Research on the Relationship Between Executive Compensation, Equity Incentive and Corporate Performance —— Evidence from China

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Abstract: This study selects the Chinese listed companies,which have already implemented equity incentive in Shanghai and Shenzhen stock markets from 2016 to 2018,as data basement and then proceeds an empirical research on the relationship between executive compensation,equity incentive and corporate performance to test the application of top-management monetary salary incentive and equity incentive mechanism in listed firms.The final outcome shows that there existing a positive correlation between the executive remuneration,equity incentive and the company's performance,and also,there depicts an "interval effect" between the strength of equity incentive and the company's achievement.These findings,to a certain extent,are helpful to correctly grasp the development of corporate governance in China and provide empirical basis for the improvement of compensation incentive mechanism.

Keywords: Executive Compensation; Equity Incentive; Corporate Performance

Introduction

In order to improve the competitiveness of Chinese enterprises in the international market,there is no doubt that encouraging the management of enterprises is necessary.Similarly,this will undoubtedly cause executives to make short-sighted actions that are unfavorable to the future and long-term development of enterprises due to improper pursuit of their own interests,and will have a bad impact on the quality of corporate culture dissemination.Therefore, the establishment of a valid executive salary incentive system is a necessary requirement of the time.Based on this theoretical and practical background,this study will take Chinese listed companies as examples to study the relationship between the remuneration of executives,equity incentives and the companies' performance.This article has contributed in at least two aspects.First of all,based on previous studies,this paper combines senior managers' compensation and equity incentive together to more comprehensively examine the influence of executive compensation incentive system on corporate performance.Secondly,this paper considers the existence of "interval effect" while studying equity incentive,which provides more detailed information for the improvement of executive compensation incentive system.

1. Research methodology and Selection of Evaluation Index

1.1 Proposition of Research Assumptions

Assumption 1: The operating performance of listed companies is positively related to the annual compensation of senior executives.

The principal-agent problem stems from information asymmetry.Measures should be taken to reduce managers' moral hazard and adverse selection and increase shareholders' wealth,such as to link executive compensation with company performance,and to establish an effective incentive and constraint mechanism to make shareholders and managers have the same interests.It is assumed that there is a positive correlation between the operating value of listed enterprises and the salary of the senior managers who working for enterprises.

Assumption 2:The operating performance of listed companies is positively related to the executive equity incentives.

This paper holds that equity incentive is a more reasonable incentive system under the market economy.Specifically,the company's senior executives are generally regarded as risk avoiders in the principal-agent theory.On the contrary,company shareholders all hope to obtain higher premium income from their investments.Obviously,shareholders do not want the company's senior management to use conservative management methods to erode the potentially high returns that shareholders may get.In order to solve the contradiction between the two,it is necessary to make the top management and the shareholders of the company achieve the consistency of interests to the maximum extent.

Assumption 3:Executive compensation is negatively related to their own shareholding ratio.

Obviously,executive compensation is the agency cost borne by shareholders.When executives have residual claim rights,it can be considered as a reduction in agency costs.At the same time,when executives hold more shares in the company,they receive more other compensatory income (besides fixed salary income),such as dividend income,etc.Under the same other conditions,for executives with the same salary level but different shares in the company,those executives with less shares will naturally request to sign the salary-performance contract again to obtain higher income as compensation.

Assumption 4:Executive compensation is positively related to enterprise size.

Many scholars have found in their research that there is also a certain relationship between executive compensation and company size.Generally speaking,the larger the size of a listed company with normal profits,the easier it will be to gain cost advantages in a highly competitive market,and the better the company's benefits,thus being able to pay more compensation to senior executives.Accordingly,executives of larger companies need to deal with heavier work,manage more employees and find more high-yield investment projects.These require higher personal experience and management skills of executives.

Assumption 5:There is an "interval effect" between the performance of listed companies and the equity incentive intensity.

Different from the proportion of senior managers' shares proposed in assumption 2,the equity incentive intensity is based on the remuneration system to study the possible effect of the general performance of the actor on the company's performance.On the basis of relevant theories and some existing researches,this study makes assumptions about the "interval effect" of incentive intensity.

