Chapter 2: Executive Incentives

True / False Questions

F_____The base salary of a CEO is solely based on characteristics of the CEO (e.g. age, experience).

T_____One advantage of awarding bonuses as opposed to giving raises, is that bonuses are one time rewards for realized performance.

T_____Performance stock is common stock of the company given to the executives only if certain performance criteria are met.

T_____If the stock price is underwater, options lose their effectiveness to motivate a CEO.

F_____If a manager receives incentives, then the company will perform well.

T_____Restricted stock usually requires a certain amount of time to pass before becoming unrestricted.

F_____The character of the CEO is really what drives the basis for their pay.

T_____Xerox admitted to the SEC that it had improperly recorded earnings and agreed to pay a $10 million fine

Multiple Choice Questions

Typically, on which accounting profit measures are cash bonuses for CEO's based on?

a. Earnings per share.
b. Earnings before interest and taxes.
c. Economic value added.
d. All of the above.
e. None of the above.

What does expensing executives options mean?

a. Cost of stock options issued to executives should be treated as an expense on the firm's financial statements.
b. Under the Sarbanes-Oxley Act, the firm has to pay an extra fee for issuing stock options to executives.
c. Under new FASB regulations, the value of granted options must no longer be deducted from the firm's reported income.
d. Both a and b.
e. None of the above.

Beyond incentives and monitoring, what could be a third way to align managers' behavior with shareholders interests?

a. Develop strong industry standards for executives' work ethics.

b. Increase penalties for managers who intentionally mislead shareholders.

c. Consult all shareholders on the operational decisions of executives.

d. Ask managers to behave more like shareholders.

e. None of the above. There is no third way.

Regarding the stock market, one problem with using stock options as incentives is:

a. The transaction costs for CEOs to sell their options are relatively high.

b. CEOs are only allowed to exercise their options when the stock price of the company is equal to the strike price.

c. Executives only have partial influence on their firm's stock price.

d. Typically, stock options expire after 2 years and therefore are short-term incentives.

e. There are no problems with using stock options to incent executives.

Which country offers the largest portion of executive pay as variable (incentive) pay?

a. United States

b. Spain

c. India

d. Sweden

e. Narnia

Why might a firm's Board re-price the executive stock options?

a. To demonstrate forgiveness.

b. To keep executives with the firm.

c. To improve the stock price by getting more shares into the market.

d. To make the owner's profit bigger after an important accomplishment.

e. Firms do not re-price executive stock options.

Problems with stock options include all EXCEPT:

a. A CEO might forego increasing dividends to use the cash to try and increase the stock price.

b. CEOs accept riskier projects because that usually causes the stock price to increase.

c. Option payoffs are closely related to the performance of the overall stock market.

d. CEOs will work hard to increase the stock price when they receive stock options.

e. There are no problems with using stock options to incent CEOs.

When must a CEO repay their loans from their corporation?

a. Within one year.

b. When they achieve a goal.

c. They often never do.

d. Upon retirement.

e. Upon being fired.