CHAPTER 2
REVIEW OF LITERATURE

In this chapter, the literature relevant to the topic under study is reviewed. The review of literature helps to identify the research gaps and thus in formulation of the research problem. It also helps in selection of other variables of the study for examining their influence on the main variable of interest. The present chapter is organized into five sections. In first section (2.1), the research studies related to the disclosure of managerial remuneration are reviewed; the section second (2.2) deals with studies which have examined the determinants of disclosure of managerial remuneration; the section third (2.3) focuses on the research studies related to the growth of managerial remuneration; the section four (2.4) deals with those research studies which have studied the determinants of managerial remuneration and in section five (2.5), the studies which have explored the impact of excess managerial remuneration on future corporate performance are reported.

2.1 Disclosure of Managerial Remuneration

Though a number of studies have been conducted to examine the corporate governance practices in different countries, but the disclosure of managerial remuneration as a field of research has been ignored. For instance, Desoky and Mousa (2012) examined the information about the disclosure of compensation of the board members along with other general and board information, for calculating the transparency and disclosure index. It was found that overall transparency and disclosure practices of the listed companies in Egypt were fairly moderate as compared to other countries with advanced capital markets. However, only 37 percent of the sampled companies disclosed information about the compensation of the board of directors. Raithatha and Bapat (2012) studied the disclosure of remuneration paid to directors, number of non-executive directors in the remuneration committee, remuneration committee chaired by the independent director, presence of the chairman of the remuneration committee in the last AGM, and the quorum at the remuneration committee meeting for calculating the corporate governance index along with other governance variables, such as composition of the board of
directors, board meetings, and audit committee, etc. It was found that average compliance with the corporate governance by Indian companies was satisfactory.

Conyon (1997) stated that almost 60 percent of sampled companies in UK had remuneration committees in 1988 which increased to 96 percent in 1993.

Hill (1997) assessed the adequacy of the remuneration disclosure regime for Australian listed public companies and advocated that a number of flaws hindered the detailed disclosure of the remuneration packages of directors. The study recommended improvements, like disclosure of the process by which director remuneration is determined, disclosure of the policies and philosophy of the board in structuring remuneration packages, including performance criteria, disclosure of the performance based components of the remuneration, disclosure of the total remuneration package and its component parts, and a clear and standardised way of disclosing director remuneration in disclosure rules.

Ward (1998) inspected the disclosure rules about director remuneration recommended by Greenbury Committee and revealed that a loophole still existed regarding the disclosure of additional income arising to directors from outside directorships. A sample of quoted companies’ 95 executive directors holding between them 145 outside directorships in other quoted companies was taken using the Arther Anderson Directors’ guide for 1993. It was found that only one company disclosed directors’ interests in outside directorships and remaining all companies made no disclosure regarding who receives the remuneration, how much time off was allowed and whether there was a company policy in connection with release for outside directorships. The study recommended that director’s primary employing company should have disclosed the directorships in companies outside the group, time spent by such directors on outside business and remuneration received for these outside directorships. Company in which director served as outside director was recommended to disclose the primary employing company of the director and any other directorships held, time spent by the director on company’s business, and remuneration paid to the director.

Conyon et al. (2002) reported high degree of information disclosure about director share options in UK 287 companies in 1994 and 1995. The study found that eighty-three
percent of the sampled companies disclosed exercise prices for all share options, whereas ninety-three percent of the companies reported exercise prices for some of the options. Sixty-nine percent of the sampled companies gave the earliest exercise dates for all share options, whereas eighty-three percent companies gave details for at least some of the options. Sixty-nine percent of the sampled companies revealed information about the expiry dates for all share options, whereas eighty-four percent companies reported this for some of the options. Thirty-one percent of the sampled companies disclosed information regarding the performance criteria to which share options were subject during 1994-95.

Lo (2003) studied the economic consequences of Securities and Exchange Commission (SEC) regulation of executive compensation disclosure in case of 195 firms in US and found that lobbying companies experienced abnormally high stock returns over the 8-month event period. The study concluded the confirmation of governance improvement hypothesis where implementation of the regulation was expected to improve corporate governance. Thus, additional mandated disclosures enhanced shareholder wealth.

