

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
5. References

Introduction

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?

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>

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

³Variables 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

Financial variables (1)

size: Firm size (total assets)

bm: Book-to-market

fcf: Free cash flow (divided by total assets)

hhí: 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

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

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 assets⁵

invest: A firm's investment ratio⁶

⁵(total assets – property, plants, and equipments value)/total assets

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

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

⁷The 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
upperf	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

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

Table 1: Missing values of raw data

Data transformation

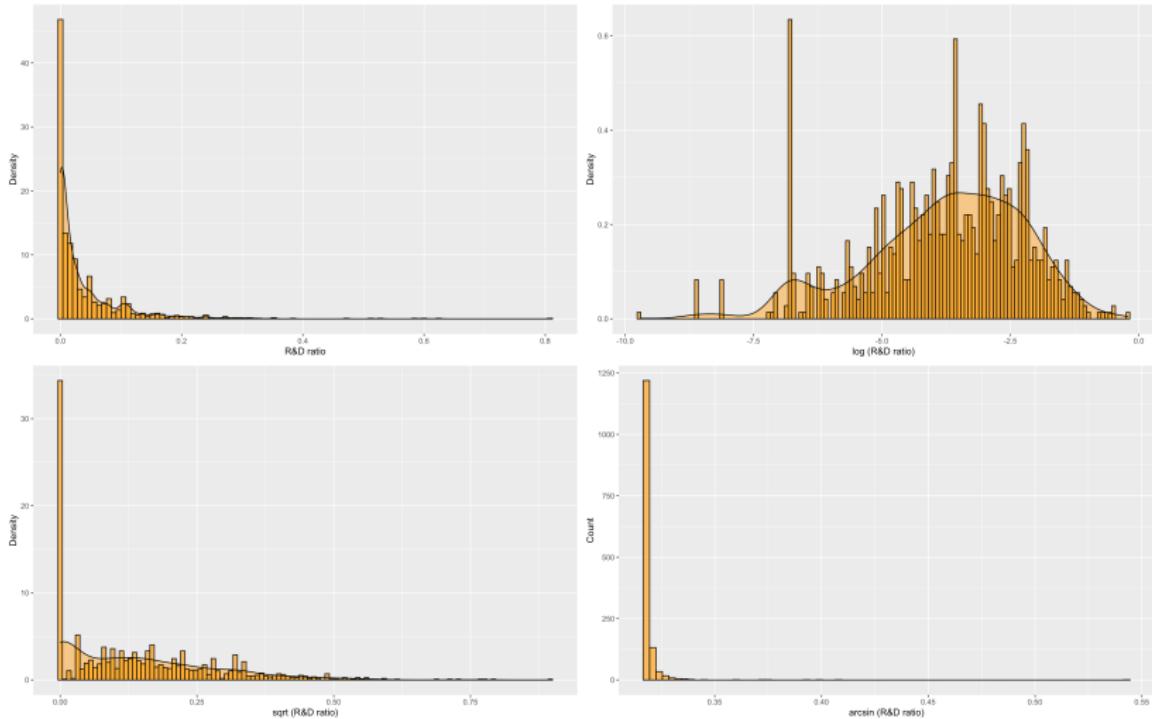


Figure 1: Transformations of rndratio

Data transformation

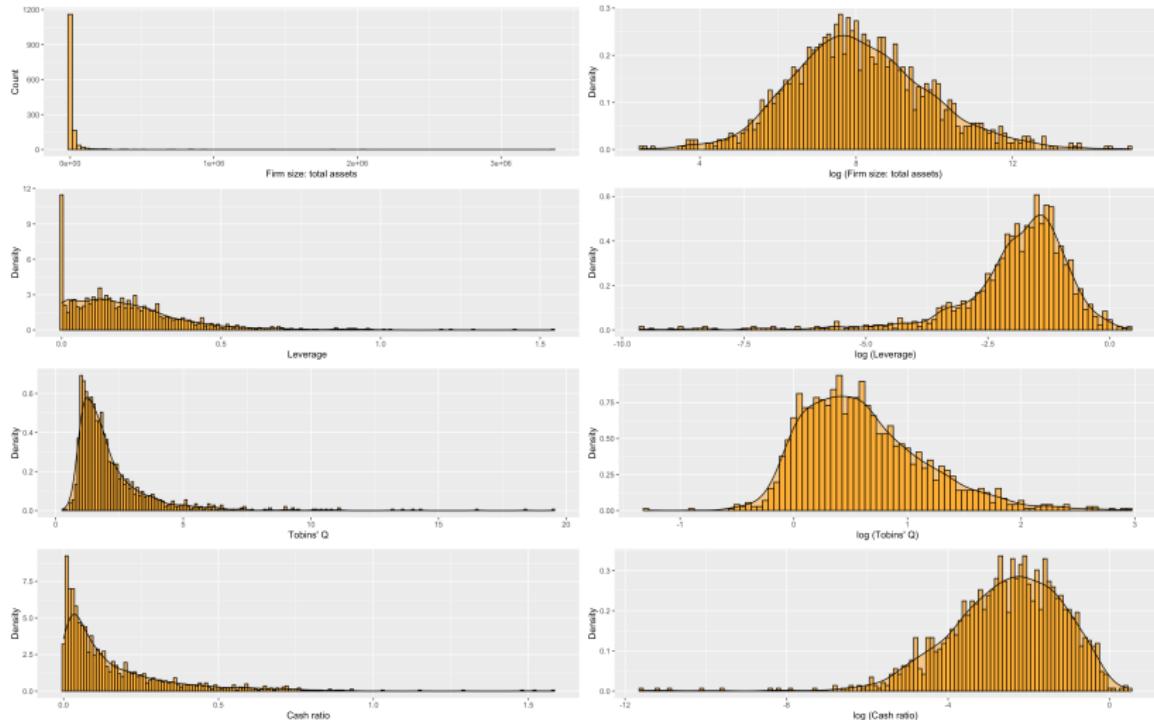


Figure 2: Log transformations of size, leverage, tobinsq, cashratio

