Managerial Compensation and Firm Value:
Evidence from Corporate Spinoffs

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Abstract

Managerial incentives in newly spun-off companies have been ignored in the spinoff literature. In this paper, we study the changes in the incentive structure of CEOs in spun-off companies and the operating performance improvements due to improved managerial incentives after the spinoffs. We construct a unique dataset which covers the corporate spinoffs between 1992 and 2004 in the U.S. Our preliminary results suggest that there is improvement in the pay-performance sensitivity (PPS) of CEOs in spun-off firms. In addition, we find a positive relationship between the PPS of the CEOs and the operating performance improvement after spinoffs.

I. Introduction and Literature Review

A corporate spinoff divides a company (referred as parent company) into two (and sometimes more) independent firms. After a spinoff, existing shareholders receive a pro rata distribution of equity in the newly created firm. Spinoffs seem to be value-enhancing for parent firms, as documented by several studies. For example, Hite and Owers (1983) and Slovin, Sushka and Ferraro (1995) have shown significantly positive market reaction to spinoff announcements. Works such as Berger and Ofek (1999) and Burch and Nanda (2003) document the reduction of value loss of diversification (a.k.a. the diversification discount) after spinoffs. Following this line of literature, sources of gains from spinoffs have been explored by several studies. For example, Gertner, Powers, and Scharfstein (2002) show that capital allocation efficiency seems to improve after spinoffs within the parents firms. Ahn and Denis (2004) also support the argument that by breaking up the conglomerate and improving investment efficiency, spinoffs create value.

In this paper, we propose to study gains to the spun-off company due to improved managerial incentives after the spinoff event. Spinoffs are considered as a remedy to agency conflict and information asymmetry problems. After spinoff, the division becomes an independent public company and is traded in the market; therefore more information about the division, including its stock price and performance, becomes observable to the public. This can potentially improve the design of a managerial compensation package and more efficiently connect managerial compensation with the new firm's performance and stock price. This translates into an improved alignment of interests between the executives and the shareholders of the spun-off firm. Also, managers of spun-off divisions would be more effectively monitored after the spinoff. In other words, spinoff improves information

transparency for the newly created firms, and provides an opportunity for shareholders and the boards of directors to implement better monitoring and governance mechanisms (Krishnaswami and Subramaniam (1999)). In addition to this, Aron (1991) argues the spinoff event itself can serve as an incentive for managers who will become spun-off firms' executives. Ahn and Walker (2007) support this theory by showing that diversified firms conducting a spinoff are associated with more effective corporate governance (such as greater ownership by outside board members, more heterogeneous boards, and fewer board members). Consequently, after spinoffs, these firms' values improve significantly. Practically, it has been observed that a spinoff often creates needs for a major surgery on executive compensation programs. If the spinoffs are done by public offerings, underwriters press for including top management employment contracts in the prospectus, while spinoffs that are accomplished by distribution to shareholders rely less on the predetermined compensation arrangements (Oschner (1991)).

However, very limited research has looked at spun-off firms' management to see whether a better incentive mechanism is indeed established after the spinoff or whether the new independent firm performs better than it was as a division in the parent company. Among them, Seward and Walsh (1996) find that CEOs of the newly created firms are mostly former managers from parent firms (insiders), they usually are given a compensation plan that includes stock options, and majority of their incomes are performance-based. Wruck and Wruck (2002) argues that spinoff events provide an opportunity for management restructuring, and they find evidence that value created in spinoff announcement is significantly associated with characteristics of the spun-off firm's top management team. However, very few researchers have investigated further about the

managerial compensation and its efficiency for the new managers in spun-off firms. More specifically, little is done as to the difference in compensation schemes as an incentive mechanism for these managers. For example, would a better compensation plan be designed and implemented after spinoff? In addition, would firms apply different strategy compensating managers according to whether the spun-off firm CEO was a former divisional manager or was a former top manager in the parent firm? Furthermore, would the change of incentive of these managers affect the spun-off firms' performance? As argued by Woo, Willard and Daellenbach (1992), little research attention has been given to the performance of the divested units around spin-offs.

Therefore in this paper we attempt to study managerial incentives in spun-off firms, with a focus on pay-performance sensitivity (PPS) from equity-based compensation. To our knowledge, this paper is closest to Pyo (2007), where he looks at the changes in managerial compensation and managerial incentives after spinoffs and finds no significant change in the compensation structure of managers on average pre and post spinoff. However, Pyo (2007) merely present a set of univariate tests that describe the change of pay-performance sensivity after spinoffs. In this paper, we extend his analysis by investigating the link between the spinoff and CEO characteristics (such as focus increasing spinoff, insider CEO, value increasing spinoff etc.) and the incentive structure change in the parent and spun-off firms. We also attempt to explore the relationship between managerial incentives in the newly created firms and operating performance change in order to provide additional evidence on the role of managerial incentives in value creation.

Overall, we find that there is a significant increase in CEOs' pay-performance sensitivity in spun-off firms, according to our Wilcoxon test results as well T-test results in

subsamples. Certain deal characteristics (such as CEO origin and refocusing effort) show impact on this improvement in pay-performance sensitivity in our univariate test results. We also show evidence supporting the conjecture that the improvement in pay-performance sensitivity are positively connected with the improvement in operating peformance after spinoffs. Specifically, we show that the PPS of both parent and spun-off firm's CEO are increasing in the combined performance improvement of the firms. In addition, the alignment of parent CEO one year after spinoff is positively related to the difference of the the operating performance of the parent firm before and after spinoff event.

This paper is organized as follows: In Section II, we explain data sources and sample selection process. In Section III we present our results. Section IV briefly concludes the paper and discusses future extensions.