Craighead et al. (2004) examined the impact of the mandatory disclosure on CEO cash compensation and stock option grants determination in largest 100 Canadian firms from 1991 to 1996, comprising three years of pre-disclosure regime from 1991 to 1993 and post disclosure regime comprised data from 1994 to 1996. The study found that CEO cash compensation in dispersed ownership firms was less performance contingent than in firms with powerful shareholders. With the imposition of the mandated disclosure, performance contingent cash compensation increased more in widely held firms than in closely held firms. The study also showed a weaker association between returns of stock market and stock option grants during pre-disclosure regime. In the post disclosure regime, CEO stock option grants became more accounting performance contingent for both widely-held and closely held firms.

Nelson and Percy (2005) investigated the transparency of executive stock option disclosures by 197 Australian listed companies for the years 2000 and 2002 and reported that the transparency of executive stock option disclosures was low but some improvement was seen in the year 2002. In 2000, only thirty-five percent of the sampled
companies complied at a level of 50 percent or greater; whereas in 2002, 50 percent of 
the sampled companies made compliance at a level of at least 50 percent. No company in 
the sample was found to comply with all the requirements of the applicable accounting 
standards.

Werder et al. (2005) studied the compliance with the corporate governance code 2002 for 
a sample of 408 German companies and stated that more than 20 percent of all companies 
were not complying with the recommendation of reporting the compensation of board 
members in terms of fixed, performance-related and long term incentive components. 
Less than two-third of the companies considered the chairmanship and the membership in 
committees of the supervisory board for additional compensation. Only half of the firms 
granted performance related compensation to the members of their supervisory boards.

Chizema (2008) investigated the disclosure of individual executive compensation in large 
126 German firms from year 2003 to 2005. The study found that in 2003, only 28 firms 
disclosed individual executive compensation, and this number rose to 95 firms in 2005.

Melis and Carta (2010) examined the impact of the mandatory adoption of IFRS2 for 
accounting for share based remuneration in a sample of 46 companies in Italy for years 
2004 and 2005. The study found that only five out of 46 companies had recorded the cost 
of share based remuneration in their annual statements before the requirement of IFRS2 
and the disclosure in annual reports concerning the cost of remuneration plans increased 
following the adoption of IFRS 2. Majority (82.6 percent) of the companies recorded the 
cost of share based remuneration under the heading personnel costs.

Nelson et al. (2010) examined the disclosure of statutory executive stock options by 115 
Australian listed companies from 2001 to 2004. Overall compliance in 2001 was found to 
be 73 percent which increased to 83 percent in 2004. Compliance with sensitive 
disclosures (pooled) during 2001-2004 was found out to be 45 percent which was much 
lower than 81 percent compliance with non-sensitive disclosures (pooled). It was 
concluded that companies were significantly less likely to disclose more sensitive 
executive stock option information. However, a progressive increase in overall and 
sensitive disclosures was found over the period of four years.
Schiehl et al. (2013) examined the voluntary executive stock option disclosure in 68 companies with active Executive Stock Option plan in 2007 in Brazil and found that the average voluntary executive stock option disclosure index ranged from 0.32 to 0.46. Only five percent of the sampled companies revealed whether stock option transfer conditions were imposed or not. The amount of authorised and exercised options were disclosed by sixty-nine percent of the sampled companies.

Malak (2014) investigated the level of voluntary disclosure of remuneration of executive directors over the period 2000 to 2008 in Malaysia. Voluntary disclosure score was derived on the basis of items that were reported in excess of the mandatory provisions of the listing rules and Financial Reporting Standard (FRS) 2. The study found an improvement in the voluntary disclosure of the remuneration of executive directors after the reforms. However, the study found a significant fall in the level of minimum disclosure in 2008.

