Moqi Groen-Xu

Assistant Professor of Finance at the London School of Economics and Political Science

Key Finding

Time pressure leads to less risk-taking and innovation.

Business Application

Longer employment contracts and evaluation periods can encourage more innovative R&D and novel strategies.

CEOs cut investment when they come to the end of their employment contract. On average, CEOs spend $8 million less each year that they come closer to the planned contract termination date. They also produce less innovative R&D, as measured by subsequent citations of patent applications. In contrast, at the beginning of their employment contracts CEOs invest in more novel but riskier technology that, on average, proves to be more successful in the long term.

For this research, I studied the employment agreements of 3,717 US-based CEOs. Two-thirds of the employment agreements stipulate a definite termination date, while the other third can be terminated at any time. CEOs who can be dismissed at any time invest, on average, $21 million less per year. Long-term contracts protect CEOs from downside risk, whereas stock options reward upside risk. The negative effects of pressure on innovation are not limited to CEOs. In related research, I have shown that scientists react to deadline-induced pressure with more but inferior publications, as measured by journal impact factors and subsequent citations.

This kind of behaviour does not need to be destructive, as long as the overall time allowed is sufficient. Long-term incentives are effective to induce risk-taking, but short-term pressure induces discipline and encourages CEOs to make big ideas marketable and to end unproductive R&D.

Ultimately, firms need to calibrate their own optimal mix of short- and long-term incentives.

Moqi Groen-Xu is an Assistant Professor of Finance at the London School of Economics and Political Science. Her research focuses on corporate finance and corporate governance. She blogs on moqixu.com and tweets @moqixu.

Research interests: CEO contracts, compensation, shareholder communication, proxy voting, incentives in academia.