1.2 Setting of Variables

1.2.1 Selection of research variables

Corporate Performance (ROE)

During this research,the return on equity is used as a research variable to measure the company's performance.Value is a parameter proposed by economist Tobin (1969) to measure the company's performance,which is equal to the scale of the company's market value to the replacement value of the firm's assets.It is precisely because it is a very good indicator to reflect the company's achievement,so in previous studies by many scholars,value has been widely used to reflect the market's evaluation of the company.

Executive Monetary Compensation ($\ln PAY$)

From the viewpoint of the regulations of China Securities Regulatory Commission,the senior management personnel disclosed in the reports of the board of directors and the board of supervisors of the company are defined as senior management.The executive compensation variable is regarded as the average value of the total salary of the top three executives with the highest compensation in listed companies.Besides,taking the top three executives as a whole is more representative and more accurate than just taking the salary level of the first senior management as the standard.

Executive Shareholding Ratio (ESR)

The essence of equity incentive is to pursue the interests of the company's executives and shareholders keep consistent to the greatest extent to reduce agency costs.Therefore,in this article,executive shareholding is defined as the proportion of the total shares held by executive,supervisors and so on to the total equity of the company,and no further distinction is made between the shares held by executives originally and the shares granted by the firm.

Equity Incentive Intensity (EII)

This paper introduces the research variable of equity incentive intensity (EII),and the calculation formula is equal to the result of the number of senior executives' shares multiplied by the year-end EPS divided by the sum of the monetary compensation and the number of senior executives' shares multiplied by the year-end share price.

Selection of control variables

Enterprise Size ($SIZE$)

Considering that the correlation between executive compensation,equity incentive and company performance is the result of a combination of factors.This paper uses the natural logarithm of the total assets of the firm as the measurement index of the company scale.There are many variables used to judge the size of a firm,of which the market value of a listed company and the total value of assets on the book are representative.

1.3 Construction of Models

Model 1:$ROE = \beta_0 + \beta_1 \ln PAY + \beta_2 ESR + \beta_3 EII + \beta_4 SIZE + \varepsilon_1$

Model 2:$\ln PAY = \gamma_0 + \gamma_1 ESR + \gamma_2 SIZE + \varepsilon_2$

2. Research results analysis

There existing a correlation between corporate value and executive monetary salary of listed companies in positive direction.But the influence coefficient between the two is very low.Therefore,listed companies should not only focus on the positive incentive impact of monetary pay when formulating compensation incentive policies in the future,but also raise the monetary salary of executives within a certain scope,thus promoting the incentive effect to be effectively utilized.

Senior executives' own shareholding ratio has a positive influence on the achievement of listed companies.Executive shareholding,as an effective long-term incentive method,has a positive impact on the firm value and growth.However,through the empirical research results of this paper,it is shown that the correlation degree between management equity scale and firm value is a little weak.

The proportion of senior manager's own shares and the scale of the enterprise have a positive influence on senior management's compensation.It is found that executive remuneration and their own shareholding ratio are not negatively correlated with theoretical assumptions before.

Under reasonable equity incentive intensity,executive compensation has a positive impact on the corporate value.It can be seen that if the equity incentive for senior executives of listed companies is too high or too low,the remuneration of senior executives has no noteworthy impact on corporate performance.The reason for this is that excessive equity incentive increases the possibility of "certainty effect".

3. Conclusion

Totally speaking,we found that,in terms of the types of incentives related to corporate performance,executive monetary compensation incentives are statistically significantly sensitive and flexible,while equity incentives are relatively less sensitive,but still have a certain significant correlation.Of course,this is also related to the strength of equity incentives,which is also supported by certain data in empirical analysis.We also find that the equity ratio of executives and the size of the enterprise have a positive correlation on executive compensation.

However,there are several issues that should be considered by the salary incentive mechanism makers,which happens to be the place where this article has not been researched in depth.Firstly,it may be due to more social responsibilities and special preferential treatment,and the connection between salary and equity incentive and performance may be weak in government-controlled listed companies.In addition,in different industry fields,their operation methods and characteristics are also different,so the particularity of the industry needs to be taken into account when formulating the incentive mechanism.

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