Only Clarkson et al. (2006) and Laksmana (2008) have analysed the remuneration disclosure practices in detail. Clarkson et al. (2006) studied CEO remuneration disclosure practices for a sample of 124 firms in Australia from 1998 to 2004. Disclosure was examined in accordance with the Company Law Review Act (CLRA) 1998 and Director and Executive Disclosures by Disclosing Entities (AASB1046) 2004. Significant improvement in disclosures was found concurrent both with CLRA 1998 and AASB1046 2004 and it was also reported that detailed black letter requirements through formal regulatory channels led to high quality disclosure. Laksmana (2008) examined the information reported in the compensation committee report in S&P 500 firms for two years, i.e. 1993 and 2002 and revealed that more than 84 percent of corporate boards disclosed the basis for determining the salary, type of general and specific measures for determining annual rewards, and discussion about annual rewards being granted on achievement of performance targets. In contrast, weights assigned to performance measures, specific performance targets, and award giving formulas were among the least reported items. A number of firms disclosed that they kept these items confidential to avoid compromising their competitive position. Compared with 1993, significant increase
was found in the percentage of firms disclosing the employment of compensation consultants, the basis for determining the salary, type of performance evaluation, weights on performance measures, and range or absolute value of rewards.

2.2 Determinants of Disclosure of Managerial Remuneration

Conyon et al. (2002) considered a sample of FTSE 287 companies of UK for the year 1994 and 1995 to examine the impact of company size, board structure, debt structure, corporate performance, and risk on the disclosure of share option details of directors. A negative impact of company size (market value), board size, leverage (debt-equity ratio), performance (return on capital employed), was found on the disclosure of exercise prices of share options. The proportion of non-executive directors had a positive relationship with the disclosure of option information. The impact of systematic risk of the ordinary shares of the companies has not been found consistent across various models developed in the study.

Nelson and Percy (2005) analysed the impact of the presence of a compensation committee, ownership concentration, and listing status on the disclosure transparency of executive stock options in a sample of 197 companies in Australia for 2000 and 2002. Company size, leverage, performance, and big 5 audit firms were taken as control variables. Disclosure transparency was represented through an index developed on the basis of disclosure of information regarding stock options in annual reports. Ownership concentration was represented through the extent of minority interest, i.e. deducting the proportion of equity holdings of wholly owned subsidiaries from 100 percent. Listing status was defined as a dummy variable taking value one if the company was listed on the US stock exchange and zero otherwise. The presence of compensation committee, big 5 audit firms and company size were found to be positively related with the disclosure score of information regarding executive stock options, whereas ownership concentration and listing status were negatively related with the disclosure score. Company performance and leverage were found to be insignificant in influencing the disclosure transparency. The study also revealed that the disclosure of executive stock options increased significantly in 2002 as compared to 2000.
Clarkson et al. (2006) used a sample of 124 Australian firms for the period 1998 to 2004 to carry out a content analysis for framing CEO remuneration disclosure index and explored the determinants of CEO remuneration disclosure. CEO remuneration disclosure was represented through an index based on the information regarding the remuneration process, pay-performance relationship, etc., as per the provisions of AASB1046. A corporate governance factor was constructed on the basis of four measures, i.e. the proportion of independent directors, independent remuneration committee members, independent audit committee members, and CEO-Chairman duality. A positive and significant relationship of total assets, corporate governance factor, big four audit firm, and international cross listing with the CEO remuneration disclosure was found. The impact of company’s return on equity, company growth, leverage, CEO-Chairman duality, change in auditor, and takeover or merger on the CEO remuneration disclosure was also examined, but all these variables were found to be insignificant. It was also revealed that CEO remuneration disclosure increased significantly over the period of the study.