II. Data Collection and Sample Formation

We draw our initial sample of spinoffs from the Security Data Corporation (SDC)'s Merger and Acquisition database. First we identify spinoff events that were announced and completed between the year of 1992 and 2004 in the U.S. market. That gives us a total of 467 spinoffs. According to the spun-off company's primary SIC code provided by SDC, we initially remove spinoffs that result in firms in financial (SIC 6000-6999) and utility industries (SIC 4000-4999). After this step, we are left with 357 observations. Based on the brief deal synopsis provided by SDC, we remove a deal from our sample set if (a) it occurred because of parent company's pressure of lawsuit or being acquired/taken-over, (b) it occurred because the parent company's acquiring another company, (c) either parent or spun-off company merged with (or acquired by) another company within one year after

spinoff, (d) it is classified as reverse spinoff, (e) the parent company holds more than 50% of the shares of the spun-off firm, or (f) after the spin off the CEO of the parent and the spun-off firms is the same person. After this procedure, we have 303 observations left in our sample.

We further restrict our sample to firms that have financial data and CEO compensation data available. For parent companies, we require two years of financial and CEO compensation data: one year before the spinoff (year -1), and one year after the spinoff (year 1). For spun-off companies, we require one year data: one year after the spinoff (year +1). Financial and CEO compensation data are initially obtained from Standard and Poor's Compustat Industrial Annual and ExecuComp databases. If either the spun-off or the parent company's data is not available directly from above databases, we try to supplement by manually collecting data from company's 10-K and proxy statements. We also cross check the spinoff deals with media coverage, such as Wall Street Journal, local newspapers, or the company's own website. Sources such as 10-K, proxy statements, and company websites also provide us information about the spinoff event and spun-off company CEO's job history. We further remove an observation if (a) we cannot find any information about the spinoff or about the company from Compustat, ExecuComp, 10-K, proxy statement, or media coverage; or (b) the information disclosed in 10-K or proxy statement reveals that either the spun-off or the parent company ceased to exist after the spin-off (due to merger/acquisition activities or bankruptcy). Overall, after intensive search, we construct a final sample with 108 observations with available financial and CEO compensation data for both spun-off and parent companies.

Alignment Incentive Measures

Alignment incentives arise from executive compensation component which is tied to the stock price of the firm and are cumulative over years. We measure it as the executive's effective ownership in the firm's equity. Consistent with Aggarwal and Samwick (2003), we define pay performance sensitivity (PPS) as the sum of stock and option sensitivities, each computed per $100 change in shareholders' wealth. Specifically,

CEO PPS = (Percentage of shares held by CEO + (delta of options x number of options held by CEO / total number of shares outstanding)) x 100

For the stock portion of CEO's equity portfolio, we use the percentage of stock ownership at the end of the year for each CEO in our sample one year before and after the spinoff. For option holdings, we first obtain the number of options held by the manager at the beginning of the year, which are option grants made in prior years. The proxy statement does not provide the exercise prices and time to maturities for these options but provides their intrinsic value if they are in the money. Following Core and Guay (2002), we determine an average exercise price for all the granted options (exercisable and un-exercisable) assuming that the intrinsic value is based on the year-end stock price, and treat all options that are held at the end of the fiscal year as a single grant with a five-year time to maturity. We compute the average delta of prior option grants using the modified Black-Scholes formula following Core and Guay (2002). We obtain the risk-free rate using data

from the five-year treasury bills constant maturity series available from the Federal Reserve Bank's official website, and the dividend yield and stock volatility from ExecuComp. For the observations which are not on the ExecuComp database, we use the average values of dividend yield and stock volatility of all observations in the ExecuComp database for the sample year.

III. Discussion of Results

Descriptive Statistics

In Table 1, we report the descriptive statistics of executive compensation components for the CEOs of sample firms. The median CEO of parent company earns $3.8 million in total compensation before the spinoff and $5.4 million after the spinoff. The median CEO of the spun-off company earns $1.7 million. Consistent with the firm size difference PPS of parent firm CEOs. The large difference in total compensation between parent and spun-off firm CEOs is consistent with the difference in sizes of parent and spun-off firms presented in Table 2. Similarly, the median PPS of parent firm's CEO is $0.76 per $100 of change in shareholders' wealth for the year prior to spinoff year, whereas the median PPS of spun-off firm's CEO is $1.70 per $100. This is also consistent with decreasing PPS as firm size increases (Core and Guay (2002)).

In Table 2, we present descriptive statistics for major financial variables for the sample firms. It's clear that the spun-off firms are much smaller in size compared to the parent firms. On average, spun-off firm's total assets in year 1 are about 13% of its parent firm's assets one year before spinoff (year -1), and the ratio is about 18% when it comes to sales comparison. The median values of Return on Assets (OROA) measured as operating

income before depreciation over total assets do not seem to vary significantly over subsamples of parent and spun-off firms. The median OROA for parent firms at year -1 is 13.7% and at year +1 is 13.3 %. The median OROA for spun-off firms at year +1 is 14.4%, slightly higher than the median values of OROA of parent firms. The summary statistics of Leverage, Tobin's Q and Dividend payout ratio of parent and spun-off firms follow a similar pattern and do not show large variance over the subsamples.

Table 3 presents the distribution of the sample based on CEO and deal characteristics. Among the 108 new CEOs of the spun-off companies, 90 (83%) of them are "insiders" and 18 (17%) of them are "outsiders". A CEO is identified as insider if he worked in the parent company at least one year prior to the spinoff year, otherwise he is identified as an outsider. This is consistent with Wruck and Wruck (2002) where they find about 20% of the spinoff top managers are outsiders. In addition, 65 out of the 108 new CEOs were promoted from other (non-CEO) positions such as divisional manager or president of the parent company. 19 (17.6%) out of the 108 new CEOs were CEOs of the parent firms. Overall, these statistics are consistent with the extant literature (For example, Seward and Walsh (1996), Wruck and Wruck (2002)) about the origin and job history of CEO in the newly spun-off companies.

In addition to CEO characteristics, we also examine certain deal characteristics. We classify a spinoff deal as "focus increasing" if the spun-off division is in different industry as the parent company. Industry here is defined by 2-digit SIC code. In other words, if the spun-off division has a different 2-digit SIC code compared to the parent company, we consider the spinoff as an effort of the parent company to refocus and reduce the negative impact of diversification. In our sample, we have 67 deals (62%) that are identified as

"focusing increasing", while in the rest 41 (38%) deals spun-off divisions share the same 2-digit SIC code as the parent company.

