

CGA Accounting Research Centre and the AFI Section DISTINGUISHED SPEAKER SERIES

*Professor Balasingham Balachandran
La Trobe University, Australia*

Dr Balasingham Balachandran is an Associate Professor in Finance at the Graduate School of Management, La Trobe University, Australia. Bala's research interests include executive compensation; corporate governance; equity valuation; earnings management; and corporate financial and dividend policy. His research work has been published in leading finance journals including the Journal of Financial Economics and the Journal of Financial and Quantitative Analysis. His work has also been published in leading practitioners' journal – Journal of Applied and Corporate Finance. He is a conference convenor of Finance and Corporate Governance Conference. He serves on the editorial board of the Pacific Accounting Review. Bala's work has also been cited in national media in Australia.



Topic: «Stock Option Grants and Firm Value When Directors' Opportunistic Behaviour is Limited»

Abstract:

Most studies of the price impact of option grants are confounded by the potential for opportunistic behaviour on the part of granting firms, such as backdating of awards or favourable timing of information releases. In Australia, such practices are limited, so a cleaner test of the wealth effects of option grants is possible. We find that the market reacts positively on average to the announcement of option grants, and particularly so for grants to non-executive directors that are not accompanied by an increase in their director fees. We also investigate the decision to award options to non-executive directors, a practice contrary to the Australian corporate governance good practices, and find that firms with smaller size, higher idiosyncratic risk, less debt and are less profitable are more likely to make such awards.

The focus of this study is to assess the impact on the market of stock option grants issued to executive and non-executive directors of firms in Australia. Australia is used for this study because such practices are limited there so that a cleaner test at the wealth effects of option grants is possible.

Studies done in the United States tend to show that stock option plans are helpful in improving managements' performance and increasing shareholders' wealth. The results are insignificant but positive.

The research study on which this presentation is based uses a sample of 633 firms over the period 1996 to 2008. The study looked at the market behaviours of stock options issued to executive directors and non-executive directors. Six models were tested using on different combination of dates, the nature of the options and wealth and whether issued to executive or non-executive directors.

The study found that the market reacts positively, on average, to the announcement of stock option grants particularly those issued to non- executive directors that are not accompanied by an increase in their director fees. Price reaction is stronger for stock option grants issued to non- executive directors rather than to executive directors only.