Data transformation

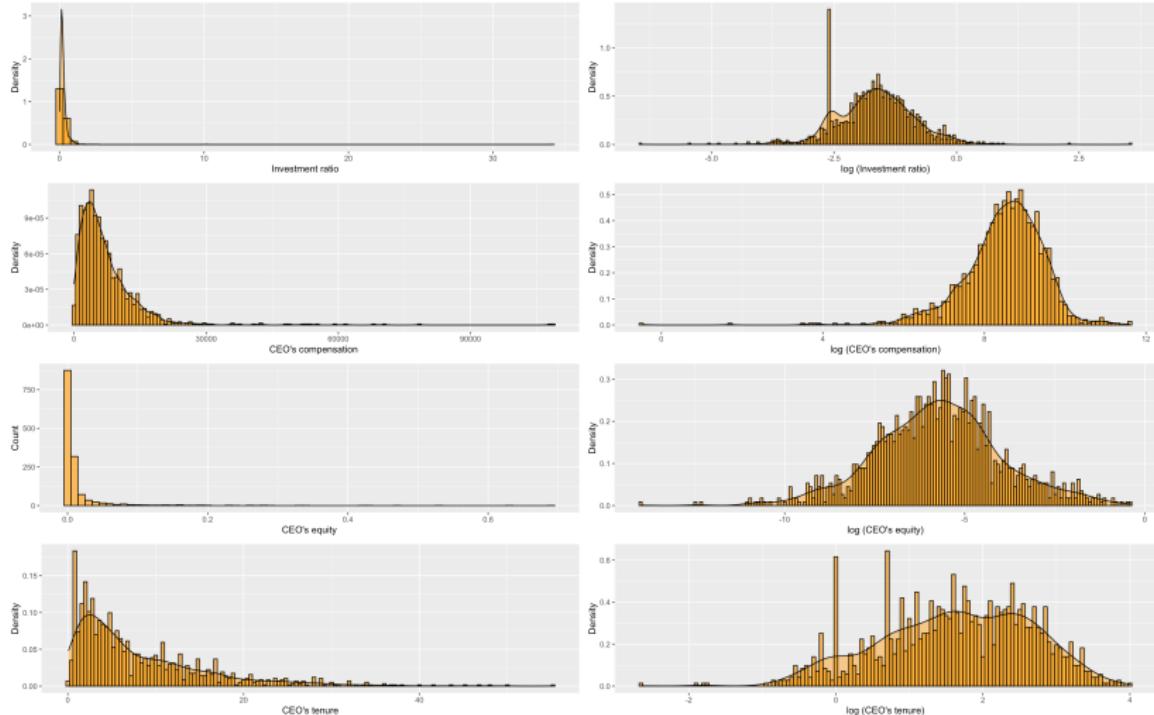


Figure 3: Log transformation of invest, ceocomp, ceoequity, ceotenure

Data transformation

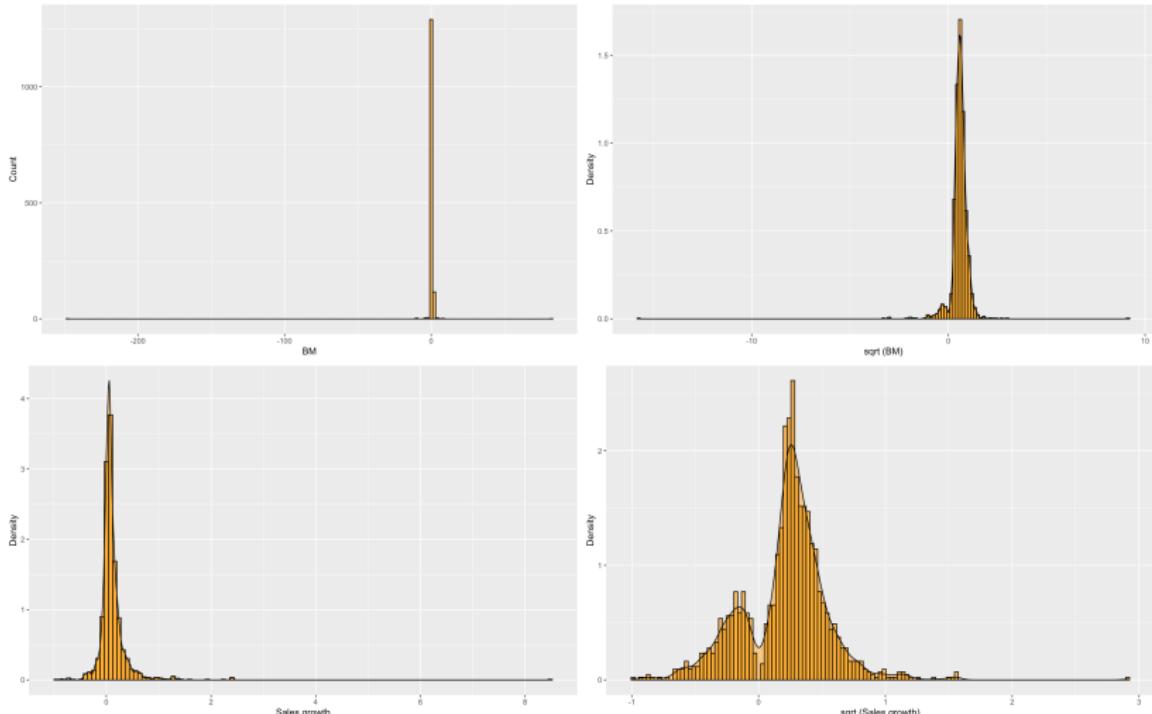


Figure 4: Square-root transformation (with sign) of bm , $salesgrowth$

Data transformation

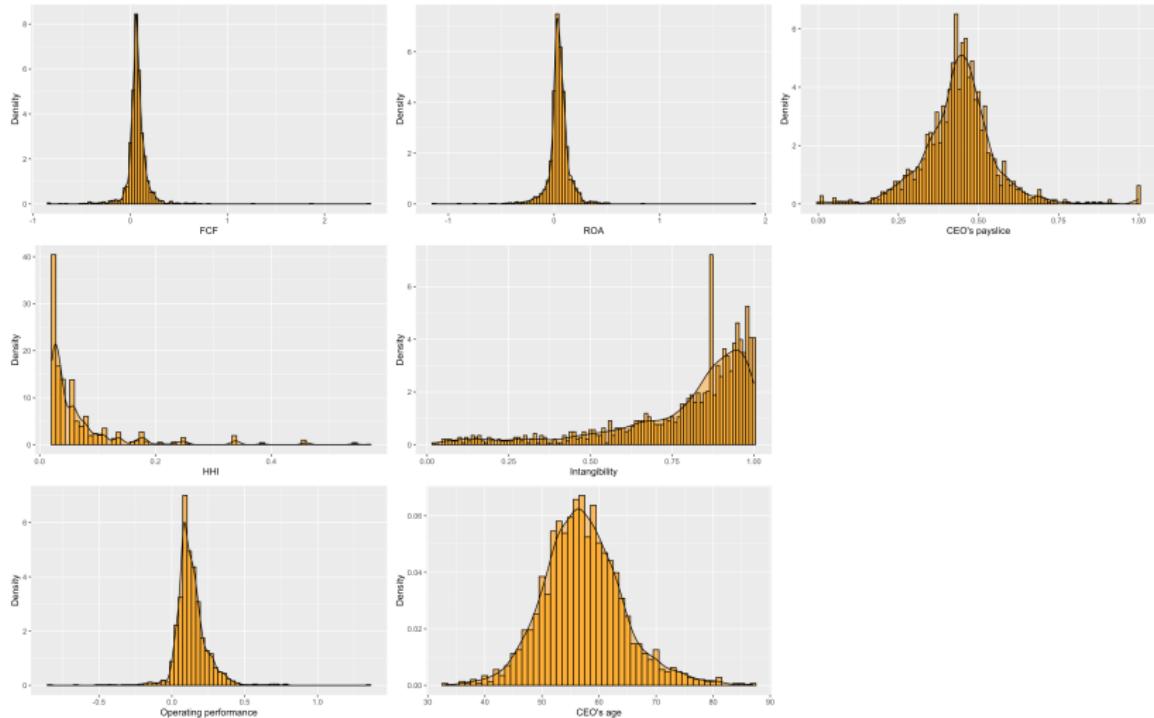


Figure 5: Not transformed

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{bm}	0.569	0.643	0.435	0.765	9.096	-15.762	313.873	-10.471
$\sqrt{salesgrowth}$	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
hh	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

