Journal of Empirical Finance 27 (2014) 40–57

Contents lists available at ScienceDirect

Journal of Empirical Finance

journal homepage: www.elsevier.com/locate/jempfin

Gentlemen do not talk about money: Remuneration dispersion and firm performance relationship on British boards

Anna Zalewska *

CGR, School of Management, University of Bath, UK
CMPO, University of Bristol, UK

A R T I C L E I N F O

Article history:
Received 31 July 2013
Accepted 3 September 2013
Available online 31 October 2013

JEL classification:
G35
J33
L29

Keywords:
Executive compensation
Board diversity
Incentive pay
Firm performance

A B S T R A C T

Using a sample of 781 U.K. firms over the period 2000–2008 we study the relationship between remuneration dispersion at executive board level and firm performance. We find that this relationship is sensitive to nationality composition of the executive boards. In contrast with findings on American data, British companies are characterized by a negative dispersion–performance relationship, i.e., the greater the dispersion is, the worse firm performance is, however, boards with American CEOs or at least 30% of American nationality non-CEO executives are characterized by a positive dispersion–performance relationship. The results are robust when controlling for various firm, board and CEO characteristics, including cross-listing on U.S. exchanges and having sales in the U.S. Implications for executive remuneration reforms and board diversity are discussed.

© 2013 Elsevier B.V. All rights reserved.

1. Introduction

The literature on executive remuneration incentives is dominated by studies of CEO remuneration. Even when broader executive board remuneration is examined it is common to focus on the difference between CEO remuneration and that of specific board members. This focus on remuneration of CEOs is congruent with perceiving a CEO as a dominant personality who bears the power and responsibility for firm performance. However, the corporate scandals of the last decade and consequent corporate governance reforms undertaken by numerous regulatory bodies stress the importance of internally strong and cooperative boards which provide a balanced partnership with a CEO. Very little, however, is known about the effectiveness of remuneration practices at board level, especially outside the U.S. This paper steps aside from the tournament literature and, using U.K. data, looks at boards as teams rather than competitors for a CEO position. Using a non-U.S. sample opens the analysis of the dispersion–performance relationship to new questions. In particular, we are concerned with whether the U.S. boards' characteristics transfer to U.K. boards, and how this is affected by the presence of American nationality executive directors.

In recent years the role and responsibility of boards has been more hotly discussed than ever before. Numerous corporate scandals have highlighted the importance of strong, well-informed and independent boards that fulfill their governing, advisory and monitoring roles (e.g., Coffee, 2002; de Jong et al., 2007; Healy and Palepu, 2003; Melis, 2005). While considerable attention has been paid to introducing structural changes which lead to the reduction of CEOs' power and dominance (e.g., separation of CEO and Chair position), the empowerment of non-executive directors (e.g., creation of non-executive Chairs, independent directors), etc., relatively little attention is paid to financial incentives at the board level. Indeed, it is a CEO's remuneration that

* School of Management, University of Bath, Bath, BA2 7AY, UK. Tel.: +44 1225 384354.
E-mail address: a.zalewska@bath.ac.uk.

0927-5398/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.jempfin.2013.09.001

initiates political debate[1] and shareholder protests[2]. It is common in the academic literature to treat boards as if they were waiting rooms full of executives determined to be the next CEO, e.g., it is common to test whether there are signs of executive tournaments and how they impact on performance (Ang et al., 1998; Bognanno, 2001; Burns et al., 2012; Conyon and Sadler, 2001; Conyon et al., 2001; Eriksson, 1999; Kale et al., 2009; Main et al., 1993; Rankin and Sayre, 2011). Lee et al. (2008) is the only study we are aware of that explicitly studies the relationship between remuneration dispersion at a board level and firm performance. Using U.S. data Lee et al. (2008) find that the bigger dispersion is, the better firm performance is. The tournament literature finds that the bigger pay differential between a CEO and other executive board members is, then the better firm performance is. Taking this together it raises the question of whether the positive relationship between remuneration dispersion and firm performance is a universal characteristic of boards or not.

For instance, if boards are not strongly hierarchical and the division of work and responsibilities tends to be balanced, then it could be that large remuneration differences among board members, hence high remuneration dispersion, impacts negatively on the team spirit and motivation. Consequently, such boards could be characterized by a negative dispersion–performance relationship. This would be consistent with theoretical studies (Akerlof and Yellen, 1988, 1990; Lazear, 1989; Milgrom and Roberts, 1988) and empirical research on cooperation in general economic situations (Drago and Garvey, 1998; Lindquist, 2010; Pfeffer and Langton, 1993; van den Assem et al., 2012).

