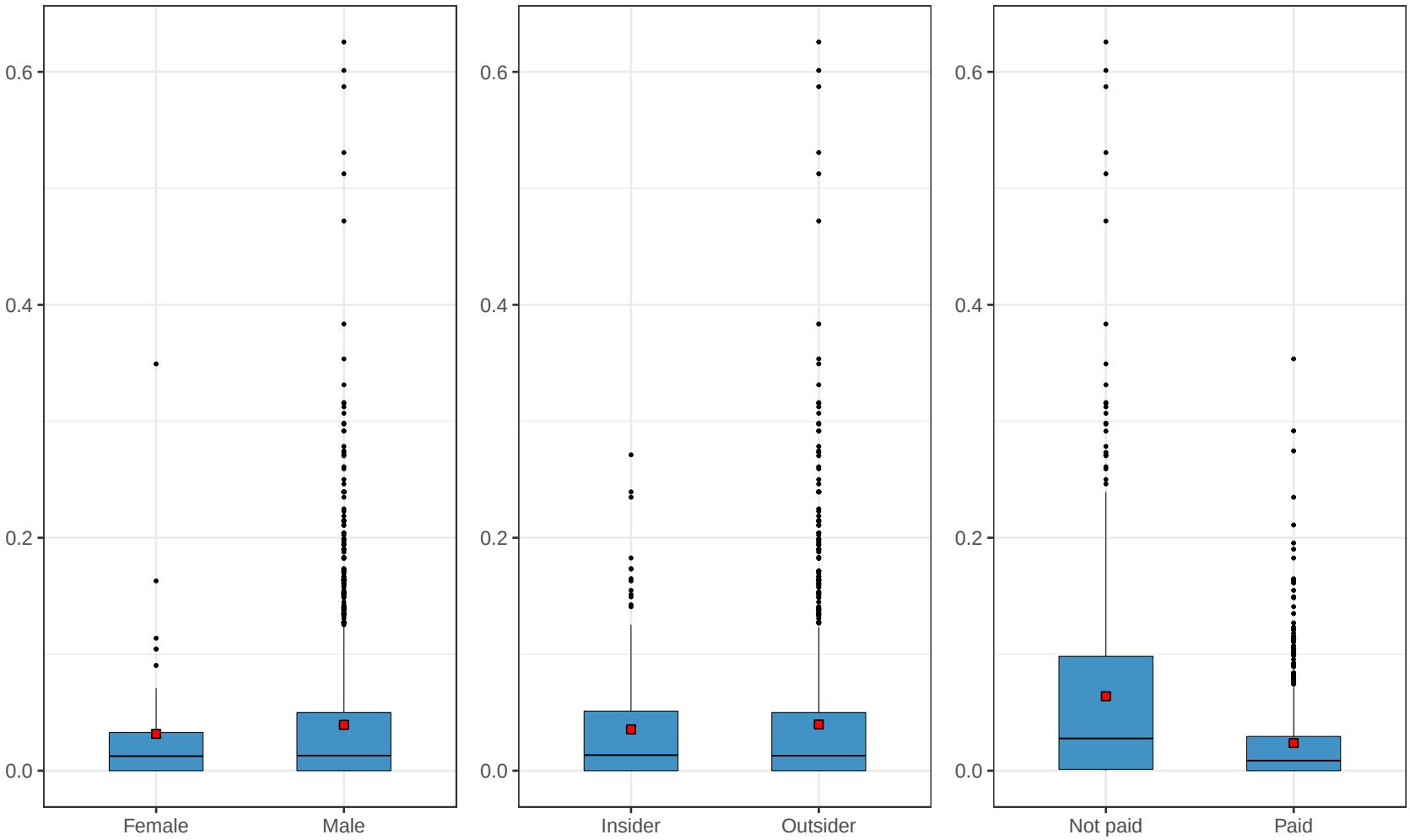

Figure 10: Box plot by `femaleceo`, `insiderceo`, `divpay`

`rndratio` — categorical variable

Welch's t-test (in which a two-tailed test is applied)

$H_{T,0}$: The two population means are equal.

$H_{T,1}$: True difference in means is not equal to 0.