Chizema (2008) examined the determinants of disclosure of individual figures of executive compensation for a sample of 126 German firms for a period 2002 to 2005. Institutional ownership, foreign ownership, dispersed ownership, bank ownership, family ownership, state ownership, the size of the supervisory board, prior adoption of a shareholder value oriented practice, and firm experience were taken as the factors affecting executive pay disclosure. Firm performance and firm size were taken as control variables. The results of the logistic regression revealed that firm size, firm performance, institutional shareholding, dispersed ownership, and state ownership were positively related with the disclosure of executive compensation. Size of the supervisory board and firm experience were found to have a negative impact on the disclosure of executive pay. Foreign ownership, bank ownership, and family ownership were insignificant in influencing the executive compensation disclosure in Germany. Companies that adopted IAS or US GAAP early were more likely to disclose individual figures of executive compensation than companies using German GAAP. The disclosure of executive compensation was also found to be time dependent, as the time dummies were found to be positive and significant.
Laksmana (2008) investigated the relationship between corporate board governance and executive compensation disclosure in US for a sample of 218 firms for the year 1993 and 232 firms for the year 2002. Board and compensation committee independence (the proportion of independent outside directors on the compensation committee and the board, the presence of a nomination committee comprised of independent directors), CEO power over the nomination process of a director (the proportion of outside directors on the compensation committee and the board that were given jobs after the appointment of current CEO, number of years the current CEO has been in the job), time commitment of directors (number of directorships of independent directors serving on the compensation committee and the board, a dummy variable taking value one if the majority of the outside directors on the compensation committee and the board served on three or more other boards), board diligence (compensation committee meeting frequency and board meeting frequency) and compensation committee and board size. On the basis of computed scores of the board governance factors through principal component analysis, five variables were retained in the regression analysis for the year 1993, i.e. independence, CEO power, busy directors, diligence and board size and four variables were retained in the regression analysis for the year 2002, i.e. independence, CEO power, busy directors, and diligence/board size. Compensation disclosure scores were calculated on the basis of disclosure of items in board compensation committee report, as required by SEC rules. The study showed that in 1993, board independence and board size were positively related with the disclosure score. CEO power over the nomination process of a director and multiple directorships by outside directors were associated with less disclosure. Board diligence was found to be insignificant in influencing the disclosure score in 1993. In 2002, board diligence was the only variable which was found to be positively related with the disclosure score.

Liu and Taylor (2008) examined the impact of corporate governance determinants on the extent of disclosure of options, share rights and termination benefits to executives in the annual reports of 191 companies in Australia for two years 2003 and 2004. Media attention regarding executive remuneration, existence of a resolution to raise executive remuneration, company size, proportion of executive directors on the board, and the presence of a remuneration committee were used for representing corporate governance
structure. It was found that media attention and the presence of remuneration committee had no significant impact on the disclosure of executives’ share rights and options. The existence of a resolution to raise executive remuneration and company size were found to be positively related with the disclosure of executives’ share rights and options. The study also stated that with an increase in the proportion of executive directors on the board, less disclosure is made regarding their equity-based remuneration.

Nelson et al. (2010) investigated the influence of corporate governance structure on the disclosure of executive stock options (ESO) for 115 Australian listed companies for 2001-2004. Board independence (chairman independence and the proportion of non-executive directors), board activity (board meetings), audit committee independence (audit committee size, independence, expertise, and meetings), and compensation committee independence (audit committee size, independence, and meetings) were used as measures for representing internal governance structure on the basis of scores derived by applying principal component analysis. External corporate governance mechanism was represented through three variables, i.e. big 4 audit firm, a dummy variable taking value one for the year Australian Shareholders’ Association (ASA) identified company as weak performer, and another dummy variable representing increasing regulatory activity by taking 2001 as the base case, 1 for 2002; 2 for 2003; and 3 for 2004. The study revealed that board independence was negatively related to ESO disclosure. ASA identified poor performers were found to disclose less information. Audit committee independence, compensation committee independence, big four audit firm, and increasing regulatory activity were found to be positively related with ESO disclosure. However, board activity was found to be insignificant in influencing the disclosure of executive stock options.

Hearn (2013) considered a sample of 69 IPO firms for the years 2000 and 2010 to examine the impact of board size, the proportion of non-executive directors on the board, opaque director earnings, and the proportion of independent non-executive directors on the likelihood of disclosure of individual executive pay. The logistic regression was applied and it was found that board size was negatively related with the disclosure of CEO salary, whereas the proportion of independent directors enhanced the disclosure of individual CEO salary. Opacity of director earnings and the proportion of non-executive
directors were found to be insignificant in influencing the disclosure of individual CEO salary.

