Examining Expensing Employee Compensation Policy: Theory and Evidence

Abstract

Different from most prior studies which examine the impact of SFAS No.123(R) to corporate governance, we explore the potential effect lies beneath the implementation of the expensing employee compensation policy from the perspective of capital structure. Through a structural framework, we argue that the implementation of such a policy would result in a potential wealth transfer from debtholders to shareholders. Based on 582 Taiwan listed firms over the period 2005-2010, we find that a significant increase in equity value as a percentage of firm total value for firms that were affected by these rulings, compared to firms that were not affected, taking into account unobservable firm effects, size, performance, and growth opportunities. The increase in equity-to-value ratio is particularly pronounced in affected firms with greater use of employee compensation policy and higher leverage. Our results suggest that mandated expensing of employee compensation affected the wealth transfers between shareholders and debtholders.