F-test of equality of variances [8]

$H_{F,0}$: Two normal populations have the same variance.

$H_{F,1}$: True ratio of variances is not equal to 1.

	F	t	accept
`divpay`	$< 2.2 \times 10^{-16}$	0.3033	$H_{F,1}$, $H_{T,0}$
`insiderceo`	3.995×10^{-09}	0.244	$H_{F,1}$, $H_{T,0}$
`femaleceo`	0.06457	0.3895	$H_{F,0}$, $H_{T,0}$

Table 6: p-values and result at $\alpha = 0.05$

[8] $H_{F,0}$: Homoscedasticity, $H_{F,1}$: Heteroscedasticity

rndratio — categorical variable

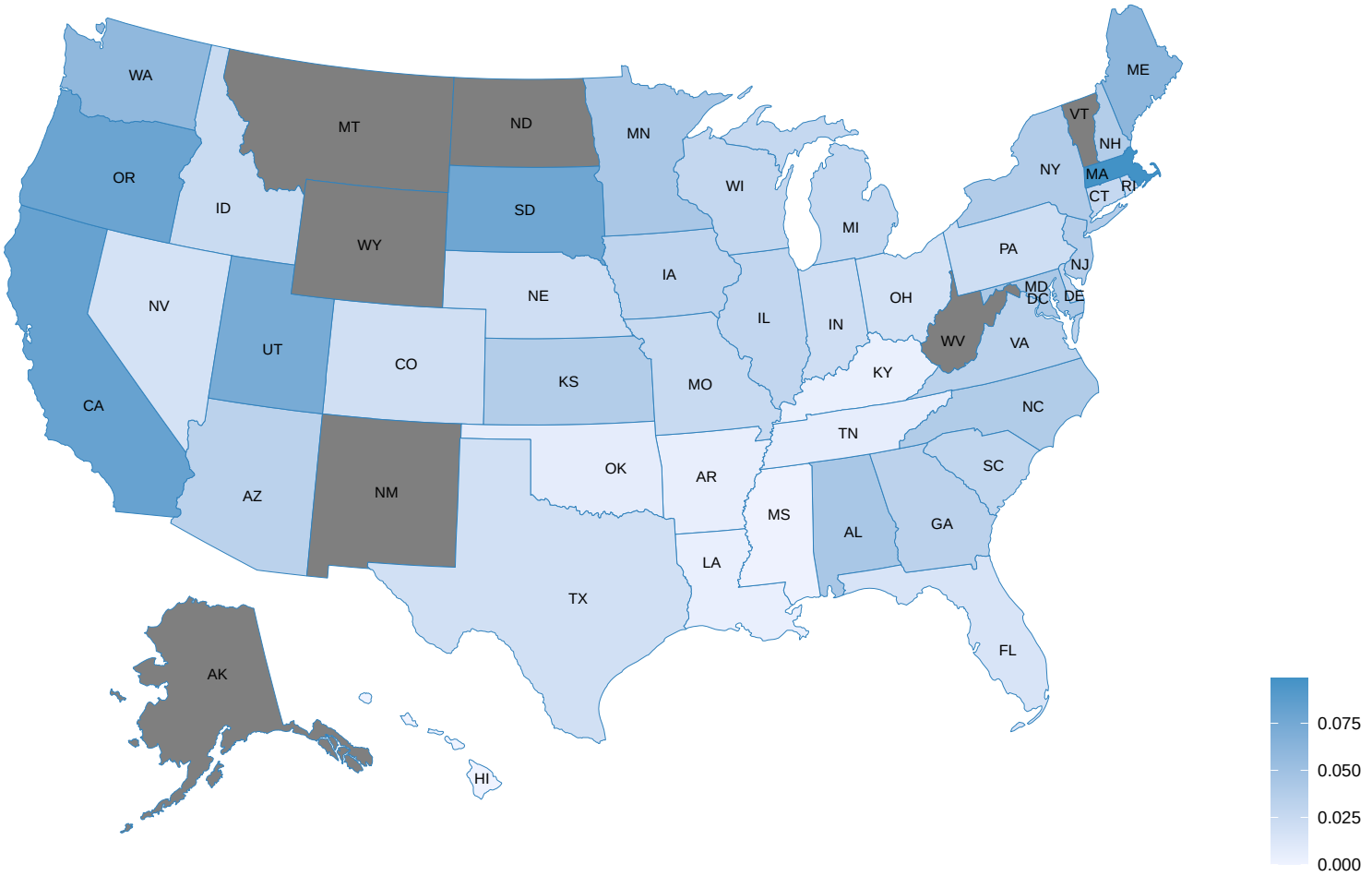

Figure 11: Mean of `rndratio` by `state`

`rndratio` — categorical variable

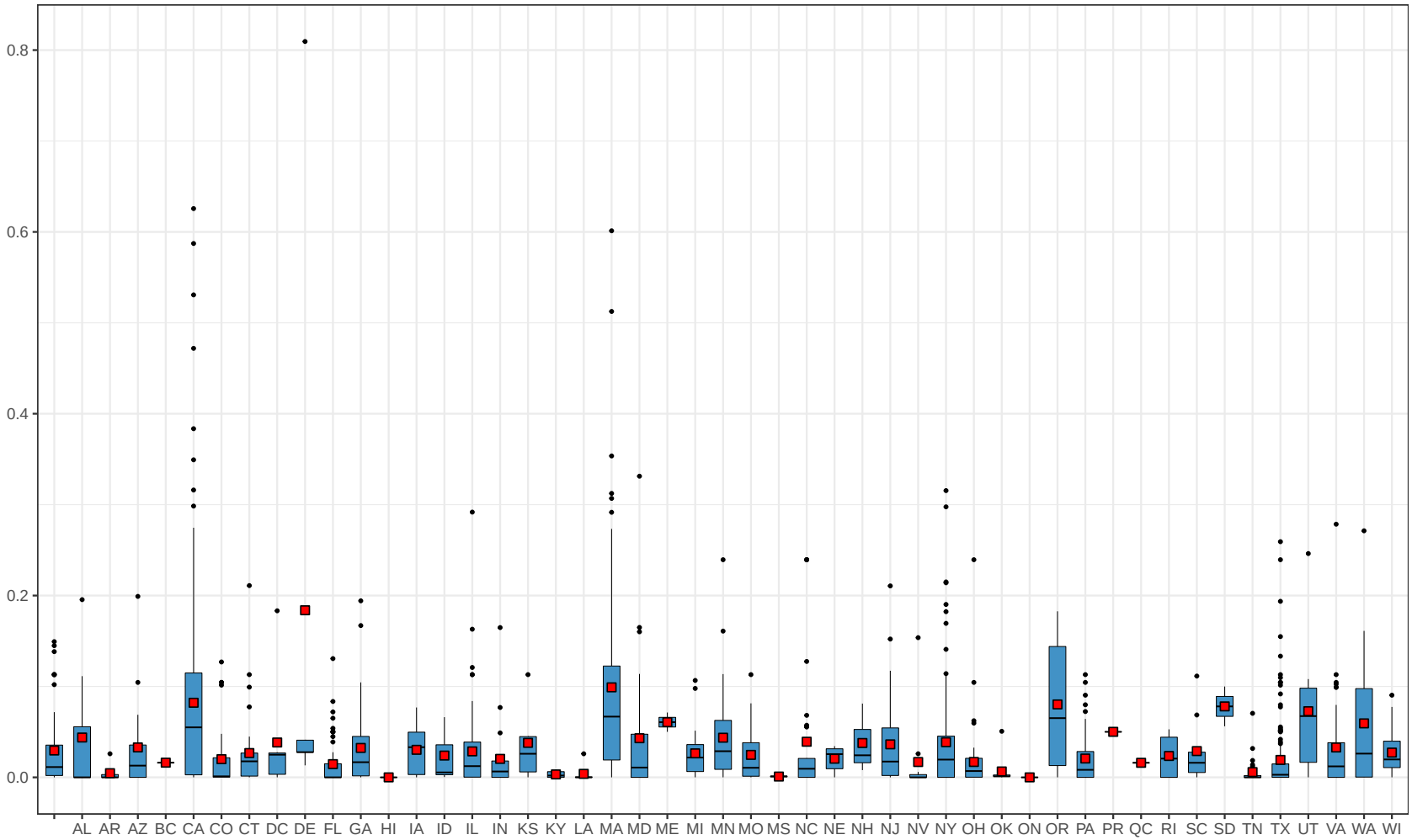