Schiehll et al. (2013) examined the relationship between the governance structure of a company and voluntary executive stock option (ESO) disclosure for a sample of 68 Brazilian companies that had active ESOs in the year 2007. Voluntary ESO disclosure index was prepared on the basis of memorandum (CVM 2007) through the content analysis. Board size, proportion of independent directors, the presence of a compensation committee, CEO-chairman duality, big 4 audit firm, concentration of voting power (the proportion of controlling shareholders’ voting power in relation to the proportion of cash flow rights), and a dummy variable signifying family controlled companies were taken as variables representing the governance structure of a company. Company size, financial leverage, company profitability, and listing on Bovespa’s premium segment were taken as control variables. Results of multiple linear regression revealed that voluntary ESO disclosure index was positively associated with board size, the presence of a compensation committee, and big 4 audit firms. However, proportion of independent directors, CEO-chairman duality, concentration of voting power, and a dummy variable signifying family controlled companies were found to be insignificant in determining voluntary ESO disclosure.

Malak (2015) investigated a sample of 200 Malaysian companies from 2000 to 2008 to identify the determinants of the disclosure of individual executive director’s remuneration. Family ownership, government ownership, foreign ownership, executive director ownership, debt, the proportion of independent directors on the board, audit quality, company size, performance and the growth of the company were examined as various factors affecting the remuneration disclosure. Logit regression was employed and the study found that family ownership significantly restricted the probability of the remuneration disclosure. Level of government ownership, executive director ownership, board independence, audit quality, and total assets were found to have a positive and significant impact on the probability of the disclosure of individual executive director’s remuneration. Foreign ownership, debt to equity ratio, return on equity, and market to book ratio were not found to play a significant role in explaining the remuneration disclosure.
2.3 Growth of Managerial Remuneration

Sarkar and Sen (1999) have found increase in the remuneration at the higher levels of organisations in post-liberalisation period in India. Barontini et al. (2013) examined the total compensation levels between 2007 and 2010 and found that board compensation levels decreased in most European countries. CEO compensation witnessed larger fall than other board members. The results of multivariate regression suggest that after controlling for total assets, tobin’s q, and ownership concentration, CEO pay was found to change in 2010 only in financial firms. Jaafar and James (2014) investigated the trends of executive pay from 2007 to 2009 in a sample of 486 listed companies in Bursa Malaysia and found that there has been a trend of increasing remuneration during and after the financial crisis. However, director remuneration was found to decrease in family firms after the financial crisis. Vemala et al. (2014) examined the effect of financial crisis on CEO compensation in a sample of Fortune 500 firms from 2004-2012 and reported that that CEO compensation was higher during the crisis times and there was a significant increase in the long-term compensation in the post-crisis period.

2.4 Determinants of Managerial Remuneration

It has been a debate on what basis directors are being remunerated. The literature dealing with the determination of managerial remuneration highlights a long list of factors, such as corporate performance, governance structure, ownership structure, etc. Based on this objective, the empirical studies conducted across the globe have been reviewed.

Main et al. (1996) examined the impact of company’s previous period stock market performance, same period overall sector stock market performance, and the rate of change in company turnover on the rate of change in executive emoluments (base pay plus bonus) and total remuneration (sum of the emoluments and any change in value as per Black and Scholes’ cash-equivalent’ value of option holdings) of entire board of directors in a sample of 60 British companies for the period 1983 to 1989. Generalised Method of Moments (GMM) is employed and the results indicated that executive emoluments and total remuneration were related to company turnover and company’s stock market performance. No significant influence of sector performance was found on executive emoluments as well as total remuneration.
Kraft and Niederprum (1999) employed a sample of 170 firms of Germany for the period 1987-1996 to assess the impact of profitability, firm size, and ownership concentration on the total compensation of executive board members. Return on Equity (ROE) was used to represent profitability and firm size was represented by natural log of sales. Using Generalised Method of moments (GMM), the study revealed a positive and significant impact of profitability and firm size on management compensation. It was also concluded that larger profit variance reduced the profit sensitivity of remuneration and less remuneration and smaller pay-performance sensitivity were there when firms were dominated by a large shareholder.

