



Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

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



CFO compensation: Evidence from Australia



Lien Duong*, John Evans

Curtin Business School, Curtin University, Australia

ARTICLE INFO

Article history:

Received 9 December 2014

Accepted 26 March 2015

Available online 2 April 2015

JEL classification:

G34

J33

M41

Keywords:

CFO compensation

Job complexity

Performance

Managerial power

ABSTRACT

We investigate the extent to which the incentive alignment theory and the managerial power theory explain the variability of CFO compensation in Australia. We find a positive relationship between the level of CFO compensation and measures of job complexity and firm stock market performance. However, we do not find the pay-for-performance link when performance is measured at the CFO-specific level. CFOs actually receive higher non-cash compensation when reporting quality is lower, suggesting a sharp contrast to predictions of the incentive alignment approach. Conversely, we find that CFOs who have more managerial power (the CFO is on the board of directors, or holds a higher level of stock ownership, or stays longer in their position) receive significantly higher compensation. For example, a CFO who has board membership receives on average \$323,590 more than the total compensation of a CFO who is not a board insider. Overall both theories are important in determining Australian CFO compensation but the managerial power hypothesis explains a larger fraction of variation in CFO pay than the incentive alignment view.

© 2015 Elsevier B.V. All rights reserved.

1. Introduction

Chief Financial Officers (CFOs) are financial stewards of companies and their main roles are to prepare financial statements, strategic planning and to assist in the development of company policies.¹ Legislative and media attention has recently been directed towards CFOs and the role they play in creating and disseminating financial information. In the wake of financial frauds and subsequent collapses of several high-profile corporations, legislators and the media are centering their blame not only on the Chief Executive Officers (CEOs)

* Corresponding author at: School of Accounting, Curtin University, Bentley Campus, GPO Box U1987, Perth, Western Australia 6845, Australia. Tel.: +61 8 9266 1212.

E-mail address: l.duong@curtin.edu.au (L. Duong).

¹ Recent research indicate that CFOs not only perform their traditional role of preparing statutory accounts, but have also moved into a "number two" position in firm hierarchy when developing strategic plans (Zorn, 2004; Copeland et al., 2005; Heibl et al., 2013).

who have final oversight authority for the company, but also on the CFOs. As a consequence, the US Congress enacted the Sarbanes–Oxley Act (SOX) 2002, and of particular relevance is Section 302 of this Act which requires both CEOs and CFOs to certify the material accuracy and completeness of the financial information and related disclosures by the company. The legislative elevation of CFOs to the same level of financial oversight responsibility as CEOs has emphasized the important role of CFOs beyond that of other company executives.²

Australia has had a number of high-profile cases, such as One.Tel, HIH Insurance and Centro, which focused attention on corporate governance and reporting quality. The Australian government has also been actively engaged in attempting to strengthen corporate disclosures and the financial reporting framework. Section 295A of the Corporations Act in Australia requires both CEOs and CFOs of listed entities to sign off on their company annual accounts and to declare that the company's financial reports present “a true and fair view in accordance with relevant accounting standards”. As an outcome of legislative elevation of CFOs, the US Securities and Exchange Commission (SEC) has required disclosure about CFO compensation since December 2002.³ In Australia, the Corporate Law and Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (also known as CLERP 9) became a law in 1 July 2004. CLERP 9, for example, requires expanded disclosure of executive remuneration by introducing a remuneration report within the directors' report of company financial reports. With the increasing awareness of the significance of the CFO function to an organization, it is therefore important to address the question of compensation paid to a CFO.

There are two competing schools of thought in the literature on rewarding company executives. One view (the managerial power or rent extraction approach) is that powerful executives influence the board of directors into paying them a high compensation with little or no obligations attached (e.g. [Core et al., 1999](#), [Bebchuk et al., 2002](#)). The other view (traditional or incentive alignment hypothesis) argues that executives are rewarded for skill, effort and performance (e.g. [Jensen and Meckling, 1976](#), [Jensen and Murphy, 1990](#)). There are a number of empirical studies that test the explanatory power of each theory in relation to CEO compensation (e.g. [Gristein and Hribar, 2004](#); [Chalmers et al., 2006](#); [Coakley and Iliopoulou, 2006](#); [Bugeja et al., 2012](#)). However, little academic research has been undertaken to examine the relative effect of each hypothesis on CFO compensation. Although a number of studies examine the determinants of CFO compensation with reference to either of the above-mentioned views (e.g. [Indjejikian and Matejka, 2009](#); [Balsam et al., 2012](#); [Bedard et al., 2014](#)), no work has been done on assessing the relative power of each theory on CFO remuneration.

The relationship between CEO remuneration, governance characteristics and performance is generally well understood and documented. Following the recommendation of CLERP 9 that executive remuneration should be continuously disclosed and monitored by the relevant industries and professional bodies, there is now a heightened awareness of remuneration paid to CFOs and a gap as to the underlying determinants of this pay. In line with the two competing theories, our work addresses two research questions. Firstly, to what extent is CFO compensation paid to align CFO incentives with value maximization? Secondly, to what extent do powerful CFOs extract rent through excessive pay? Our study contributes to the literature by testing the relatively explanatory power of the incentive alignment and managerial power theories on CFO compensation. By doing this, our study responds to the recommendation of CLERP 9 requiring close scrutiny of executive remuneration. Our CFO remuneration and corporate governance data is obtained from Capital IQ and annual reports, and is collected for the period 2006–2010.⁴

² There is evidence in the literature that CFOs possess superior information due to their roles in the firm's financial policy and financial reporting process ([Geiger and North, 2006](#); [Jiang et al., 2010](#)). [Wang et al. \(2012\)](#) find that CFO trades are more informative about future stock returns than CEO trades. Specifically, they document that CFOs earn significantly higher abnormal returns following their purchases of company shares than CEOs.

³ Some recent US studies have provided empirical evidence to support SEC's new disclosure requirement on CFO compensation by showing that the CFO's influence on company financial performance can be stronger than that of the CEO. For example, in a study of CEOs and CFOs influence on earnings management, [Jiang et al. \(2010\)](#) find that earnings management is significantly larger with CFO equity incentives than CEO equity incentives. Similarly, [Chava and Purnanandam \(2010\)](#) note that CFO's equity incentives have relatively stronger power in explaining company debt structure and accruals management than that of CEOs.

⁴ Capital IQ database has data on CFO remuneration and CFO characteristics, however, there are a number of missing observations, particularly in the earlier years. For example, the name of companies and CFOs are in the database but without remuneration, share ownership and appointment date. Consequently, we have manually extracted missing data from company financial reports.

Download English Version:

<https://daneshyari.com/en/article/975217>

Download Persian Version:

<https://daneshyari.com/article/975217>

[Daneshyari.com](https://daneshyari.com)