Understanding the dispersion–performance relationship at board level is important for several reasons. First, if corporate governance reforms are to succeed it is vital to fully understand board dynamics. There is no point to work hard to improve the board architecture if remuneration practices hamper, and even prevent, cooperation among board members. Second, if the dispersion–performance relationship is not universally positive, then the answer to the question of how to determine the remuneration structure that should be in place is even more complicated than currently acknowledged. If reward systems and practices are determined by cultural attitudes and values, as Pennings (1993) argues, it may be that it is fruitless to search for universal solutions, and studies of remuneration incentives should be done at a cultural, or at least country, level. Third, if the dispersion–performance relationship is not universally positive, the issue of how to remunerate culturally diverse boards emerges. This issue is particularly important in the modern era of business globalization. Indeed, given high labor mobility, companies do not have to expand businesses to foreign markets to find themselves facing issues of how to structure the remuneration of multicultural boards.

This paper studies the dispersion–performance relationship using a sample of 781 British companies listed on the London Stock Exchange in the period 2000–2008 to assess to what extent the American findings of the positive relationship are universal and robust. U.K. boards provide particularly interesting material for such an investigation. On one hand, the U.S. and the U.K. are commonly perceived as the core of the Anglo-Saxon corporate governance system, and therefore, one may expect that U.S. and U.K. boards are characterized by similar features. On the other hand, the countries are quite different culturally,[3] and a deeper analysis of their board structures and practices indicates substantial differences in their corporate architecture, with the U.K. being less ‘linear’ and less CEO-centered (e.g., Aguilera et al., 2006; Toms and Wright, 2005). Consequently, one could conjecture that British boards may not be characterized by a positive dispersion–performance relationship, i.e., the American findings do not carry over to the British sample. If this is the case, however, one could also ask what the dispersion–performance relationship is when American executives sit on British boards. Given that the past literature documents that American boards are characterized by a positive dispersion–performance relationship we test whether the presence of American executives on British boards is still associated with a positive dispersion–performance relationship. If yes, this would support Newman and Nollen's (1996) argument that practices that are aligned with national culture lead to better performance.

Controlling for various firm and board characteristics we find strong evidence of a negative dispersion–performance relationship on British boards. This result is further strengthened when the analysis is restricted to companies which do not have any overseas executives. We also find that the presence of American executives is associated with the change of the sign of the dispersion–performance relationship. In particular, we find that boards which have at least 30% of executives of American nationality are characterized by the positive dispersion–performance relationship.

This research contributes to the existing literature on the link between executive remuneration and performance, and on board diversification issues in several ways. First, it enriches our understanding of the relationship between pay differentials within an executive board and firm performance. This is the first study that documents that the relationship may be negative, and that it is related to cultural characteristics of executives (in our case — nationality) rather than to the country of origin of the company. Second, it adds to our understanding of potential costs and benefits of board diversity. The fact that the effectiveness of remuneration incentives may be strongly affected by individuals' culturally shaped attitudes toward how they and others are financially rewarded adds an additional complication to the, already complex, issue of structuring executive boards incentives.

The fact that remuneration dispersion may impact negatively on firm performance has strong implications for the on-going debate on how to reform executive remuneration so that it provides the right incentives. It highlights the importance of treating

[1] E.g., see “Labour urges ‘responsible capitalism’ in executive pay”, David Batty, The Guardian, 7 January 2012; “We'll rein in executive pay, vows David Cameron”, Tom Ross, The Telegraph, 7 January 2012; “Ed Miliband has been pick-pocketed by David Cameron on executive pay. Has he noticed yet?” Dan Hodges, The Telegraph, 9 January 2012.

[2] E.g., see “Shareholder revolt set to continue with investors ready to vote against pay deals at William Hill, Unilever and WPP”, This is Money Reporter, May 6, 2012; “Investors rebuke Citi board over pay”, T Braithwaite and D. McCrum, Financial Times, April 18, 2012. Also see Kuhnen and Niessen (2012).

[3] For instance, Geert Hofstede™ Cultural Dimensions show that the Power Distance Index, that is the extent to which the less powerful members of organizations and institutions accept and expect that power is distributed unequally, puts the UK on the same level as Germany, with the value of the index at 35, while the US scores 40.

Download English Version:

https://daneshyari.com/en/article/958532

Download Persian Version:

https://daneshyari.com/article/958532

Daneshyari.com