Dogan and Smyth (2002) investigated the relationship of firm performance, sector performance, ownership concentration, and firm size with the board remuneration in a sample of companies listed on Kuala Lumpur Stock Exchange (KLSE) in Malaysia over the period 1989-2000. Firm performance was represented by stockholder wealth and return on assets. Sector performance was represented by stockholder wealth and return on assets averaged over firms in each sector. Sales turnover was used to represent firm size and ownership concentration was measured through the percentage of shares owned by the largest stockholder. Using the Dynamic Panel Data (DPD) package, the study found that the relationship of board remuneration with stock market performance and firm size measures were positive, whereas accounting performance measure and ownership concentration were negatively related with the board remuneration. No significant impact of sector performance was found on board remuneration. The study also revealed that the Asian financial crisis affected the board remuneration negatively.

Cladera and Gispert (2003) used a sample of large 113 Spanish companies for the period 1990 to 1995 to measure the impact of company performance, industry performance, company size, ownership concentration and firm leverage on board remuneration. Company performance was represented through return on assets and shareholder return. Industry ROA and average industry shareholder return were used to represent industry performance. Company size was measured through the sales turnover and ownership concentration was measured by the percentage of direct and indirect shares owned by the largest shareholder. Firm leverage was measured by the debt to assets ratio. The study presented a positive relationship between company performance and board remuneration,
where the relationship of board remuneration with accounting measures was roughly 10 times stronger than the market performance measures. Negative relationship between board remuneration and industry performance was found. Firm size was found to be positively related with board remuneration. Remuneration-performance relationship was found to be negatively related with ownership concentration, whereas firm leverage played no significant role in determining board remuneration policies.

Fatemi et al. (2003) studied the top managers’ (chairmen, CEOs, presidents and senior level vice-presidents) compensation for a sample of 1965 observations in US for the period 1992 to 1995. Using cross-sectional regression analysis, the study found that executive compensation was positively related to return on assets (ROA), market value added (MVA) and firm risk. The study also concluded that EVA and MVA was a better predictor of cross-sectional variation in executive compensation. Pay for performance relationship was found to be unaffected by the extent of the firm’s global activities.

Ryan and Wiggins (2004) considered a sample of 1018 US firms for the period 1995 to 1997 to examine the impact of four characteristics of board independence, i.e. board size, board composition, CEO entrenchment, and CEO/chair duality on the total compensation of outside directors. Ordinary least squares regression has been employed and it was revealed that when boards lack independence, directors received less total compensation and less likely to receive equity-based incentives. It implied that compensation structure provided weaker incentives to monitor, when the CEO has power over the board. Higher compensation was paid to directors in case of larger firms, firms with more investment opportunities, and family controlled firms.

Cheng and Firth (2005) examined the impact of directors’ shareholding, institutional shareholding, the proportion of non-executive directors, company size, and performance on the average executive directors’ compensation for a sample of 2016 firm-year observations of Hong Kong from 1994 to 1999. Company performance has been represented through return on equity and stock return. Panel regression was employed and study indicated that company size, return on equity, leverage and the proportion of non-executive directors were positively related to average executive directors’ remuneration. Institutional share ownership had a negative impact on the compensation
of executive directors. The study also concluded that institutional shareholders and non-executive directors did not appear to enhance pay for performance schemes for top management.

Abdullah (2006) examined a sample of 162 firms in Malaysia for the year 2001 to study the relationship between company performance and various governance measures and total directors’ remuneration. Firm performance, represented through ROA, CEO duality, extent of shareholding by executive directors and outside blockholders were found to be insignificant in explaining directors’ remuneration. Whereas, one year lagged ROA was negatively related with directors’ remuneration. Firm’s internal growth, represented by total assets, was positively related with directors’ remuneration. The extent of board independence and shareholding by outside directors were found to be related with lower directors’ remuneration.