We also compute Cumulated Abnormal Returns (CARs) for parent firms for an event window of day (-1, +1) around the spin-off announcements using the conventional event study methodology. Stock price and market returns data for parent companies are obtained from CRSP. CARs are measured relative to a CRSP value-weighted market return. In our sample 7 parent firms do not have their stock return data available from CRSP and therefore have to be excluded from our CARs computation. Mean value of CARs for our sample firms is 4.29%, and it's significantly positive at 5% level. This is consistent with literature about the overall perceived positive effect of spinoffs. However not all parent firms enjoyed positive announcement effect from the spinoff events. Among the 101 sample parent firms, 66 (65%) of them have positive CARs, while the other 35 (35%) firms experienced negative abnormal returns after spinoff announcements.

Univariate Analysis

In Table 4, we present our first set of univariate test results for major variables investigated in this study. We examine the mean and median values of the difference in several major variables for the spun-off firms in year +1, parent firms in year +1 and parent firms in year -1. These variables include pay-performance sensitivity that captures equity based incentives for CEOs, Tobin's Q, OROA (operating performance), leverage and dividend payout ratio. We conduct both T-test and Wilcoxon sign-rank tests to examine the difference in these variables between (a) spun-off firms and parent firms after spinoff (both in Year +1), (b) pre-spinoff parent firms (Year -1) and spun-off firms (Year +1), and (c) pre- and post-spinoff parent firms (Year -1 vs. Year+1) . According to the Wilcoxon test

results, spun-off firms demonstrate significantly higher pay-performance sensitivity compared to both pre- and post-spinoff parent firms. However T-test results cannot give us the same conclusion, suggesting certain level of skewness in our sample data. Meanwhile T-test result suggest significant improvement of operating performance in spun-off firms when we look at the mean value of difference in OROA between spun-off firms and pre-spinoff parent firms. In addition, Wilcoxon test results show that spun-off firms pay significantly lower level of dividend payout compare to the pre- or post-spinoff parent firms. We do not find any significant difference in leverage and Tobin's q between spun-off and parent firms.

To address the skewness issue we detect in our data, we divide our sample into four subgroups according to the quartiles in pre-spinoff parent firm CEOs' PPS level. We report our t-test results for PPS difference in Panel B of Table 4. As seen from Panel B, interestingly, it is only in spinoffs that come from parent CEOs in the highest quartile (above 75%) that we can observe lower PPS in spun-off firms. In all three other quartiles, pay-performance sensitivity is significantly higher in spun-off firms than in post-spinoff parent firms. When we look at the difference of PPS between spun-off firms and pre-spinoff parent firms, the pattern is similar, but less significant. Overall, results from Panel A and Panel B of Table 4 suggest that PPS of CEOs in spun-off firms are higher than CEOs of parent frims.

It's been argued in managerial compensation literature that size of a company is negatively related to its pay-performance sensitivity (see, for example, Baker and Hall (2004) and Schaefer (1998)). Therefore whether our results are driven by better executive

alignment, or are merely a size effect due to the fact that spun-off firms are much smaller, still waits for multivariate analysis that we present in the last part of this section.

To further study the impact of deal characteristics and CEO characteristics on changes of pay-performance sensitivity, we break down our sample into several sets of subsamples according to whether the spinoff announcement bring positive abnormal returns (CARs) to parent firms, whether the spun-off firm CEO is an insider or outsider, and whether the spin-off is considered as a refocusing effort. We also conduct both T-test and Wilcoxon sign-rank tests to examine the 3-way difference in these variables among spun-off firms, pre-spinoff parent firms, and post-spinoff parent firms. These results are reported in Panel A and B of Table 5. Results show that the positive differences of PPS in spun-off firms are generally more significant in deals that have insider CEOs (Panel A), that bring positive abnormal returns to parent firms (Panel B), and that are considered focusing increasing (Panel C). Interestingly, the pattern of lower dividend payout level we observe for our overall sample (Table 4) is also more significant in subgroups that we mentioned above.

Multivariate Analysis

In this section, we describe our findings for the relationship between the equity incentives of spin-off firms' CEOs (both parent and spun-off firms) and the change in operating performance for the firms after the spinoff event controlling for several firm, CEO and deal characteristics. Since it is difficult to identify the performance of the spun-off firms prior to the spinoff where the divisions' performance is not reported separately, we measure the performance difference in several ways.

First, we compute the combined operating performance of the parent and spun-off firm one year after spinoff year weighted by total assets of the firms. The difference between this computed combined performance one year after spinoff and the operating performance of parent firm one year before spinoff year is a proxy for the improvement or deterioration of operating performance due to spinoff. This measure is illustrated in the following two equations.

$$combined\ performance = \frac{ROA_{p,1}*TA_{p,1}+ROA_{s,1}*TA_{s,1}}{TA_{p,1}+TA_{s,1}} \qquad (1)$$

$$\Delta performance = combined\ performance\ in\ year\ 1 - ROA_{p,-1} \qquad (2)$$

In above equations, $TA_{p,\ 1}$ and $TA_{s,\ 1}$ stand for total assets in year 1 for parent company and spun-off company, respectively. $ROA_{p,-1}$, $ROA_{p,1}$, and $ROA_{s,1}$ stand for operating performance for parent company at year -1, parent company at year 1, and spun-off company at year 1, respectively.

In this analysis, we explore the relationship between the change of this performance (between pre and post spinoff events) and pay-performance sensitivity of the CEOs of the parent and spun-off firms. We hypothesize that if the spinoff event improves the alignment of the CEO of the spun-off firm, performance difference is positively related to the equity incentives of the CEOs.

