SIBR-RDINRRU 2014 CONFERENCE
ON INTERDISCIPLINARY
BUSINESS & ECONOMICS RESEARCH

September 27th - 28th, 2014
Kimberley Hotel, Hong Kong

"The Interdisciplinary Approach to Research, Practice and Learning"

Conference Proceedings
Volume 3 (2014), Issue 3
ISSN: 2223-5078
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Published by Society of Interdisciplinary Business Research, 2014, Volume 3 (3)
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Effects of ownership concentration, executive characteristics and firm performance on executive cash compensation for Thailand: 2009-2013

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Presented at the: SIBR 2014 Hong Kong Conference on Interdisciplinary Business and Economics Research, 27th-28th September 2014, Hong Kong.

ABSTRACT

This paper aims to examine relationship among ownership concentration, executive characteristics, and firm performance; and their impacts on executive compensation. Panel data of eight industries of listed companies, including Agro & Food Industry, Consumer products, Resources, Technology, Services, Industrials, Property & Construction, and Finance, during 2009 to 2013 were collected from firm’s annual reports, 56-1 forms, and SETSMART database. Based on agency concept, executive compensation is constructed and estimated using fixed effects method. The study findings reveal that firm performance, measured by Tobin’s Q, significantly and positively related with executive compensation in Consumer products, Technology, Services, and Financial sectors. Characteristics of executives significantly affected executive compensation. Male executive earn more compensation than female.

Keywords: firm performance, executive compensation, executive characteristics

1. INTRODUCTION

Executive compensation is used as an incentive to maximize profits (Becker, 2004) in forms of salary and bonus that are increased with executive performance. Executives are motivated to achieve a good management, so that they receive a good compensation in return (McConnell & Brue, 2005).

Performance represents the annual performance of a business measured from return on assets (ROA), return on equity (ROE) and ratio of market value of equity (Tobin’s Q). Effective firm performance increases the ability to pay compensation (Richard, 2009; Jiang & Habib, 2009; Tobin, 1969).

Executive characteristics are known to be related with compensation. Male executives can deal with decision making and managerial risks better than female. As such, male executives may receive more compensation (Niederle & Vesterlund, 2007). Executives’ level of academic education may affect their management. Executives with higher education have better skills and ideas of management than executives with lower education (Lam, 2013). Agents (executives) that have a family member as a large block shareholder suggest a stronger management by which executives are well entrusted and favorably cooperated by shareholders. These executives are motivated to operate to the utmost because their family members are stakeholders. Thus compensation pay is higher than that of businesses with no interested person in executives’ families (Fama & Jensen, 1983).
2. THEORETICAL FRAMEWORK AND HYPOTHESES

2.1. Theoretical Framework

2.1.1 Motivation Theory
Motivation Theory (Herzberg, 1968; McClelland, 1976) is a theory that explains thought processes of motivating expectations and believes; managers who exert a high level of effort to achieve the goals and receive compensation from their performances will induce inspiration to succeed and develop their performances, as to be socially acceptable, preeful, compensated and appropriately awarded. Performance of operation is measured from the efficiency of firm performance (Lunenbury, 2011).

2.1.2 Agency Theory
Agency theory is the theory that explains relationship between two persons, the principal and the agent, that have different management perspectives. Executives desire to act in their own best interests that are not complied with the agreement leading to an occurrence of conflicts of interest between the principal and the agent. Conflicts of interest are categorized into 4 types, according to McColgan (2001).

   a) Moral-Hazard is a situation arisen from ethical issues. Executives (the agent) perform with regard to their own interests rather than interests of shareholders and not complied under the contract of employment. The long-term contract leads to the management not being performed with full effort and the likelihood of distortion may arise, such as numerical manipulation on financial report that is difficult to monitor by external auditors. As executives hold more information over shareholders, asymmetric information exists between the agent and the principal. Inefficient performance is a cause of the reduction of the firm value.

   b) Earnings Retention is a conflict concerning firm size. Executives are willing to operate by increasing the size of the firm to have more obligation and more responsibilities on management. A search for internal financing (retained earnings) is preferred over external financing (liabilities) to protect them from being monitored externally. Using such capital structure causes a lower compensation paid to shareholders which affects compensation pay from investments. Shareholders prefer external funds rather than internal financing to increase investment returns and wealth to shareholders.

   c) Time Horizon has arisen from investment horizon in which shareholders will emphasize on long-term investments that offer higher returns, while administrators will give priority to short-term investments over long-term ones at the time of their tenure.

   d) Managerial Risk Aversion is the tendency to avoid investment risks because executives have no interest in case of executive compensation is a fixed salary. Whilst shareholders prefer executives to make decisions on risky investments as investment returns are higher which, in turn, it increases returns for shareholders.