Figure 12: Box plot by `state`

rndratio — categorical variable

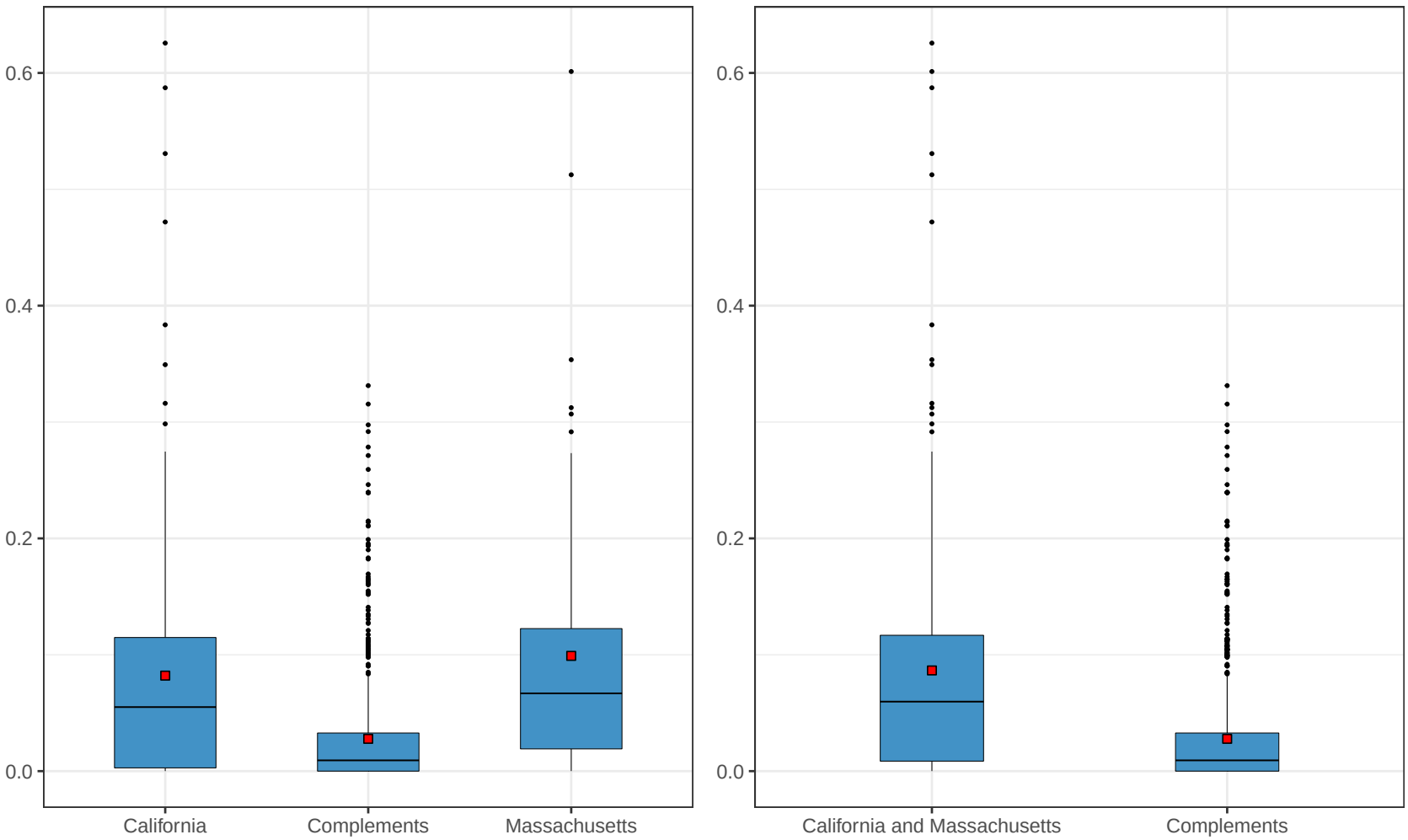

Figure 13: Regrouping `state`

Between continuous variables

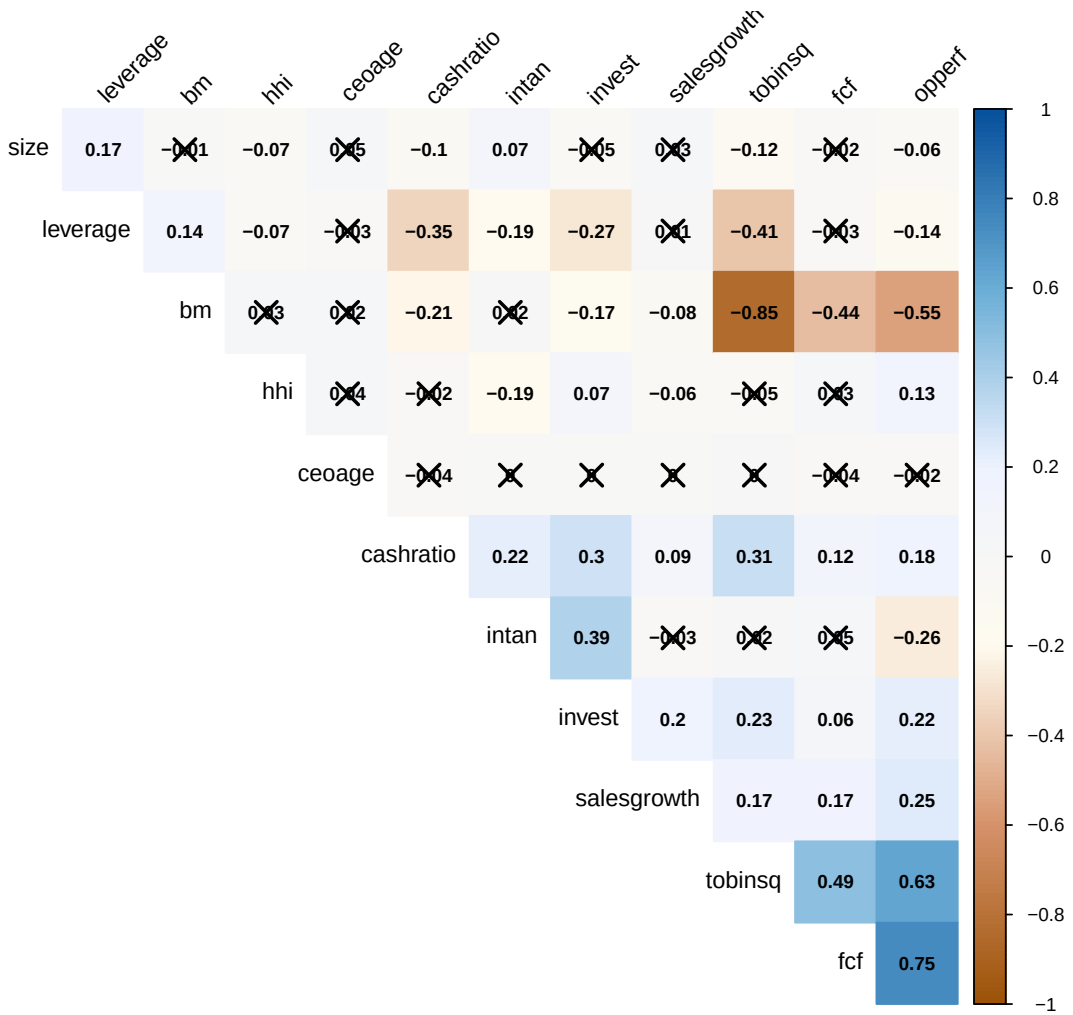

Figure 14: Spearman correlogram with significance test

Between continuous variables

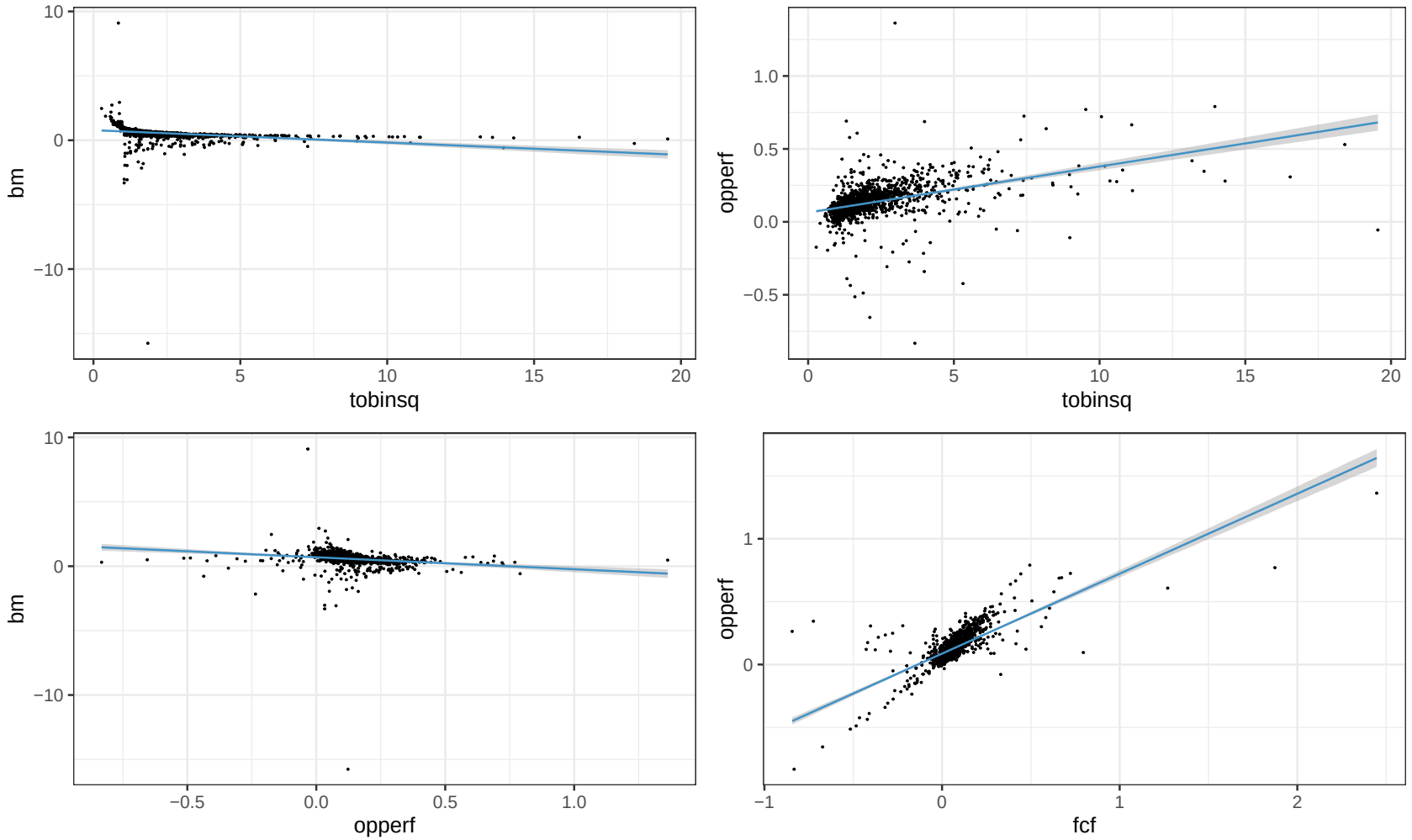