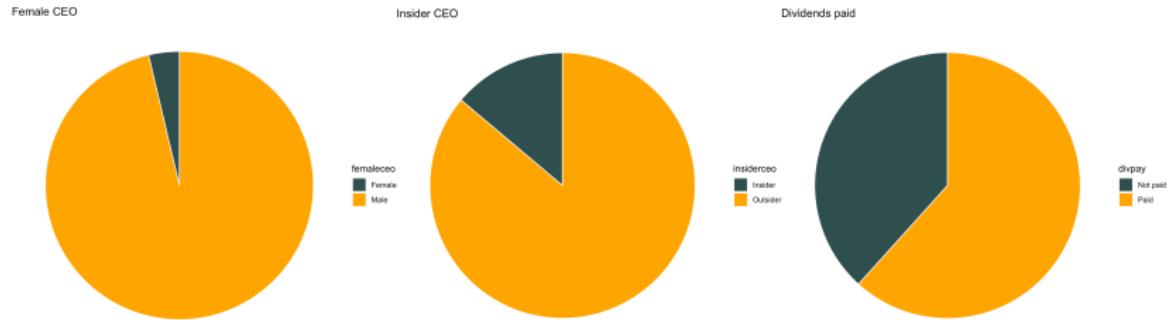


Figure 6: Pie chart of femaleceo, insiderceo, divpay

Summary statistics

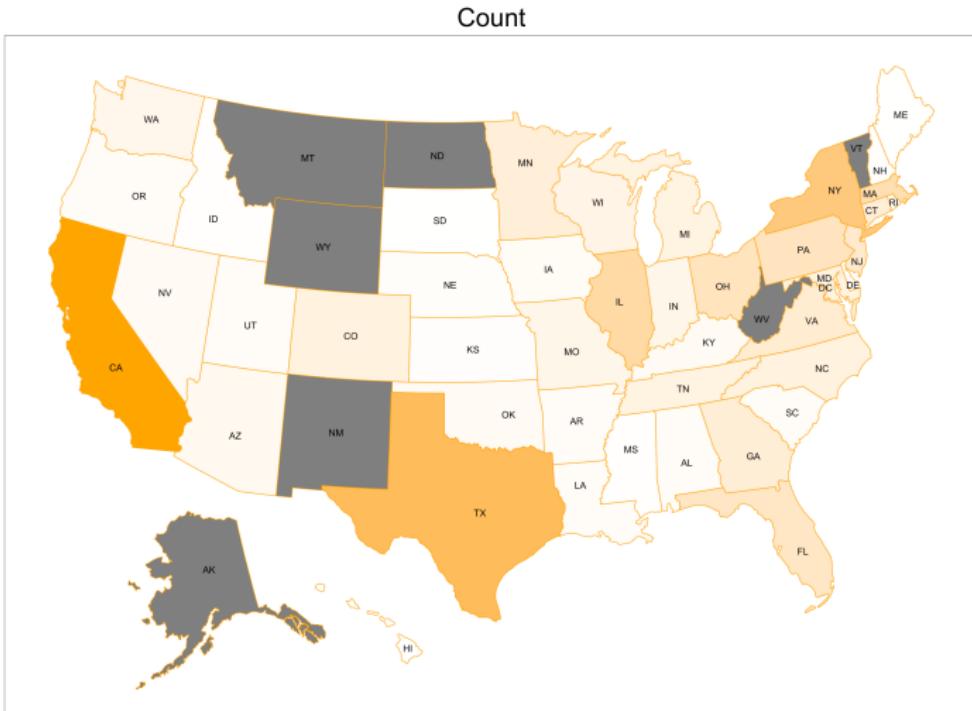


Figure 7: Count by state

Correlation Analysis

rndratio — continuous variable

	τ	<i>p</i> -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

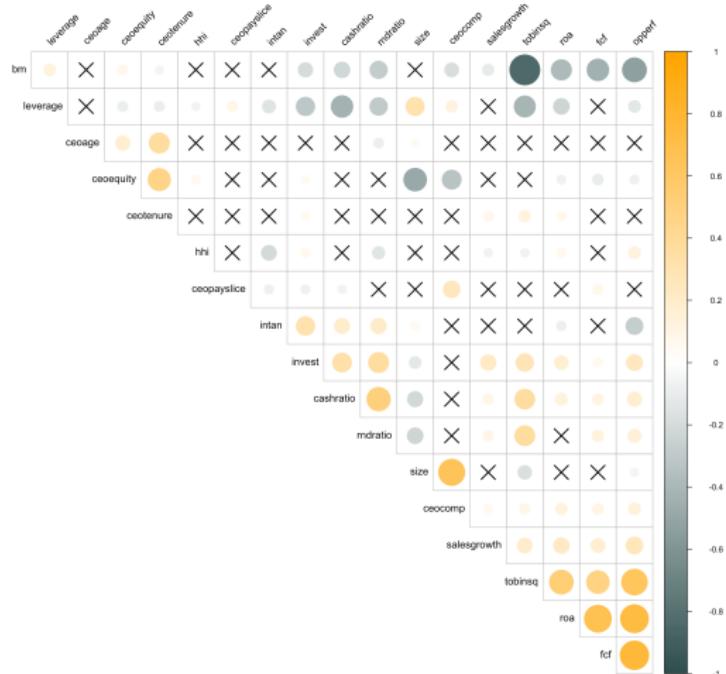


Figure 8: Combining Spearman correlogram with significance test

rndratio — continuous variable

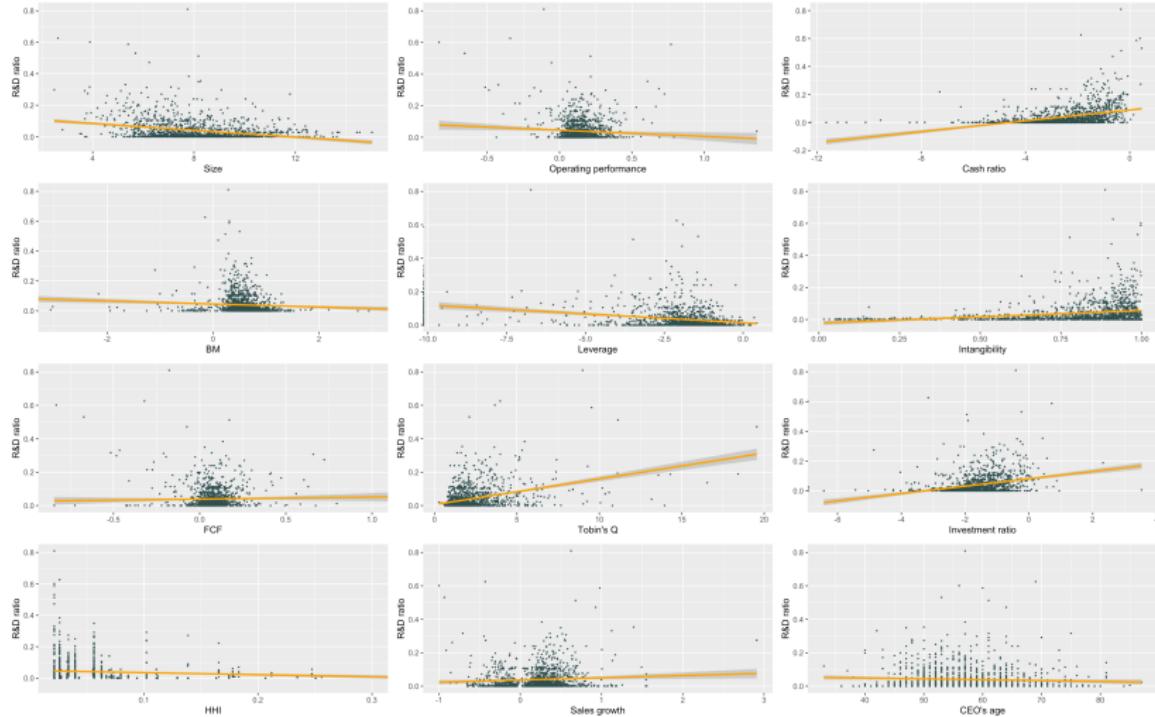


Figure 9: Scatter plot and regression line

rndratio — continuous variable

	Dependent variable: R&D ratio					
	(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*** (0.008)	0.014*** (0.003)	0.006** (0.003)	0.089*** (0.003)	0.081*** (0.004)	0.069*** (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 (df = 1427)	0.063 (df = 1299)	0.064 (df = 1427)	0.064 (df = 1424)	0.065 (df = 1400)	0.069 (df = 1427)
F Statistic	114.643*** (df = 1; 1427)	59.035*** (df = 1; 1299)	246.718*** (df = 1; 1427)	266.045*** (df = 1; 1424)	128.159*** (df = 1; 1400)	3.897** (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: R&D ratio					
	(1)	(2)	(3)	(4)	(5)	(6)
\sqrt{BM}	-0.010*** (0.003)					
$\sqrt{SALESGROWTH}$		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*** (0.002)	0.037*** (0.002)	0.039*** (0.002)	0.049*** (0.002)	0.045*** (0.003)	-0.023*** (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