We report our findings in Table 6. In all three models in Table 6, the dependent variable ($\Delta\ combined\ performance$) is the difference between the combined operating performance of the parent and spun-off firm one year after the spinoff and the operating performance of the parent firm one year before the spinoff, as illustrated in Equation (1)

and (2). All the specifications in this table include control variables such as log value of total assets for parent firm and spun-off firm before and after spinoff, debt ratio of the spun-off firm and parent firm before and after spinoff, and asset ratio (ratio between total assets of the spun-off firm and total assets of parent firm in year 1). We also include two dummy variables "Insider" and "Focus" in the specifications to explore the impact of CEO and deal characteristics on the potential operating performance change.

In the first model in Table 6, we look at the relationship between PPS of spun-off firm's CEO and operating performance change of the combined firm. The coefficient on this variable is positive (0.0050) and statistically significant (t-value=1.95). In the second model, in addition to the PPS of spun-off firm's CEO we also include PPS of the parent firm's CEO before and after spinoff as two separate variables. In this specification, the coefficient on PPS (Parent, Yr +1) is positive and significant. However the coefficient of PPS (Spunoff, Yr +1) is not significant at conventional levels (t-value = 1.48), though remains positive. In model 3, we interact our focus variable PPS (Spunoff, Yr +1) with the positive abnormal return dummy variable. "Positive AR" dummy variable takes value of one if the parent experienced positive abnormal return after spinoff, and zero if otherwise. We use this interaction to account for the possibility of a different slope for the effect of PPS of spun-off firm's CEO on operating performance difference in the case of spinoffs which have positive stock price reaction to the event announcement. In this model, both PPS of spun-off firm's and parent firm's CEO at year +1 are positive and significant. However, the coefficient on the interaction of Positive AR and PPS (Spunoff, Yr +1) is statistically insignificant.

These OLS regression estimations offer some support for the conjecture that PPS of both spun-off firm's CEO and parent firm's CEO positively affect the combined operating performance of spun-off and parent firm after the spinoff event. We do not find any statistical evidence for the effect of deal characteristics on the change of operating performance after spinoff. The coefficients on Asset Ratio, Insider and Focus increasing are all statistically insignificant in all three models in Table 1.

We report our findings on the PPS of parent firm's CEO before and after spinoff on performance change of parent firm in Table 7. In all the three models in this table, the dependent variable is the change in operating performance (ROA) of the parent firm between year 1 (one year after spinoff year) and year -1 (one year before spinoff year). The models include the control variables of total assets, debt ratio of the parent firm before and after spinoff, asset ratio, and dummy variables for focus-increasing spinoff deals and for positive-abnormal return deals. In this analysis, we hypothesize that the operating performance difference of parent firm is increasing in the PPS of parent firm's CEO after spinoff and decreasing in PPS of parent firm's CEO before spinoff due to improved information asymmetry.

In the first specification in Table 7, the coefficient on PPS (Parent, Yr+1) is positive (0.0038) and significant (t-value = 2.27). However, the coefficient on PPS (Parent, Yr -1) is statistically insignificant. In model 2 and 3, we add positive AR dummy variable and an interaction of positive AR and PPS (Parent, Yr+1), respectively. Similar to the previous analysis, with the addition of this interaction term we expect to capture any potentially different marginal effect of PPS (Parent, Yr+1) on operating performance difference in the subgroups of spinoffs that have positive or negative announcement effect. In model 2 with

the addition of Positive AR dummy as a control variable, the coefficient on PPS (Parent, Yr+1) remains positive and significant. The coefficient on Positive AR is negative and significant (t-value = -1.83) which is counter intuitive. In the third model, the interaction of positive AR and PPS (Parent, Yr+1) is added to the specification. With the addition of the interaction term, although both coefficients on PPS (Parent, Yr+1) and interaction term are positive, they are insignificant at conventional levels. The coefficient on Positive AR remains negative and significant. Based on this result, we conclude that the effect of PPS (Parent, Yr+1) on operating performance change of parent firm does not differ in the groups of spinoffs with positive and negative announcement effects. Overall, findings from second table suggest that the change in operating performance in parent firms is positively related to the PPS of the CEOs in the parent firms after spinoff.

IV. Summary and Conclusion

In this paper, we investigate the change of managerial incentives after spinoff in both parent and spun-off companies and the effect of managerial incentives on the operating performance of spinoff firms due to improved information asymmetry. In the univariate comparisons, we find certain level of pay-performance sensitivity improvements for the CEOs of spun-off firms. This result seems to be driven mainly by the subsamples of spinoffs where the new CEO of spun-off firm is an insider, the spinoff has a positive announcement effect and the spinoff is focus increasing. However, we do not find any systematic change in the equity based incentives of CEOs of parent firms before and after spinoff event.

In our multivariate analyses, we explore the relationship between PPS of the CEO spinoff firms and the operation performance change of firms before and after the spinoff. In this set of analysis, we find evidence that both PPS of spun-off firm's CEO and parent firm's CEO are positively related to the operating performance difference between combined firm (parent and spun-off firm one year prior to the spinoff) and parent firm (one year after spinoff). We also find that PPS of the CEO of parent firm one year after the spinoff is positively related to the operating performance change of parent firm after the spinoff.

We argue that after the spinoff, the equity based compensation of the new CEO of the spun-off firm is directly linked to the performance of the spun-off division; therefore the new CEO is more effectively aligned with the benefits of the shareholders. This better alignment of the new CEO reflects on the operating performance improvement of the spun-off firm. Overall, our study provides evidence that improved managerial incentives are one of the sources of gains in spinoffs.

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Table 1- Descriptive Statistics of CEO Compensation

"Parent Year -1" stands for variable information for parent companies one year before the spinoff. "Parent Year 1" stands for variable information for parent companies one year after the spinoff. "Spunoff Year 1" stands for variable information for spun-off companies one year after spinoff. All dollar amounts are in thousands, and have been converted to 2005 dollars.