The agency problem exists between executives (agents) and shareholders (principals) that have conflicts of interest on asymmetric information (Jensen & Meckling, 1976). Shareholders cannot directly control the administration of executives. As a result, executives operate the management for their personal interests rather than interests of shareholders that causes a moral-hazard. Supervision by the board of committee is required for administrators to perform efficiently; however, it is difficult to control due to covering up of information causing complication on inspection which results in agency cost. Therefore, a way to cope with the agency problem for effective
management and good performance is to have a good compensation plan. Compensations include salary and bonus. A fixed salary is paid when executives achieve the goals set in the agreement. As if executives have competency of management beyond the predestined goals, they will receive award or bonus as incentives for higher level of effectiveness (Bebchuk & Fried, 2003).

Salary and bonus will be paid as cash compensations (Mehran, 1995), in which it can be measured as follows. First, it is evaluated by firm performance. If the company has a good firm performance, executive compensations will be at a high rate. Firm performance is measured from ROA and ROE that are then compared between ROA, ROE and Tobin’s Q (Tobin, 1969). Second, it is determined by executive characteristics that are related with compensation plan such as academic education, gender and family ownership. Male executives are less risky on management than females (Khan & Vieito, 2013). Third, it is measured from ownership concentration by determining from the first five large block shareholders. Bonus pay is in a form of cash compensation. Bonus compensation is an incentive for employee’s loyalty to the organization for the best outcome of administration and beneficial for shareholders. Executives will manage to make profits and stock is increased, so that they have advantages from increased value of shares because they are also one of the owners (Bergman & Jenter, 2007).

Furthermore, shareholder structure with ownership concentration is beneficial on performance of executives, votes and executives being acknowledged to shareholders. As family members are shareholders, it is an incentive for executives to exert a high level of effort to effectively operate for the best benefit and wealth of family members as shareholders (Stanca, 2009).

2.2 Hypotheses

**Independent Firm Performance**

Executive compensation will be at a high rate when a company has a good performance, by using ROA, ROE and Tobin’s Q as a measures.

H1: Firm performance is related with executive cash compensation

**Executive characteristics**

Executive characteristics include gender, academic education and family ownership. Gender is involved in compensation paying in which male executives can manage decision making more efficiently than female, thus receive a higher rate of compensation. Academic education is taken as a factor for compensation paying in which executives with a higher level of education receive more payment. Family ownership is also determined. Five percent of equity ownership within the firm are family members of executives, as present in annual reports, are measured.

H2: Executive characteristics are related with executive cash compensation

**Ownership concentration**

Ownership concentration includes the first five large block shareholders by measuring the percentage of total issued and paid-in shares.

H3: Ownership concentration is related with executive cash compensation
3. METHODOLOGY

3.1 Data collection and Sample

The data of companies listed of the Stock Exchange of Thailand (SET), including Agro & Food industry, Consumer products, Resources, Technology, Services, Industrials, Property & Construction and Financials, during 2009-2013 (total of 5 years) were collected from the website of the Securities and Exchange Commission (SEC). Moreover, annual reports and the Form 56-1, financial information in the financial statements, information for executive compensation were also collected from SETSMART.

3.2 Model Specification and variables

Model estimated with Random Effect model can be expressed as

\[ Y_{it} = \beta_0 + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + \beta_4 x_{4it} + \beta_5 x_{5it} + \beta_6 \text{Size}_{it} + \beta_7 \text{IND}_{it} + \beta_8 \text{Age}_{it} + \varepsilon_{it} \]  

(1)

where:

I = Individual dimension (t=1,…, N)
t = Time dimension (t=1,…, T)
\( \beta \) = Unknown parameters
\( \varepsilon \) = Error term
\( Y_{it} \) = Salary plus bonus compensation of the company i at time t
\( X_1 \) = Firm performance measured by ROA, ROE and Tobin’s Q
\( X_2 \) (WOMEN) = Gender
\( X_3 \) (MASTERS) = Academic education
\( X_4 \) (FAMILY5%) = Family ownership
\( X_5 \) (OWNER) = Ownership concentration
\( X_6 \) (LNSIZE) = Firm size measured from Natural Logarithm of total assets at the end of year. There are a number of employees in a large company resulting in more responsibilities for executives, hence more compensation (Wu, 2013; Veprauskaite & Adams, 2013; Sampson, 2008).
\( X_7 \) = Firm industry. Different types of industries suggest different responsibilities, thus different compensation payment (Veprauskaite & Adams, 2013; Wu, 2013; Cichello, 2005; Sampson, 2008)
\( X_8 \) (AGE) = Firm age measured from Natural Logarithm of the number of registered years. It is a quantitative variable that indicates the age of firm registered in SET. A newly listed company may not have a steady performance, therefore executives have more responsibilities. Hence, executive compensation is also dependent upon firm age (Veprauskaite & Adams, 2013; Cao, Pan & Tian, 2011; Sampson, 2008)
4. RESULTS

Estimation results with Fixed Effects are shown in Table 1. As estimated using fixed effects method, it was found that relationships between executive compensation and firm performance in Consumer products, Technology, Services and Financials were positive, in which firm performance was measured through Tobin’s Q. This is complied with the H1 hypothesis. However, Agro&Food Industry, Resources, Industrials and Property& Construction did not show any correlation between executive compensation and firm performance.