Brick et al. (2006) examined the impact of firm characteristics, CEO characteristics, and governance characteristics on cash compensation (annual and meeting fees) and total compensation (base cash compensation and the value of stock and options granted) of outside directors for a sample of 1441 firms of US for the period 1992 to 2001. The results of the fixed effects regression revealed that directors’ cash compensation was positively related to firm size, number of board meetings, CEO experience, and in case the CEO joined the company more than a year before he or she became CEO, and negatively related to the percentage of equity owned by CEO, stock volatility, holding period stock return for the past three years, and when the CEO was also the chair of the board. Directors’ total compensation was found to be positively related to average return on assets, average holding period stock return, firm size, if the CEO was a female, if the CEO was also the chair of the board, and number of board meetings, and negatively related to cash flow risk, represented through the standard deviation of first differences in ROA for the prior 8 years. The study also found a significant and positive relationship between CEO and director compensation.

performance, represented through ROA, was found to be positively related with total board compensation, whereas current and previous year adjusted tobin’s q had no significant effect on total board compensation. Firms associated with business groups paid less board compensation. The increase in the stock return volatility, measured through the standard deviation of the stock return of the last month of financial year, and increase in non-executive directors on board decreased board compensation. When the CEO was also the chair of the board, CEO was the relative of the founder of the firm, when the firm had more than one CEO, and increase in board size were found to increase the board compensation. Promoters’ shareholding and corporate diversification index were found to have a positive impact on board compensation. With the increase in shareholding of government and private corporate bodies, board compensation was found to decrease.

Feng et al. (2007) examined the relationship of board and CEO characteristics, and financial variables with director compensation for a sample of 136 Real Estate Investment Trusts (REITs) of US for the year 2001. Total director compensation was represented by the sum of total cash compensation and total equity-based compensation. Company size and company leverage were taken as control variables. The study found that total compensation was positively related with company size and market to book ratio, whereas it was negatively related with board size. Presence of outside directors, CEO tenure, CEO duality, CEO ownership, and independent nomination committee had no significant impact on total director compensation.

Dong and Ozkan (2008) examined the impact of institutional investors on the executive directors’ pay and pay-performance relationship for a sample of 546 firms of UK over the period from 2000 to 2004. Cash compensation of all executive directors, including CEOs, was taken as the dependent variable, and tobin’s q was used to represent company performance. Ownership structure was represented by the percentage of equity ownership owned by executive directors. The study classified institutional investors into two categories, i.e. dedicated and transient institutional investors on the basis of their portfolio turnover. Institutional ownership was represented by four variables, i.e. the sum of financial institutional shareholdings greater than 3 percent, the sum of shareholdings greater than 3 percent held by dedicated institutions, the sum of shareholdings greater
than 3 percent held by transient institutions and the ratio of dedicated institutional ownership over total institutional ownership. Size, leverage, cash flow and dividend, measured through total cash dividend to total assets, were taken as the control variables. The study found no significant impact of institutional ownership in determining executive directors’ pay and in improving pay-performance relationship. However, dedicated institutional investors were found to restrain directors’ pay and made the pay-performance relationship stronger. Size, cash flow and dividend payout were found to positively influence the directors’ pay.

Duffhues and Kabir (2008) for a sample of Dutch listed companies for 1998-2001, investigated the relationship between executive directors’ compensation and firm performance. Firm performance was represented by return on assets, return on sales, annual stock return and tobin’s q. Firm size and leverage were used as control variables and found to be positively related with the cash compensation of executive directors. The study found that executive compensation was negatively related with current as well as lagged one year performance. Only, lagged one year stock return was found to be insignificant in explaining executive compensation. When total compensation of executive directors i.e. the sum of cash compensation and the value of stock options, was taken, then the study revealed that the total compensation of executive directors was found to be negatively related with current year and one year lagged tobin’s q.

Fernandes (2008) examined the impact of annual stock return, company size, risk, book to market ratio, board size, and the proportion of non-executive directors on the board on the compensation of all directors in a sample of 51 companies of Portugal for the period 2002 to 2004. The study indicated no significant impact of stock return on the compensation of executive directors and total board compensation. However, stock return was a positive and significant determinant of the variable component of executive compensation. Company size, book to market ratio, and board size were found to be insignificant in explaining total board compensation and executive directors’ compensation. Risk was negatively related with total board compensation and executive directors’ compensation. Executive directors’ compensation was higher when the board had a larger proportion of non-executive directors. The study also revealed that executive directors’ remuneration was linked to shareholders’ performance in the firms with no
non-executive members. Pay-performance relationship disappeared for firms with one or more non-executive directors.

