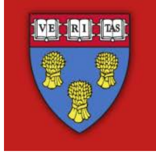
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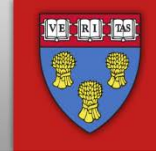

Strategic News Releases in Equity Vesting Months

Posted by R. Christopher Small, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Tuesday November 11, 2014

Editor's Note: The following post comes to us from Alex Edmans, Professor of Finance at London Business School; Luis Goncalves-Pinto of the Department of Finance at the National University of Singapore; Yanbo Wang of the Finance Area at INSEAD; and Moqi Xu of the Department of Finance at the London School of Economics.

In our paper, Strategic News Releases in Equity Vesting Months, which was recently made publicly available on SSRN, we study the link between the equity vesting schedules of CEOs and the timing of corporate news releases. We show that, in months in which the CEO has equity vesting, the firm releases more news. This is an easy way to pump up the short-term stock price, as news attracts attention to the stock. This attention also increases trading volume, which allows the CEO to cash out his equity in a more liquid market. Indeed, we find that these news releases lead to significant increases in the stock price and trading volume in a 16-day window, but the effect dies down over 31 days, consistent with a temporary attention boost. The median CEO cashes out all of his vesting equity within seven days—within the window of price and volume inflation.

The increase in news releases only relates to discretionary news, which are within the CEO's control, and not non-discretionary news. Moreover, the CEO reduces discretionary news releases in both the month before and the month after the vesting month, suggesting a strategic reallocation of news into the vesting month and away from adjacent months. In addition to releasing a greater number of news items during the vesting month, the CEO releases more positive news—media articles immediately following these news releases contain significantly more positive words than normal.

The timely release of information is central to the efficiency of both financial markets and the real economy. Information can influence real decisions either directly, or indirectly via affecting stock prices which agents use as signals (see the survey of Bond, Edmans, and Goldstein (2012)). For example, suppliers, employees, and investors may base their decision of whether to initiate,

continue, or terminate their relationship with a firm on news releases, or stock prices that are affected by news.

News can also have distributional as well as efficiency effects. In particular, news reduces information asymmetry between investors, thus protecting uninformed investors from trading losses. Indeed, Regulation FD aims to "level the playing field" between investors by restricting selective disclosure. Moreover, these distributional consequences in the secondary market may feed back into efficiency consequences in the primary market. Uninformed investors, who expect future trading losses due to information asymmetry, may withdraw from the market (Bhattacharya and Spiegel (1991)) or require a higher cost of capital (Diamond and Verrecchia (1991)), in turn hindering investment.

Timely information flows are thus important. Subsequent to Regulation FD in October 2000 and Sarbanes-Oxley in July 2002, corporate news releases have been particularly important in communicating new information to investors. News releases do not occur mechanically whenever corporate events take place, but are a discretionary decision of the CEO.

However, documenting that CEOs disclose more (favorable) news in months in which they sell equity would not imply a causal relationship from equity sales to disclosure, because the decision to sell equity is endogenous. For example, if a particular month happens to coincide with many favorable events, the CEO will undertake many positive news releases (even in the absence of strategic considerations) and take advantage of any resulting stock price increase by opportunistically selling equity. Thus, disclosure causes equity sales rather than expected equity sales causing disclosure.

We identify a CEO's likelihood of selling equity in a given month by whether he has stock or options scheduled to vest in that month. These "vesting months" depend on the timing and vesting schedule of equity grants made several years prior, and thus are unlikely to be affected by the current information environment. It is unlikely that boards can forecast, to the exact month, when news is most likely to be released several years in the future. We identify vesting months between 2006 and 2011 using a new dataset from Equilar, and hand-collect it from proxy statements and SEC Form 4 filings from 1994 to 2005.

We find that CEOs are likely to sell equity shortly after it vests, consistent with the optimal exercise behavior of an undiversified agent. Controlling for CEOs' unvested and vested equity and other determinants of equity sales, they are 23% (14%) more likely to sell shares in months in which their stock (options) vest, compared to non-vesting months. Thus, scheduled vesting of equity indeed leads to equity sales and thus short-term stock price concerns.

We use data from Capital IQ's Key Developments database as our source of corporate news releases. We show that firms release significantly more discretionary news in vesting months than in non-vesting months, controlling for other determinants of news releases, such as months in which there is an earnings announcement, AGM or board meeting, analyst coverage, and unvested and vested equity. Firms also significantly reduce disclosures in the months before and after the vesting month. There are 2% more discretionary news releases in vesting months than non-vesting months, and 5% more than in prior months. The value of vesting equity is also significantly associated with the number of news releases. In contrast, the amount of non-discretionary news releases is no different between vesting and non-vesting months. These results are robust to removing out-of-the-money options, which are unlikely to be exercised upon vesting, and equity with performance-based vesting provisions, which may not vest if performance thresholds have not been met.

We then examine the positivity of news releases by studying the tone of media coverage immediately afterwards. Textual analysis from Thomson Reuters News Analytics indicates that media articles after discretionary news releases are more favorable in vesting months than non-vesting months, suggesting that the CEO releases more favorable discretionary news in vesting months. There is no difference in the tone of media coverage following non-discretionary news.

As discussed earlier, we show that discretionary news releases in vesting months lead to a short-term increase in both the stock price and trading volume. These effects are stronger over a 16-day window than a 31-day window, consistent with a temporary attention boost. The median CEO cashes out the entire amount of vesting equity within 7 days.

Our paper contributes to the literature on CEO short-term incentives in particular, and to the literature on CEO compensation in general. While the latter literature is substantial, it is very difficult to document causal effects. The survey of Frydman and Jenter (2010) notes that "compensation arrangements are the endogenous outcome of a complex process. This makes it extremely difficult to interpret any observed correlation between executive pay and firm outcomes as evidence of a causal relationship." We use a measure of CEO incentives that is unlikely to be driven by the current contracting environment, allowing us to show that CEO contracts affect behavior.

The full paper is available for download here.