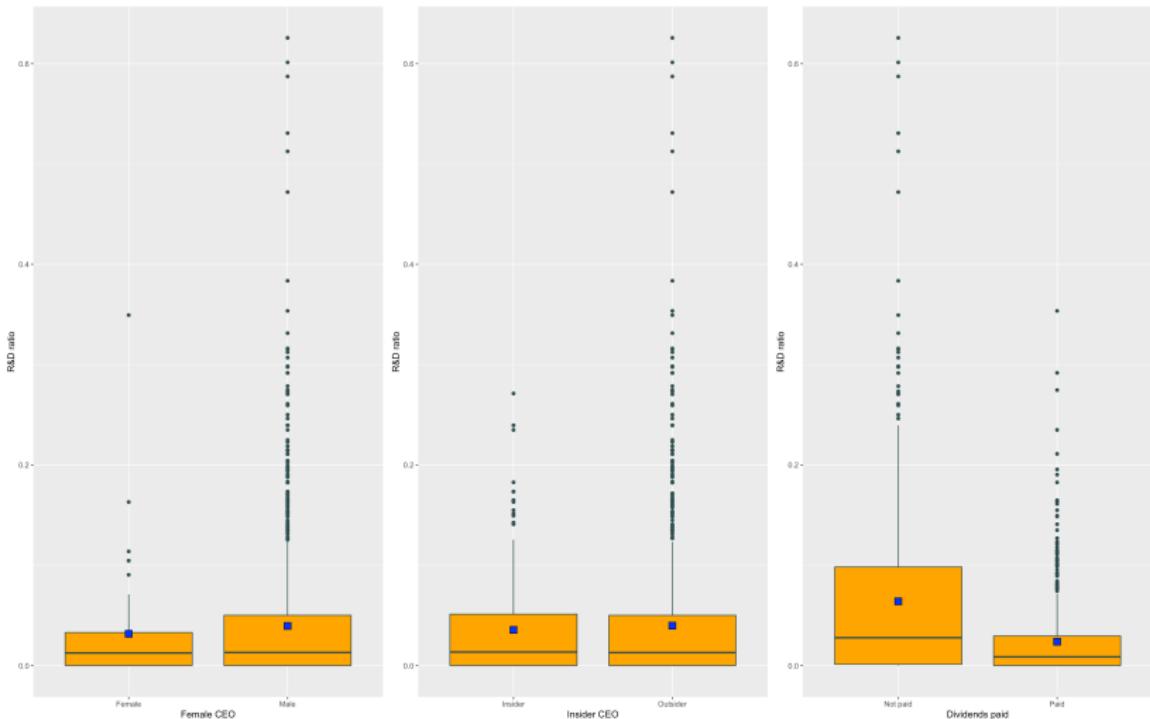


Figure 10: Box plot by femaleceo, insiderceo, divpay

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

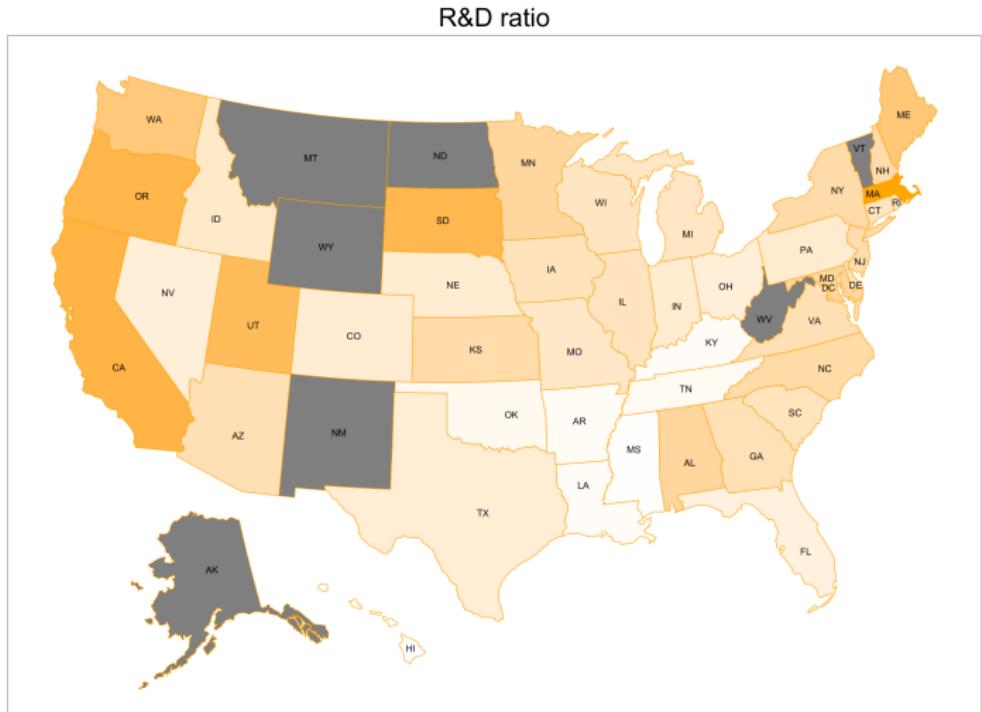


Figure 11: Mean of rndratio by state

rndratio — categorical variable

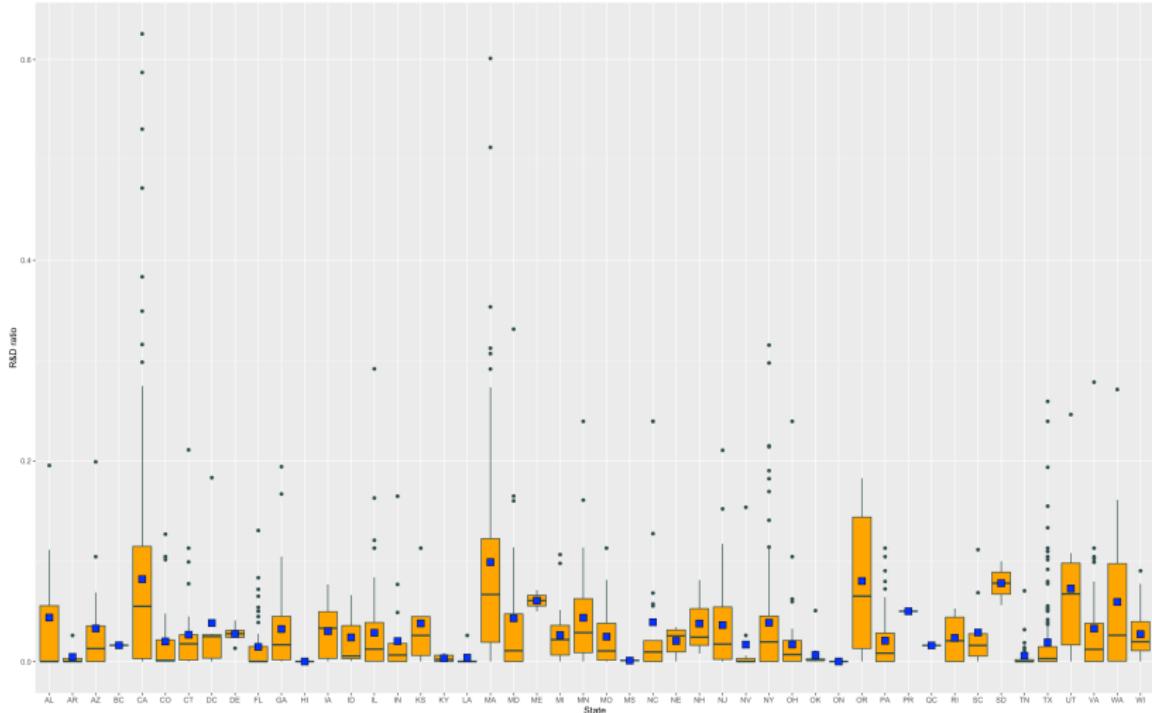


