Available online at www.sciencedirect.com
SCIENCE DIRECT
Journal of Financial Economics 80 (2006) 211–242
JOURNAL OF Financial ECONOMICS
www.elsevier.com/locate/jfec

Flights of fancy: Corporate jets, CEO perquisites, and inferior shareholder returns☆

David Yermack*

Department of Finance, Stern School of Business, New York University, 44 West 4th Street, Suite 9-160, New York, NY, 10012, USA

Received 4 October 2004; received in revised form 18 March 2005; accepted 2 May 2005
Available online 20 October 2005

Abstract

This paper studies perquisites of CEOs, focusing on personal use of company planes. For firms that have disclosed this managerial benefit, average shareholder returns underperform market benchmarks by more than 4% annually, a severe gap far exceeding the costs of resources consumed. Around the date of the initial disclosure, firms' stock prices drop by an average of 1.1%. Regression analysis finds no significant associations between CEOs' perquisites and their compensation or percentage ownership, but variables related to personal CEO characteristics, especially long-distance golf club memberships, have significant explanatory power for personal aircraft use.

JEL Classification: G30; J33

Keywords: Executive compensation; Perquisites; Corporate jets

1. Introduction

This paper studies perquisite consumption by executives of major corporations, with a focus on the personal use of company aircraft by CEOs.

☆I thank Yakov Amihud, Eliezer Fich, Stuart Gillan, William Greene, Dirk Jenter, Andrew Karolyi, Ernst Maug, Eli Ofek, Darius Palia, Charu Raheja, Robert Whitelaw, Julie Wulf, Jeffrey Wurgler, an anonymous referee, and seminar participants at the American Finance Association annual meeting, the Duke-North Carolina corporate finance conference, the Federal Reserve Bank of New York, the IDC/Arison financial economics conference, the National Bureau of Economic Research corporate governance meeting, the University of Basel, Fordham University, Lehigh University, New York University, and Vanderbilt University for helpful comments and data assistance.
*Corresponding author. Tel.: +1 212 998 0357; fax: +1 212 995 4220.
E-mail address: dyermack@stern.nyu.edu.

doi:10.1016/j.jfineco.2005.05.002

Perquisites may arise in optimal employment contracts (Fama, 1980), but they may also exist because a firm's governance or incentives are too weak to limit the use of company assets by managers (Jensen and Meckling, 1976). According to the former story, perks may motivate executives to work hard, and they create economic surplus if the company can acquire assets more cheaply than the manager due to purchasing power or tax status. According to the latter view, however, perks reduce firm value directly if managers consume more than desired by shareholders, and indirectly if workers observe managers' perquisites and react adversely. In this case, perks can catalyze shirking, unethical behavior, or low morale throughout a company.

These competing perspectives motivate empirical questions about whether perks lead to increases in company value because they represent an efficient way to pay managers, or alternatively, whether firm performance suffers in the presence of perks because their consumption is symptomatic of waste, poor corporate governance, or unethical management behavior. Until now, no empirical study has tested the association between perks and company performance.

This paper conducts a range of tests based upon CEOs' personal use of company aircraft, as disclosed in annual proxy statements filed pursuant to Securities and Exchange Commission (SEC) regulations. In principle, the paper could examine a wider range of perks such as automobiles, country club memberships, catered lunches, plush office furnishings, and the like, but I focus upon aircraft use for several reasons. First and most importantly, the SEC's reporting rules make data for aircraft use much more reliable than data for other, less expensive perks. The SEC requires perk disclosure only above certain fixed dollar thresholds, and these cutoff levels are generally too high to be triggered by perks other than aircraft. Therefore, empirical tests related to plane use are likely to have higher statistical power than tests related to other perks such as catered lunches or country club memberships, which often remain both undisclosed to shareholders and unobserved by other workers. Second, data presented below indicate that unlike other perks, disclosed CEO personal aircraft use grew explosively in recent years, more than tripling during the 1993 to 2002 sample period. Third, academic and shareholder commentators cite corporate jets far more often than any other perquisites as representative symbols of agency problems within firms. See, for example, Persons (1994, p. 437), Borokhovich et al. (1997, p. 1444), Hall and Liebman (1998, p. 658), and Core and Guay (1999, p. 155). Rajan and Wulf (2005) characterize company planes as "the canonical example of an excessive perk." A representative example of a shareholder activist's critique of CEOs' corporate jet use appears in Minow (2001). Finally, company planes have played a central role in some of the most notorious corporate disclosures involving managerial excess, whether prompted by disciplinary hostile takeovers (such as RJR-Nabisco[1]) or prosecutions for fraud (such as Adelphia Communications[2]).

[1] Burrough and Helyar (1990) provide an account of managers' aircraft use at RJR-Nabisco, which before its 1991 leveraged buyout maintained an "RJR Air Force" of ten aircraft. The planes were flown by a squad of 36 company pilots, housed in "the Taj Mahal of corporate hangars," and made available for use by CEO F. Ross Johnson to a range of friends, celebrities, golf instructors, and family pets (one of whom was listed on a passenger manifest as "G. Shepherd"). The authors write that "the jets were a symbol of the increasingly fuzzy line between what constituted proper use of a corporate asset and what constituted abuse" (1990, pp. 93–94).

[2] In the 2004 Adelphia securities fraud trial, prosecutors alleged that founding CEO John Rigas twice requisitioned company aircraft to deliver a Christmas tree to his daughter (the second flight became necessary after the first tree was rejected as unsuitable), while Rigas's son Timothy, the company's chief financial officer, repeatedly made company planes available to Australian actress-model Peta Wilson in a futile attempt to "impress" her.