Variable	Year	N	Mean	Median	Lower Quartile	Upper Quartile
Salary ($000)	Parent Year -1	108	882.18	851.22	578.46	1,099.46
	Parent Year 1	108	825.76	786.33	548.64	980.74
	Spunoff Year 1	108	562.88	549.03	365.40	679.88
Bonus ($000)	Parent Year -1	108	1,129.30	558.27	124.59	1,198.16
	Parent Year 1	108	911.94	545.95	11.61	962.82
	Spunoff Year 1	108	460.67	231.29	37.36	567.12
Option Grants	Parent Year -1	108	4,567.24	1,523.06	394.35	4,831.13
($000)	Parent Year 1	108	3,914.17	1,892.68	225.53	5,033.34
	Spunoff Year 1	108	2,668.27	481.24	0.00	2,348.72
Total	Parent Year -1	108	6,986.93	3,864.59	1,951.71	8,706.65
Compensation	Parent Year 1	108	8,122.37	5,439.09	2,028.08	11,178.09
($000)	Spunoff Year 1	108	3,817.04	1,759.91	707.870	3,825.44
Stock Ownership	Parent Year -1	108	2.00	0.23	0.04	1.11
(%)	Parent Year 1	108	1.64	0.16	0.04	0.47
	Spunoff Year 1	108	1.04	0.27	0.06	1.24
PPS	Parent Year -1	108	3.00	0.76	0.40	3.12
($ per $100 of SH wealth)	Parent Year 1	108	2.74	1.17	0.44	2.42
	Spunoff Year 1	108	2.66	1.70	0.88	3.27

Table 2 - Descriptive Statistics of Major Financial Variables

All dollar amounts are in millions and have been converted to 2005 dollar. "Parent Year -1" and "Parent Year 1" are for parent companies one year before or after the spinoff event, respectively. "Spunoff Year 1" records the spun-off company's financial data one year after the spinoff. OROA is operating income before depreciation (OIBD) standardized by total assets. Leverage computed as total long-term liabilities over total assets. Tobin's Q is computed as market value of firm assets (MV) divided by the book value of assets, where MV equals to the market value of equity plus the difference between total book value of assets and book value of common equity. Dividend ratio is computed as common dividend paid over net income.

Variables	Year	N	Mean	Median	Lower Quartile	Upper Quartile
Assets ($Million)	Parent Year -1	108	12,950.85	3,280.17	1,395.91	9,326.19
	Parent Year 1	108	11,657.69	3,085.55	943.94	7,581.87
	Spunoff Year 1	108	1,725.26	751.32	241.84	1,750.36
Sales ($Million)	Parent Year -1	108	10,214.00	2,914.72	901.49	9,697.71
	Parent Year 1	108	9,160.15	2,381.73	718.86	7,789.88
	Spunoff Year 1	108	1,889.86	738.28	197.62	2,071.85
Capital Expenditure ($Million)	Parent Year -1	106	742.41	180.69	48.83	581.45
	Parent Year 1	107	778.35	109.94	25.15	424.55
	Spunoff Year 1	106	144.17	37.05	8.26	98.93
OIBD ($Million)	Parent Year -1	106	1,731.22	427.70	174.17	1,387.06
	Parent Year 1	106	1,291.36	320.34	105.74	1,158.62
	Spunoff Year 1	107	268.85	114.58	16.67	258.60
Net Income ($Million)	Parent Year -1	108	500.63	120.23	6.10	457.60
	Parent Year 1	108	186.75	103.67	2.90	346.45
	Spunoff Year 1	108	53.02	21.36	-6.67	92.32
OROA	Parent Year -1	106	0.1352	0.1386	0.0899	0.1872
	Parent Year 1	106	0.1272	0.1335	0.0812	0.1825
	Spunoff Year 1	107	0.0911	0.1440	0.0749	0.2046
Leverage	Parent Year -1	108	0.2093	0.1918	0.0914	0.3100
	Parent Year 1	108	0.2260	0.2206	0.0787	0.3373
	Spunoff Year 1	108	0.2109	0.1742	0.0026	0.3218
Tobin's q	Parent Year -1	102	2.2431	1.6667	1.2871	2.3144
	Parent Year 1	104	1.8963	1.5084	1.2043	2.3174
	Spunoff Year 1	108	1.9744	1.6092	1.0957	2.4357
Dividend Payout Ratio	Parent Year -1	108	0.0971	0.0082	0.0000	0.3761
	Parent Year 1	108	0.3223	0.0000	0.0000	0.4116
	Spunoff Year 1	108	0.3989	0.0000	0.0000	0.0100

Table 3 - Deal and CEO Characteristics

A spun-off firm's CEO is labeled as insider if he/she has been working in the parent firm (either at the corporate or divisional level) for at least one year before the spinoff. Otherwise he/she is considered an "outsider". Dummy variable "Promo" equals to 1 if the spun-off firm's new CEO is promoted from a non-CEO position and 0 otherwise. Positive AR is equal to 1 if the sum of cumulative abnormal returns of spinoff event is positive over (-1, +1) event window, 0 otherwise. "Focus" equal to 1 if the spun-off firm have different 2-digit SIC code with the parent firm, and 0 if the two firms share same 2-digit SIC codes.

Dummy Variable	N	1	0
Insider		CEO is an insider	CEO is an outsider
		90	18
	108	83.3%	16.7%
Promo		Promoted to be CEO	Not a promotion
		65	43
	108	60.2%	39.8%
AR Positive		Positive Abnormal Return	Non-Positive Abnormal Return
		66	35
	101	65.4%	34.6%
Focus		Focus Increasing	Non- Focus Increasing
		67	41
	108	62.0%	38%

Table 4 - Univariate Tests

Panel A: Mean and median statistics

PPS is stock price sensitivity of the executive's stock and stock option portfolio. Tobin's q is computed as market value of firm assets (MV) divided by book value of assets, where MV equals to the market value of equity plus the difference between total book value of assets and book value of common equity. Leverage is computed as total long-term liabilities over total assets. Payout ratio is computed as common dividend paid over net income. OROA is operating income before depreciation (OIBD) standardized by total assets. (s, 1) stands for spun-off firms one year after spinoff, (p,1) stands for parent firms one year after spinoff, and (p, -1) stands for parent firms one year before spinoff. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