Figure 12: Box plot by state

rndratio — categorical variable

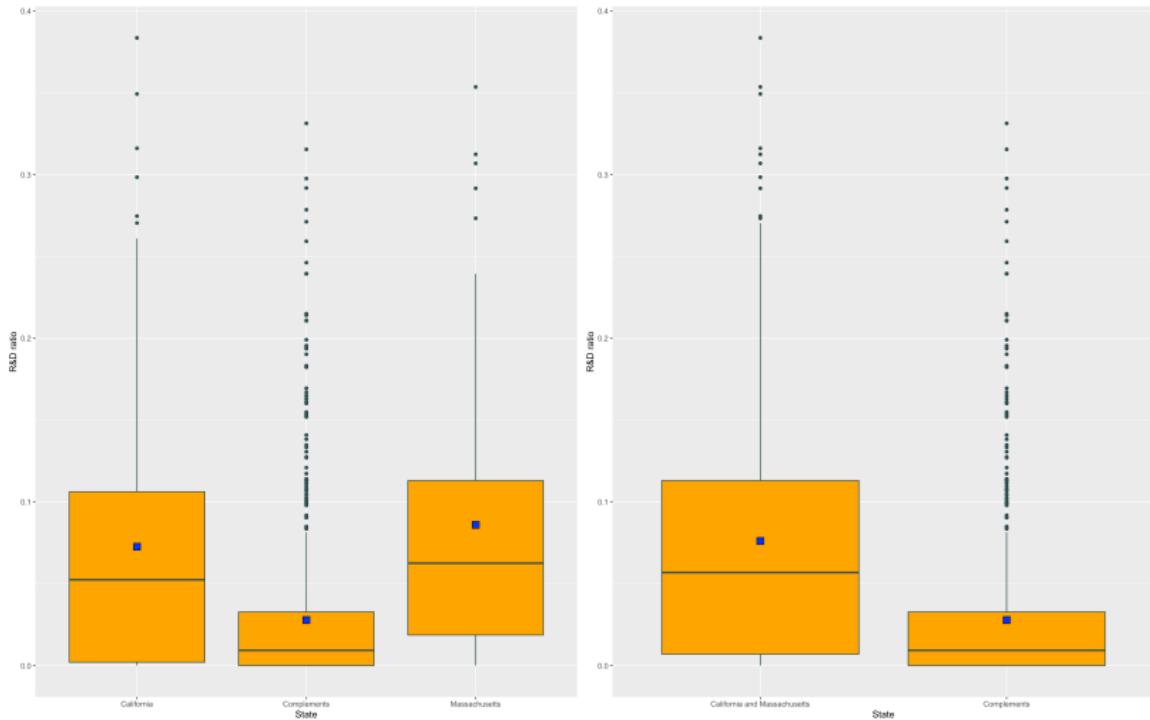


Figure 13: Regrouping state

Between continuous variables

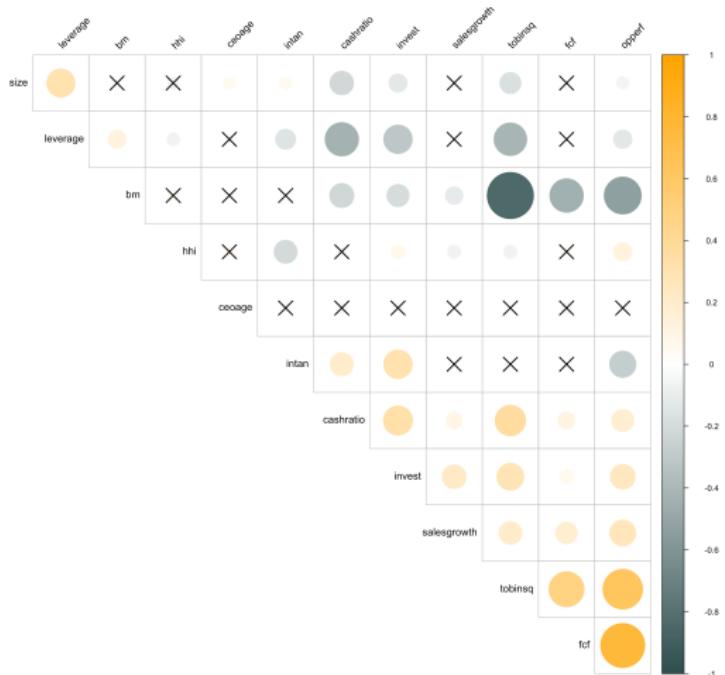


Figure 14: Combining Spearman correlogram with significance test

Between continuous variables

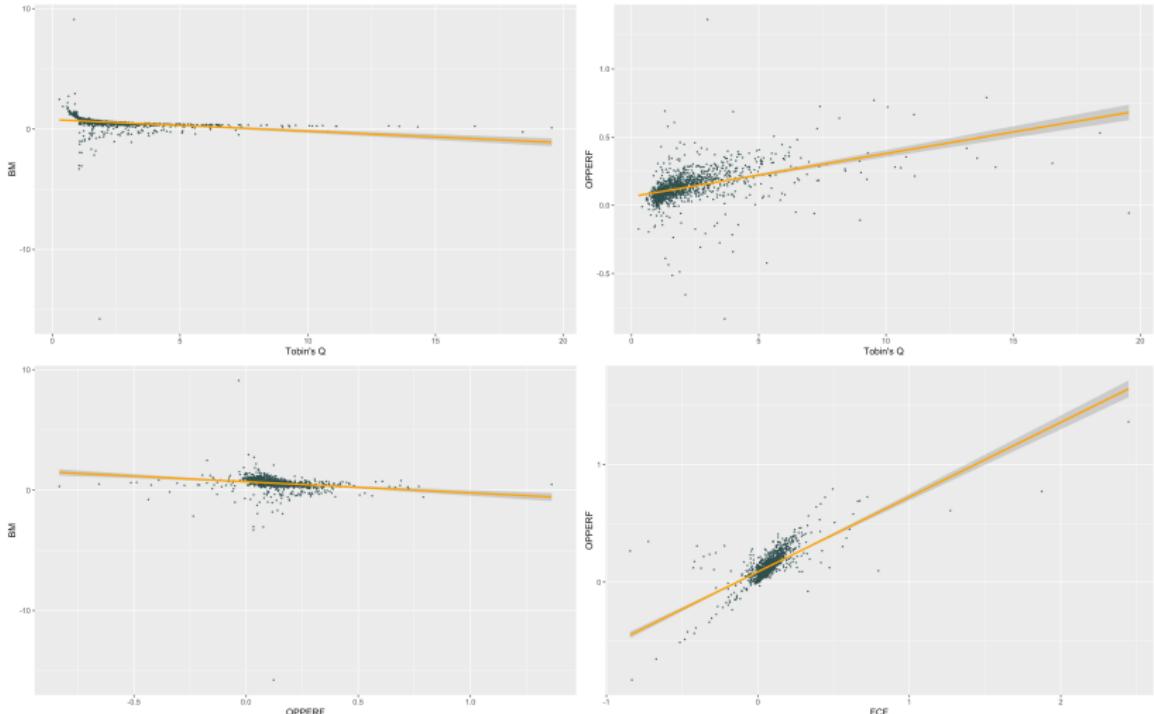


