Title: It's About Time: Evidence of a New Strategy Boards Use to Mitigate the Ex Post Settling Up Problem

Abstract: Boards that compensate executives with cash face a costly ex post settling up problem: boards may compensate executives for gains which later fail to be realized. Using a novel linear mixed data sampling (MIDAS) method to exploit the variation in daily stock returns, we provide evidence of techniques that boards use to mitigate the ex post settling up problem. Using stock returns as a proxy for performance, we first show that cash compensation is more sensitive to returns earlier in the year than returns later in the year. Second, we show that while cash compensation is very sensitive to returns around the release of accounting earnings, this sensitivity dissipates over time. Finally, we reexamine the asymmetric sensitivity of compensation to unrealized gains and losses and show that compensation is more sensitive to early period returns for both positive and negative returns. Our findings suggest that boards, in an attempt to mitigate the ex post settling up problem, rely on the passage of time and more heavily weight performance earlier in the year when exercising discretion over cash compensation. In addition to these theoretical contributions, we provide an important methodological improvement for the study of executive compensation: the linear MIDAS model allows us to reject the implicit assumption in the literature that the sensitivity of compensation to returns is time invariant over the course of the compensation period.