Available online at www.sciencedirect.com
ScienceDirect
Pacific-Basin Finance Journal 16 (2008) 606–623
PACIFIC-BASIN FINANCE JOURNAL
www.elsevier.com/locate/pacfin

Executive pay and firm performance in the Philippines

Angelo A. Unite [a], Michael J. Sullivan [b,*], Jeffrey Brookman [c], Mary Anne Majadillas [d], Angelo Taningco [a]

[a] *De La Salle University, Manila, Philippines*
[b] *University of Nevada, Las Vegas, United States*
[c] *Idaho State University, United States*
[d] *Florida State University, United States*

Received 7 December 2005; accepted 28 December 2006
Available online 17 November 2007

Abstract

This paper provides the first systematic evidence on the nature of the relation between executive compensation and firm performance in the Philippines. Comparable to studies of Japan, Korea, and China, we find a positive relation between executive compensation and performance in the Philippines for those firms not affiliated to a corporate group, but that this relation does not hold for affiliated firms. We conclude that the substantial portion of the Philippine economy that is under the control of group networks incentivize managers in ways other than through use of pay–performance schemes.

JEL classification: G15; G30; J33; O53
Keywords: Executive compensation; Corporate governance; Emerging markets

1. Introduction

Based on agency theory it has been reasoned that the interests of managers and shareholders can be aligned by linking manager's compensation to firm performance (Murphy, 1985, 1999). This relation between executive compensation and firm performance has been studied extensively for firms domiciled in the United States (see Murphy, 1999). However, outside of the United States, investigation of this pay–performance relation has been limited to countries with larger or more mature economies, due in large part to data constraints. For example, countries studied in

* Corresponding author. University of Nevada, Las Vegas; Las Vegas, NV 89154-6008, United States. Tel.: +1 702 895 4669; fax: +1 702 895 4650.
E-mail address: michael.sullivan@unlv.edu (M.J. Sullivan).

0927-538X/$ - see front matter
doi:10.1016/j.pacfin.2006.12.002

Asia include Japan (Kato and Rockel, 1992; Kaplan, 1994; Kato, 1997; Abe et al., 2005; Basu et al., 2006; Kato and Kubo, 2006), Korea (Kato et al., 2006), and China (Mengistae and Xu, 2004; Kato and Long, 2005; Firth et al., 2006). In general, these authors find a positive pay–performance relation, similar to what has been documented in the United States.

The pay–performance relation for firms in Japan and Korea have been shown to depend upon group affiliation (Abe et al., 2005; Kato et al., 2006), and in China on state ownership (Firth et al., 2006). Abe et al. (2005) find that the pay–performance relation in Japan is strongest for firms not affiliated with a keiretsu group, and argue this evidence demonstrates that the group monitoring inherent in keiretsu firms reduces the need to induce certain managerial behavior by tying pay to performance. Similarly, Kato et al. (2006) find the pay–performance relation is strongest for Korean firms that are not affiliated to a chaebol group and postulate this indicates that top executives of chaebol firms pursue the interests of the overall business group and not necessarily interests of shareholders. For Chinese firms, Kato and Long (2005) and Firth et al. (2006) find that state ownership disrupts the link between executive pay and performance, which otherwise holds for non-state firms.

Based on these prior studies, we expect similar findings of a pay–performance relation that is strongest for Philippine firms not affiliated to one of the influential family corporate groups. In other words, if group interests dominate managerial actions within Philippine family corporate groups, we expect managers' compensation to be less sensitive to performance compared to managers of non-affiliated firms. However, in contrast to mature, long-established corporate networks, such as Japanese keiretsu or Korean chaebol, corporate groups in the Philippines can be considered to be in their infancy as these groups are, in general, a more recent phenomenon. For example, most Philippine corporate groups are still centered around the founding family and oftentimes the founding individual. This may be important as differences in corporate group networks between countries have been shown to result in differential effects on firm performance (Khanna and Rivlin, 2001). As such, one question our research answers is whether the effect of group affiliation on the pay–performance relation also varies by country.

Marked differences exist between Japan, Korea, and the Philippines in terms of the center of influence within the corporate group network. In Japan, main banks play an important role in monitoring keiretsu firms, while banks are not active monitors of Korean chaebol or Philippine group firms (Sheard, 1989; Saldańa, 2001; Bae et al., 2002). Consequently, other governance mechanisms play key roles in Korean and Philippine group firms. While corporate groups in both Korea and the Philippines are family-controlled, there appears to be a greater separation between management and the controlling family in the Philippines.[1] Claessens et al. (2000) report that the CEO, board chairman, or vice-chairman are from the controlling family in 80.7% of firms in Korea, but only in 42.3% of firms in the Philippines. Moreover, they show that a second significant stockholder (defined as having a 10% or greater ownership interest) exists for firms in the Philippines (64.2% of firms), substantially more often than in either Japan (12.8%) or Korea (23.3%). These findings suggest that it may be more common to have independent, professional managers who are unrelated to the controlling family in the Philippines as compared to Korea. As a support, Saldańa (2001) finds that in a survey of Philippine firms the chairman of the board and

[1] Claessens et al. (2000) find that families own 9.7% of all firms in Japan, 48.4% in Korea, and 44.6% in the Philippines. A major difference between family ownership of corporate assets in Korea and the Philippines is the degree of concentration of ownership. The top 15 families in Korea own 38.4% of listed corporate assets making up 12.9% of GDP, while the higher concentration in the Philippines is demonstrated in the top 15 families owning 55.1% of corporate assets making up 46.7% of GDP.