According to the H2 hypothesis, in Technology industry, female executive was in a negative relationship with compensation, in which compensation is at a higher rate than that of males. Unlike Technology group, the rest of industry groups pay more compensation to male executives than females. Family ownership (5% shares) was significantly found to be negatively correlated with executive compensation in Property & Construction. Family ownership in other industries had no relationship with executive compensation. For ownership concentration as in the H3 hypothesis, there was no relationship found with executive compensation.

Firm size had an effect on executive compensation in which the relationship is positive in companies with large total assets. Large-sized firms are likely to pay a high rate of executive compensation, but firm size was not correlated with compensation in Agro & Food Industry.

By using ROA and ROE, there was no statistical relationship found between firm performance and executive compensation. However, only firm performance of Industrials that was significantly associated with executive compensation at p<0.1.
Table 1: Relationship between executive compensation and firm performance measured from Tobin's Q in each industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>Consumer Resources</th>
<th>Technology</th>
<th>Services</th>
<th>Industrials</th>
<th>Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 &amp; Food</td>
<td>-0.00471</td>
<td>0.00670</td>
<td>-0.00426</td>
<td>-0.00691</td>
<td>-0.00231</td>
</tr>
<tr>
<td>0 &amp; Energy</td>
<td>-0.00389</td>
<td>-0.0000813</td>
<td>0.000547</td>
<td>-0.00549</td>
<td>-0.00549</td>
</tr>
<tr>
<td>0 &amp; Mining</td>
<td>-0.00511</td>
<td>0.0453</td>
<td>-0.00829</td>
<td>-0.00103</td>
<td>-0.000371</td>
</tr>
<tr>
<td>0 &amp; Oil &amp; Gas</td>
<td>0.00126</td>
<td>0.00298</td>
<td>0.1761</td>
<td>0.000193</td>
<td>-0.0341</td>
</tr>
<tr>
<td>0 &amp; Utilities</td>
<td>-0.00278</td>
<td>0.00171</td>
<td>0.00822</td>
<td>0.000190</td>
<td>16.67***</td>
</tr>
<tr>
<td>0 &amp; Other Manufacturing</td>
<td>-0.00208</td>
<td>0.00715</td>
<td>0.00822</td>
<td>0.000190</td>
<td>16.67***</td>
</tr>
<tr>
<td>0 &amp; Other Services</td>
<td>0.00792</td>
<td>0.2611</td>
<td>0.00822</td>
<td>0.000190</td>
<td>16.67***</td>
</tr>
</tbody>
</table>

Note: p < 0.01
Table 2 Relationship between executive compensation and firm performance measured from ROA in each industry.

<table>
<thead>
<tr>
<th>Industry Type</th>
<th>Agriculture &amp; Food</th>
<th>Consumer Products</th>
<th>Resources Technology</th>
<th>Services</th>
<th>Industrials</th>
<th>Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.00307</td>
<td>-0.00112</td>
<td>-0.0035</td>
<td>0.00181</td>
<td>0.000621</td>
<td>0.00774</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>-0.01051</td>
<td>-0.00780</td>
<td>-0.00331</td>
<td>0.00802</td>
<td>0.00729</td>
<td>0.00934</td>
</tr>
<tr>
<td>Correlation</td>
<td>-0.00292</td>
<td>-0.00228</td>
<td>-0.00055</td>
<td>0.00372</td>
<td>-0.00228</td>
<td>-0.000774</td>
</tr>
<tr>
<td>Significance</td>
<td>0.00141</td>
<td>-0.0145</td>
<td>0.00958</td>
<td>-0.00988</td>
<td>-0.000952</td>
<td>0.00313</td>
</tr>
<tr>
<td>p-value</td>
<td>&gt;0.001</td>
<td>&gt;0.001</td>
<td>&gt;0.001</td>
<td>&gt;0.001</td>
<td>&gt;0.001</td>
<td>&gt;0.001</td>
</tr>
</tbody>
</table>

