Are CFOs Smarter Than CEOs — or Do They Just Invest That Way?

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A new study shows that CFOs are smarter than CEOs when it comes to predicting their company's stock price performance. A forthcoming article in the *Journal of Financial and Quantitative Analysis* by professors **Weimin Wang**, **Yong-Chul Shin**, and **Bill B. Francis** found that CFO stock purchases are a more reliable predictor of stock price performance than CEO purchases.

They concluded that "CFOs earn statistically and economically higher abnormal returns following their purchases of company shares than CEOs," with an excess return 5 percent higher, even controlling for risk factors. In addition, "CFO purchases are associated with more positive future earnings surprises than CEO purchases."

Past studies have looked at CEO stock trades as predictors of future stock price or as incentives for earnings management. But this look at what we can tell from the variance between the personal portfolio decisions of chief executives versus their own top numbers people is illuminating. The authors believe the numbers suggest "that CFOs incorporate better information about future earnings."

Better informed, or just more motivated?

I think CFOs are just more motivated. Every dollar they make on the stock matters more to them because of the monumental differential in the amount and kind of pay they receive. Take a look at **JP Morgan Chase**, which has just announced a 67 percent increase in profits and a surge in executive compensation (though lower revenues and decreased lending).

CEO **Jamie Dimon** has a base salary of $1 million and a bonus of $5 million. CFO **Michael J. Cavanagh** gets a base salary of $500,000 and a bonus of $3,400,000. Dimon received stock worth $7,952,400 and options worth $6,244,300. For Cavanagh, it was $3,274,500 and $1,836,600. And Cavanagh got nothing in other compensation while Dimon received $579,624 (more than Cavanagh's base pay) in personal use of aircraft, personal use of car, moving expenses, and "other." If Cavanagh wants to afford plane tickets, he has to be pretty careful about his stock purchases and sales.

At the other end of the scale is **Costco**, where CEO **James Sinegal**'s $300,000 salary and $190,400 bonus is less than the $600,000 salary and $76,160 paid to CFO **Richard A. Galanti**. They have almost identical "other" compensation including deferred compensation, insurance, and vehicle allowance — all so low that I double-checked to make sure that there was no footnote explaining that the figures were in thousands.

Many of the firms in this category are, like Costo, founder-led (also, Sinegal holds 10 percent of Costco's stock). Ownership at that level is one of the strongest predictors of good results for shareholders. At least in theory, all of the other incentive compensation elements are there to make non-founders care as much about shareholder returns as if they owned the place.

Lucian A. Bebchuk, J. Martijn Cremers, and **Urs Peyer** have created a new measure they have dubbed the CEO Pay Slice to assess the relative importance of the CEO within the hierarchy of a firm, with a paper examining the proportion of the total pay for the top five executives at a firm that goes to the CEO as a component of performance. My firm, **GovernanceMetrics International**, considers it a red flag if the ratio of the CEO's pay to the median pay of other named executive officers is 3x or more.

Our preliminary executive pay scorecard for 2011 shows that to be the case in 49 percent of the proxies we have reviewed so far. This year, it's been the most frequent factor in raising the threat level on the boards we assessed. CEOs get all the attention, but the CFO's stock trades and pay levels may be a better predictor of corporate performance than analyst projections.