		Mean	Median	Std	t-test	Wilcoxon sign-rank test
PPS	(s, 1) vs. (p, 1)	-0.0797	0.4790	5.6523	-0.1465	875***
	(s, 1) vs. (p, -1)	-0.3452	0.5003	6.3141	-0.5682	881***
	(p, 1) vs. (p, -1)	-0.2656	0.0609	6.0031	-0.4597	188
Tobin's q	(s, 1) vs. (p, 1)	0.0788	-0.0468	1.7130	0.4690	-59
	(s, 1) vs. (p, -1)	-0.2443	0.0401	2.2945	-1.0752	-2.5
	(p, 1) vs. (p, -1)	-0.3396	-0.0073	1.9816	-1.7220*	-133.5
Leverage	(s, 1) vs. (p, 1)	-0.0151	-0.0060	0.2614	-0.6002	-344.5
	(s, 1) vs. (p, -1)	0.0016	0.0000	0.2424	0.0683	-158
	(p, 1) vs. (p, -1)	0.0167	0.0010	0.1550	1.1193	153
Payout Ratio	(s, 1) vs. (p, 1)	0.0766	0.0000	3.5759	0.2225	-568.5***
	(s, 1) vs. (p, -1)	0.3018	0.0000	3.4697	0.9040	-459***
	(p, 1) vs. (p, -1)	0.2252	0.0000	1.2956	1.8068*	163
OROA	(s, 1) vs. (p, 1)	-0.0370	0.0081	0.2563	-1.4794	67.5
	(s, 1) vs. (p, -1)	-0.0426	0.0032	0.2455	-1.7790*	-64.5
	(p, 1) vs. (p, -1)	-0.0090	-0.0030	0.0979	-0.9469	-104.5

Panel B: t-test of Pay-performance Sensitivity in Quartile Groups

t-test results for Pay-performance sensitivity (PPS) in subsamples according to quartile classification of the PPS in parent firms one year before spinoff. (s, 1) stands for spun-off firms one year after spinoff, (p,1) stands for parent firms one year after spinoff, and (p, -1) stands for parent firms one year before the spinoff. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels respectively.

T-test for PPS	PPS of Parent CEO (p, -1)			
	1st Quartile	2nd Quartile	3rd Quartile	4th Quartile
(s, 1) vs. (p, -1)	1.17(1.69*)	1.43(3.51***)	-0.30(-0.24)	-2.62(-1.75*)
(s, 1) vs. (p, 1)	1.74(2.25**)	1.78(4.22***)	0.97(2.41**)	-5.87(-3.11***)

Table 5 - Univariate Tests by Groups

Panel A: Mean and median statistics by CEO Origin (Insider)

Group O contains spinoffs where spun-off firm CEOs are "outsiders", and Group I contains spinoffs where spin-off firm CEOs are "insiders". A spun-off firm's CEO is labeled as insider if he/she has been working in the parent firm (either at the corporate or divisional level) for at least one year before the spinoff. Otherwise he/she considered an "outsider". PPS is stock price sensitivity of the executive's stock and stock option portfolio. Tobin's q is computed as market value of firm assets (MV) divided by book value of assets, where MV equals to the market value of equity plus the difference between total book value of assets and book value of common equity. Leverage is computed as total long-term liabilities over total assets. Payout ratio is computed as common dividend paid over net income. OROA is operating income before depreciation (OIBD) standardized by total assets. (s, 1) stands for spun-off firms one year after spinoff, (p,1) stands for parent firms one year after spinoff, and (p, -1) stands for parent firms one year before spinoff. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

		N		Mean		Median		t-test		Wilcoxon sign-rank test	
		O	I	O	I	O	I	O	I	O	I
PPS	(s, 1) vs. (p, 1)	18	90	-0.0764	-0.0803	0.4790	0.4846	-0.04	-0.15	41.5*	529.5**
	(s, 1) vs. (p, -1)	18	90	-0.2497	-0.3643	0.2669	0.6194	-0.14	-0.57	22.5	597.5***
	(p, 1) vs. (p, -1)	18	90	-0.1733	-0.2840	0.0361	0.0609	-0.07	-0.62	-0.5	172.5
Tobin's q	(s, 1) vs. (p, 1)	17	87	0.2563	0.0441	-0.0506	-0.0240	0.66	0.24	3.5	-56
	(s, 1) vs. (p, -1)	16	86	-0.8068	-0.1396	0.0574	0.0324	-0.83	-0.69	-1	5.5
	(p, 1) vs. (p, -1)	16	85	-1.0903	-0.1982	-0.1465	-0.0073	-1.17	-1.27	-15	-40.5
Leverage	(s, 1) vs. (p, 1)	18	90	-0.0617	-0.0058	-0.1225	-0.0008	-0.87	-0.22	-32.5	-123
	(s, 1) vs. (p, -1)	18	90	-0.0823	0.0184	-0.1077	0.0005	-1.18	0.76	-31.5	77.5
	(p, 1) vs. (p, -1)	18	90	-0.0206	0.0241	-0.0136	0.0068	-0.57	1.48	-24	262
Payout Ratio	(s, 1) vs. (p, 1)	18	90	-0.0683	0.1055	0.0000	0.0000	-1.11	0.26	-5.5	-475***
	(s, 1) vs. (p, -1)	18	90	0.1780	0.3266	0.0000	-0.0199	0.96	0.82	4.5	-450.5***
	(p, 1) vs. (p, -1)	18	90	0.2464	0.2210	0.0000	0.0000	1.20	1.53	4	99
OROA	(s, 1) vs. (p, 1)	17	88	-0.0469	-0.0351	0.0136	0.0033	-0.64	-1.32	13.5	-8
	(s, 1) vs. (p, -1)	17	88	-0.0837	-0.0347	0.0398	0.0002	-1.20	-1.37	-5.5	-35
	(p, 1) vs. (p, -1)	18	87	-0.0419	-0.0023	0.0050	-0.0047	-1.48	-0.23	-10.5	-19