Note: The table continues with additional data points and significance levels, denoted by symbols such as ** for p < 0.001.
<table>
<thead>
<tr>
<th>Industry</th>
<th>Agro&amp;Food</th>
<th>Consumer Products</th>
<th>Resources</th>
<th>Technology</th>
<th>Services</th>
<th>Industrials</th>
<th>Property*</th>
<th>Construct</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.00000530</td>
<td>-0.000149</td>
<td>0.00552</td>
<td>0.000546</td>
<td>0.00266</td>
<td>0.00444*</td>
<td>-0.00081*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-0.0105***</td>
<td>-0.00186</td>
<td>-0.00914*</td>
<td>0.00910**</td>
<td>-0.00218</td>
<td>-0.00788*</td>
<td>-0.0231**</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-0.00325</td>
<td>-0.00322</td>
<td>-0.00116</td>
<td>0.000951</td>
<td>-0.00172</td>
<td>0.00282</td>
<td>0.00308</td>
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</tr>
<tr>
<td></td>
<td>-0.00674</td>
<td>-0.00116</td>
<td>0.0276</td>
<td>0.0473</td>
<td>0.0137</td>
<td>-0.00818</td>
<td>-0.0991*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-0.0115*</td>
<td>0.000507</td>
<td>-0.00164</td>
<td>-0.00560</td>
<td>0.00402</td>
<td>-0.00194</td>
<td>-0.00315</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.0152</td>
<td>-0.00628</td>
<td>0.319***</td>
<td>0.172*</td>
<td>0.293***</td>
<td>0.423***</td>
<td>0.0466*</td>
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</tr>
<tr>
<td></td>
<td>0.0153</td>
<td>0.00926</td>
<td>0.0239</td>
<td>0.0308</td>
<td>0.00415</td>
<td>0.00374</td>
<td>0.0384***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>17.64***</td>
<td>16.75***</td>
<td>12.06***</td>
<td>14.08***</td>
<td>12.31***</td>
<td>10.52***</td>
<td>16.91***</td>
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<tr>
<td></td>
<td>179</td>
<td>106</td>
<td>73</td>
<td>115</td>
<td>252</td>
<td>228</td>
<td>234</td>
<td></td>
</tr>
<tr>
<td></td>
<td>39</td>
<td>26</td>
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<td>106</td>
<td>73</td>
<td>115</td>
<td>252</td>
<td>228</td>
<td>234</td>
<td></td>
</tr>
<tr>
<td></td>
<td>36.96</td>
<td>2.864</td>
<td>40.19</td>
<td>29.41</td>
<td>39.57</td>
<td>45.95</td>
<td>58.24</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.187</td>
<td>0.0586</td>
<td>0.559</td>
<td>0.251</td>
<td>0.400</td>
<td>0.275</td>
<td>0.418</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.182</td>
<td>0.0788</td>
<td>0.304</td>
<td>0.205</td>
<td>0.0475</td>
<td>0.109</td>
<td>0.0518</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.166</td>
<td>0.0666</td>
<td>0.573</td>
<td>0.243</td>
<td>0.400</td>
<td>0.362</td>
<td>0.483</td>
<td></td>
</tr>
</tbody>
</table>

* p < 0.05
** p < 0.01
*** p < 0.001

Table 3: Relationship between executive compensation and firm performance measured from ROE in each industry.
5. CONCLUSION

The study of the relationship between executive compensation and firm performance by measuring Tobin’s Q is to determine the increased market value of equity resulting in an increase in executive compensation. Statistically, by using ROA and ROE, firm performance was not significantly related with executive compensation. This is consistent with the Motivation theory (Herzberg, 1968; McClelland, 1976) and studies of Tobin (1969) (Jiang & Habib, 2009; Riachi & Schwienbacher, 2013; Mehran, 1995; Wu, 2013; Veprauskaite & Adams, 2013).

For characteristics of executives, female executives earn a lower compensation than male executives. In Thailand, gender inequality widely exists and varied across different industries. This is consistent with studies of Gustafsson & Sai (2000), Lam (2013) and Niederle & Vesterlund (2007).

Ownership concentration of the first five shareholders was significantly associated with compensation in Agro & Food industry, by which ROE was in a negative relationship with executive compensation while ROA and Tobin’s Q measurements were not correlated with compensation (Jiang & Habib, 2009; Hartzell & Starks, 2003; Cheung, 2005; Amoako-Adu, 2011; Gallego & Larrain, 2012).

Firm size had an effect on executive compensation in which the relationship was positive in all industries. A company with large total assets or large firm size is likely to pay a high level of executive compensation, apart from that of Agro&Food industry which firm size did not affect. Large companies have responsibilities more than small companies, thus can pay more compensation (Wu, 2013; Veprauskaite & Adams, 2013; Sompson, 2008).

Statistically, firm age had a significant effect on executive compensation in only Property & Construction, while there was no relationship found in other groups (Veprauskaite & Adams, 2013; Cao, 2011; Sompson, 2008).

Suggestion on further studies could be the relationship between executive experience and executive compensation, in listed companies of SET and the similar methodology could be used.

REFERENCES


Cao Jerry, Pan Xiaofei and Tian Gary. (2011). Disproportional ownership structure and