Figure 15: Cases of $|\rho| > 0.5$

Between categorical and continuous variables

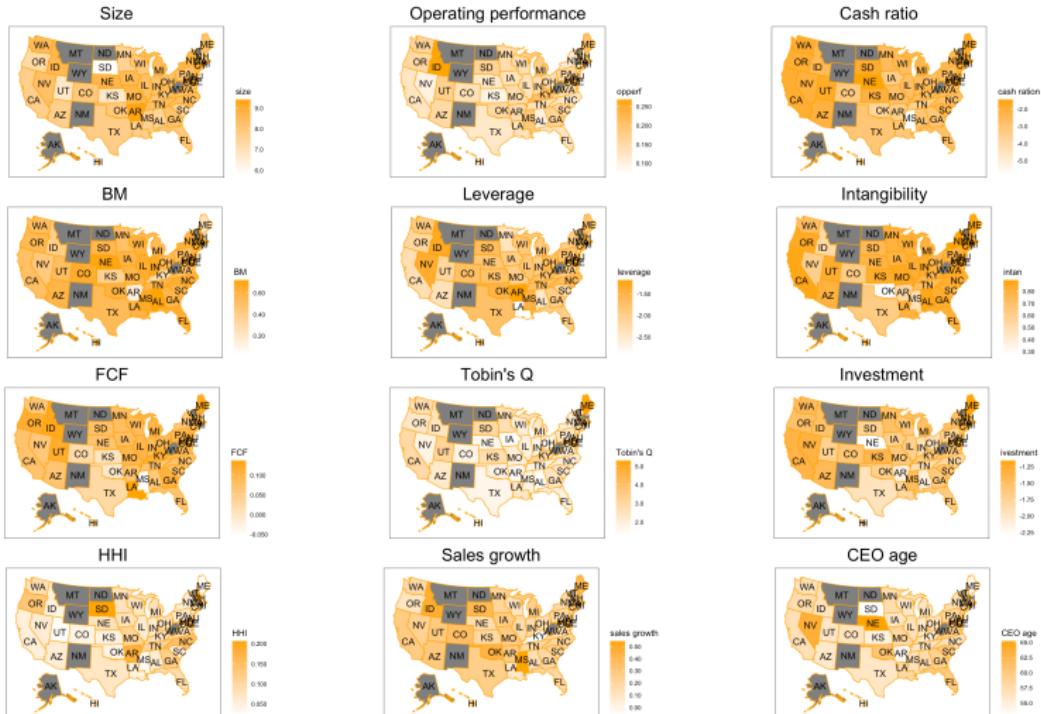


Figure 16: Surviving continuous variables by state (indistinguishable)

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

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