Panel B: Mean and Median Statistics by Abnormal Returns

Group P contains spinoff observations that bring positive abnormal return for parent firms. Group N contains observations from which parents' abnormal returns are non-positive. PPS is stock price sensitivity of the executive's stock and stock option portfolio. Tobin's q is computed as market value of firm assets (MV) divided by book value of assets, where MV equals to the market value of equity plus the difference between total book value of assets and book value of common equity. Leverage is computed as total long-term liabilities over total assets. Payout ratio is computed as common dividend paid over net income. OROA is operating income before depreciation (OIBD) standardized by total assets. (s, 1) stands for spun-off firms one year after spinoff, (p,1) stands for parent firms one year after spinoff, and (p, -1) stands for parent firms one year before spinoff. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

		N		Mean		Median		t-test		Wilcoxon sign-rank test	
		N	P	N	P	N	P	N	P	N	P
PPS	(s, 1) vs. (p, 1)	35	66	0.3539	-0.3097	0.6161	0.4629	0.30	-0.49	103*	360.5**
	(s, 1) vs. (p, -1)	35	66	0.9299	-1.1074	0.5423	0.4161	1.07	-1.27	94	317.5**
	(p, 1) vs. (p, -1)	35	66	0.5760	-0.7976	0.0504	0.0609	0.49	-1.13	22	9.5
Q	(s, 1) vs. (p, 1)	32	65	0.3015	0.0588	0.0226	-0.0560	1.20	0.25	42	-29.5
	(s, 1) vs. (p, -1)	32	64	-0.4694	-0.1473	-0.0124	0.0985	-0.86	-0.61	-22	63
	(p, 1) vs. (p, -1)	32	63	-0.7709	-0.2264	-0.1650	0.0267	-1.62	-1.15	-103	5
Leverage	(s, 1) vs. (p, 1)	35	66	0.0101	-0.0360	0.0000	-0.0130	0.18	-1.38	-19.5	-214
	(s, 1) vs. (p, -1)	35	66	0.0702	-0.0377	0.0645	-0.0348	1.42	-1.45	61.5	-237.5**
	(p, 1) vs. (p, -1)	35	66	0.0601	-0.0017	0.0071	0.0010	2.03**	-0.10	79.5	-57.5
Payout Ratio	(s, 1) vs. (p, 1)	35	66	-0.1248	0.2073	0.0000	0.0000	-2.48**	0.37	-75.5	-188**
	(s, 1) vs. (p, -1)	35	66	-0.1214	0.5871	0.0000	0.0000	-1.14	1.08	-71	-115
	(p, 1) vs. (p, -1)	35	66	0.0034	0.3798	0.0000	0.0000	0.04	1.95*	10.5	98
OROA	(s, 1) vs. (p, 1)	34	64	-0.0297	-0.0452	-0.0019	0.0103	-0.79	-1.26	-4.5	31
	(s, 1) vs. (p, -1)	35	63	-0.0103	-0.0672	0.0055	-0.0033	-0.28	-1.96*	27	-143
	(p, 1) vs. (p, -1)	34	64	0.0136	-0.0237	0.0102	-0.0113	0.91	-1.80*	76.5	-219

Panel C: Mean and Median Statistics by Focus

Group F contains spinoffs that are considered as a refocusing effort of the parent firms. Group NF contains spinoffs that do not suggest refocusing effort. We label a spinoff deal as refocusing (or focus-increasing) if the spun-off firm has different 2-digt SIC code compared to the parent firm, and non-refocusing if the spun-off firm shares the same 2-digt SIC code with parent firm. PPS is stock price sensitivity of the executive's stock and stock option portfolio. Tobin's q is computed as market value of firm assets (MV) divided by book value of assets, where MV equals to the market value of equity plus the difference between total book value of assets and book value of common equity. Leverage is computed as total long-term liabilities over total assets. Payout ratio is computed as common dividend paid over net income. OROA is operating income before depreciation (OIBD) standardized by total assets. (s, 1) stands for spun-off firms one year after spinoff, (p,1) stands for parent firms one year after spinoff, and (p, -1) stands for parent firms one year before spinoff. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

		N		Mean		Median		t-test		Wilcoxon sign-rank test	
		NF	F	NF	F	NF	F	NF	F	NF	F
PPS	(s, 1) vs. (p, 1)	41	67	0.0628	-0.1669	0.4852	0.4727	0.14	-0.20	103.5	369**
	(s, 1) vs. (p, -1)	41	67	-1.0095	0.0612	0.6804	0.4189	-1.01	0.08	99	399**
	(p, 1) vs. (p, -1)	41	67	-1.0723	0.2281	-0.0093	0.0934	-1.13	0.31	-25.5	144
Tobin's q	(s, 1) vs. (p, 1)	39	65	-0.1617	0.2230	-0.2904	0.0036	-0.56	1.08	-71	93.5
	(s, 1) vs. (p, -1)	39	63	-0.3099	-0.2036	-0.0755	0.0493	-0.86	-0.69	-25	46
	(p, 1) vs. (p, -1)	38	63	-0.1737	-0.4396	0.0830	-0.0587	-0.74	-1.55	35.5	-165
Leverage	(s, 1) vs. (p, 1)	41	67	0.0037	-0.0266	0.0000	-0.0129	0.09	-0.87	-33.5	-165
	(s, 1) vs. (p, -1)	41	67	0.0063	-0.0013	0.0002	-0.0241	0.15	-0.05	-16.5	-72.5
	(p, 1) vs. (p, -1)	41	67	0.0026	0.0253	0.0000	0.0015	0.11	1.31	-13	125
Payout Ratio	(s, 1) vs. (p, 1)	41	67	-0.0692	0.1658	0.0000	0.0000	-1.10	0.30	-68	-249.5***
	(s, 1) vs. (p, -1)	41	67	-0.0440	0.5134	0.0000	0.0000	-0.49	0.96	-75.5	-153.5**
	(p, 1) vs. (p, -1)	41	67	0.0252	0.3476	0.0000	0.0000	0.43	1.77	-9	111.5
ROA	(s, 1) vs. (p, 1)	41	64	-0.0876	-0.0046	-0.0058	0.0122	-1.70*	-0.19	-57.5	124
	(s, 1) vs. (p, -1)	40	65	-0.0878	-0.0148	0.0002	0.0066	-1.63	-0.75	-31	19.5
	(p, 1) vs. (p, -1)	40	65	0.0008	-0.0151	0.0027	-0.0054	0.05	-1.24	28	-112.5