Figure 15: Cases of $|\rho| > 0.5$

Between categorical and continuous variables

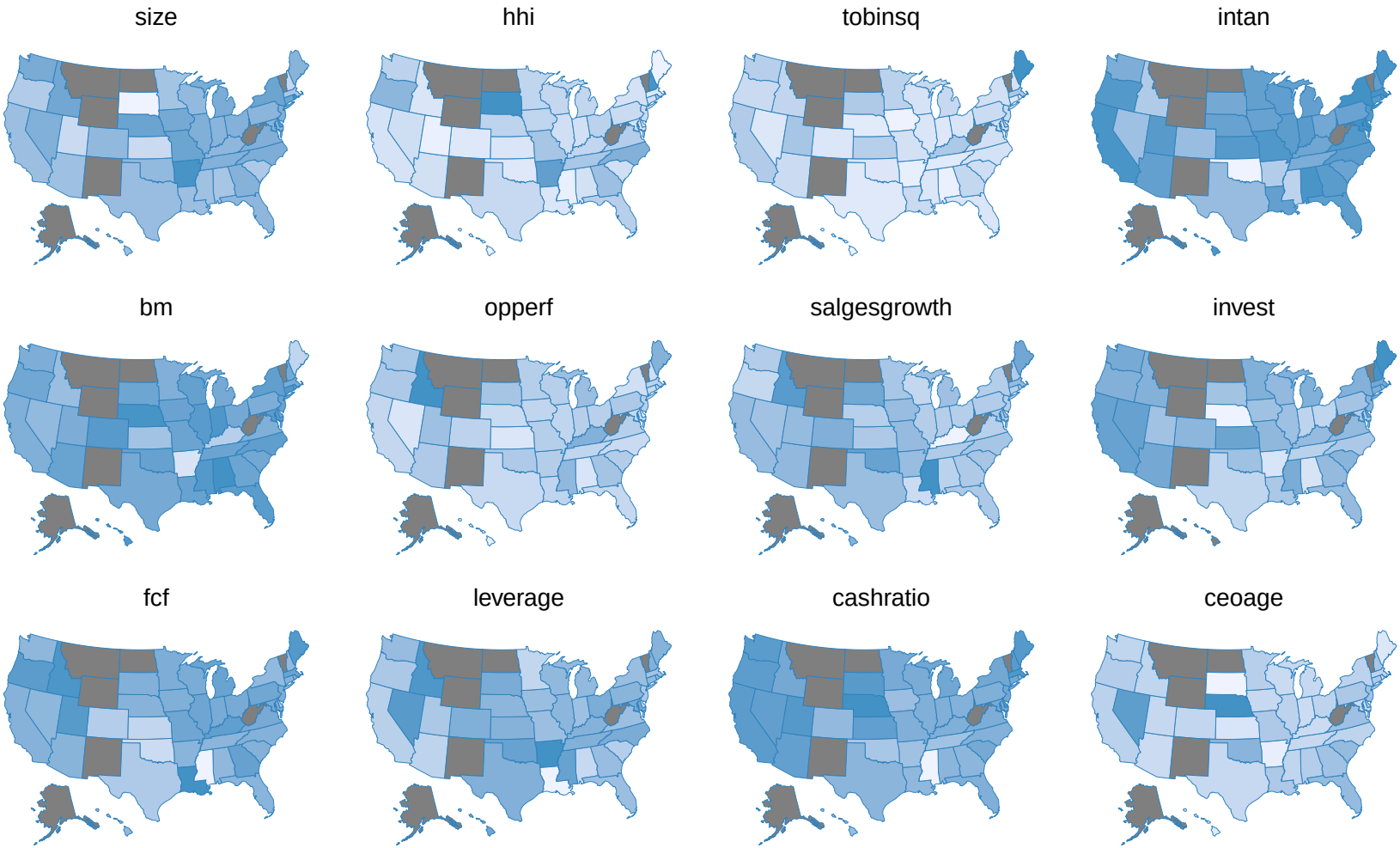

Figure 16: Surviving continuous variables by `state` (indistinguishable)

Conclusion

Answers to subquestions

What financial variables are relevant to the extent of the firm's R&D investment?

All financial variables used except ROA.

Does the variable that characterizes the CEO lack explanatory power for R&D investments?

Correlation analysis confirms that not all CEO characteristics are uncorrelated with R&D ratio.

If so, what characteristics correlate?

CEO age is most relevant to the degree of R&D investment.

Remaining analysis

- Check effects of normalization of R&D ratio (standard score)
- Eliminate multicollinearity based on VIF
- Select variables: FS, BS, SM
- Residual Analysis: Regression Assumptions, Influence and Outliers

Any questions?

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