Table 6 – Operating Performance and Pay Performance Sensitivity of Spinoff CEOs

The sample consists of 100 firms that completed a spin-off between 1992 and 2004. Operating Performance is the ratio of net income to total assets. "Parent Yr -1" and "Parent Yr +1", stand for one year before or after the spinoff event, respectively. "Spunoff Yr +1" stands for one year after the spinoff event. PPS is stock price sensitivity of the executive's stock and stock option portfolio. Positive AR is equal to 1 if the the sum of cumulative abnormal returns of spinoff event is positive over (-1, +1) event window, 0 otherwise. Debt ratio is computed as total long-term liabilities over total assets. Asset ratio is the ratio of total assets of spun-off firm to total assets parent firm. Insider is equal to 1 if the new CEO of the spun-off firm was employed at least one year prior to the spinoff, 0 otherwise. Focus increasing is equal to 1 if the parent firm and spun-off firm share the same two-digit SIC code. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable	Δ Combined Operating Performance	Δ Combined Operating Performance	Δ Combined Operating Performance
Coefficient	Model 1	Model2	Model 3
PPS (Spunoff , Yr +1)	0.0050*	0.0039	0.0049*
	(1.95)	(1.48)	(1.80)
PPS (Parent, Yr -1)		-0.0015	-0.0014
		(-.88)	(-0.88)
PPS (Parent, Yr +1)		0.0032**	0.0031**
		(2.23)	(2.18)
Positive AR*PPS (Spunoff , Yr +1)			-0.0050
			(-1.29)
Total Assets (Spunoff, Yr +1)	0.0034	0.0007	-0.0008
	(0.36)	(0.08)	(-0.09)
Total Assets (Parent, Yr -1)	0.0406**	0.0452**	0.0445**
	(2.23)	(2.50)	(2.47)
Total Assets (Parent, Yr +1)	-0.0427**	-0.0428***	-0.0418**
	(-2.60)	(-2.65)	(-2.60)
Leverage (Spunoff, Yr +1)	0.0553*	0.0635*	0.0596*
	(1.69)	(1.96)	(1.84)
Leverage (Parent, Yr -1)	0.0994*	0.0902	0.1191*
	(1.68)	(1.54)	(1.91)
Leverage (Parent, Yr +1)	-0.1015**	-0.1003**	-0.1147**
	(-2.18)	(-2.18)	(-2.43)
Asset Ratio	0.0032	0.0056	0.0059
	(0.41)	(0.73)	(0.78)
Insider	0.0193	0.0176	0.0205
	(1.02)	((0.95)	(1.10)
Focus Increasing	-0.0185	-0.0215	-0.0194
	(-1.28)	(-1.51)	(-1.36)
Constant	-0.0438	-0.0617	-0.0542
	(-1.02)	(-1.23)	(-1.07)
Adjusted R^2	0.12	0.15	0.15
No. of Observations	100	100	100

Table 7 – Operating Performance and Pay Performance Sensitivity of Parent Firm CEOs

The sample consists of 101 firms that completed a spin-off between 1992 and 2004. Operating Performance is the ratio of net income to total assets. "Parent Yr -1" and "Parent Yr +1", stand for one year before or after the spinoff event, respectively. PPS is stock price sensitivity of the executive's stock and stock option portfolio. Positive AR is equal to 1 if the sum of cumulative abnormal returns of spinoff event is positive over (-1, +1) event window, 0 otherwise. Leverage is computed as total long-term liabilities over total assets. Asset ratio is the ratio of total assets of spun-off firm to total assets of parent firm. Focus increasing is equal to 1 if the parent firm and spun-off firm share the same two-digit SIC code. ***, **, * represent statistical significance at the 1%, 5%, and 10% levels, respectively.

Dependent Variable	Δ Operating Performance	Δ Operating Performance	Δ Operating Performance
Coefficient	Model 1	Model2	Model 3
PPS (Parent, Yr -1)	-0.0011	-0.0009	-0.0014
	(-0.61)	(-0.50)	(-0.66)
PPS (Parent, Yr +1)	0.0038**	0.0035**	0.0029
	(2.27)	(2.11)	(1.39)
Positive AR*PPS Parent, Yr+1 +1			0.0016
			(0.49)
Total Assets (Parent, Yr -1)	0.0582***	0.0598***	0.0598***
	(3.06)	(3.17)	(3.16)
Total Assets (Parent, Yr +1)	-0.0577***	-0.0594***	-0.0594***
	(-3.01)	(-3.13)	(-3.12)
Leverage (Parent, Yr -1)	0.0461	0.0854	0.0823
	(0.66)	(1.19)	(1.14)
Leverage (Parent, Yr +1)	0.0008	-0.0211	-0.0178
	(0.01)	(-0.38)	(-0.32)
Asset Ratio	-0.0151**	-0.0147**	-0.0147**
	(2.16)	(-2.11)	(-2.11)
Focus Increasing	-0.0260	-0.0203	-0.0208
	(-1.54)	(-1.19)	(-1.21)
Positive AR		-0.0327*	-0.0368*
		(-1.83)	(-1.86)
Constant	-0.0073	0.0083	0.0115
	(-0.14)	(0.16)	(0.22)
Adjusted R^2	0.10	0.12	0.11
No. of Observations	101	101	101