Sapp (2008) examined a sample of 416 listed companies of Canada for the period 2000 to 2005 to investigate the relationship of internal and external governance related factors with the top five executives’ compensation. Company size was found to be positively related with the compensation of executives other than CEOs and such executives earned significantly more in financial services firms as compared to executives in other industries. The study used measures of multi class shares, income trust, cross listing status, and the controlling shareholder for representing the ownership structure of companies and found that high degree of control used by a single shareholder was found to significantly reduce the compensation levels, whereas cross listed companies paid higher compensation than non cross listed companies. The dummy variables for multiple classes of shares and income trusts were found to have insignificant coefficients. Among the directors’ characteristics, increasing number of family related directors led to a decrease in the compensation of executives. With an increase in the average tenure of directors and increase in the proportion of directors who sit on multiple boards, executive compensation was also found to increase. Other characteristics of the board of directors, the proportion of independent directors, the proportion of directors who were also CEOs, and the board members’ shareholding were found to be insignificant. Among the compensation committee characteristics, the proportion of independent members on the compensation committee was positively related with the executive compensation, whereas the proportion of members having financial expertise was found to be negatively related with the executive compensation. The proportion of committee members who were also CEOs was insignificant in influencing executive compensation. Among the CEO characteristics, executive compensation appeared to increase in case of CEO-Chairman duality and the use of comparables for determining the compensation, However, the use of an outside CEO and an increase in CEO tenure led to a decrease in the compensation of executives. CEO age and the proportion of CEO shareholding failed to exercise any significant impact on the remuneration of executives.

Su et al. (2010) examined the relationship between ownership concentration and executive compensation for a sample of 967 firms of China for the year 2005. Executive
compensation was measured by the average compensation composed of salary and bonus paid to top managers and ownership concentration was represented by the ownership ratio of the largest shareholder. Firm performance, firm size, age, CEO duality, CEO ownership, and board size were taken as the control variables. It was found that there was no significant relationship between ownership concentration and executive compensation in state-owned enterprises, whereas a u-shaped relationship existed in non-state owned enterprises. Firm performance, firm size, CEO ownership and board size were positively related to executive compensation in non-state owned enterprises.

Barontini and Bozzi (2011) examined a sample of 215 Italian firms listed on Milan stock exchange for the period 1995-2002 to know the impact of the ownership structure on total board compensation. The proportion of cash flow rights of the ultimate owner, the wedge between cash flow rights and voting rights of the ultimate owner, the proportion of ownership for the second largest shareholder, the presence of shareholders’ agreement, and dummy variables identifying the controlling shareholding of family, state and widely held companies were used to represent the governance structure of companies. Firm size, accounting and market performance, growth opportunities, firm risk, the presence of stock option plans and industry dummies were used as control variables. Firm size, lagged firm operating performance, investment opportunities, and the presence of stock option plan were found to be positively related with board compensation, whereas firm risk was negatively related with total board compensation. Ownership concentration, wedge between cash flow and voting rights were negatively related with total board compensation. The proportion of ownership for the second largest shareholder was found to be insignificant in explaining board compensation. Board compensation was found to be higher in the presence of shareholders’ agreement. Family-owned firms’ board compensation was found to be significantly higher as compared to widely held firms, whereas state-owned firms paid less.

Andreas et al. (2012) considered a sample of 928 firm-year observations of German companies from the period 2005 to 2008 to examine the impact of firm characteristics, corporate performance, ownership structure and board characteristics on the director compensation. Firm characteristics included size, leverage, free cash flow, investment opportunities, risk, and competition. Corporate performance was represented by total
shareholder return, dividend yield, return on assets, and return on invested capital. Ownership concentration, management ownership, external blockholder, institutional blockholder, board size, meetings, directorships, chairman independence, and professional directors were used to represent ownership and board characteristics. Director compensation was found to be negatively related with leverage, ownership concentration, and board size. Company size, free cash flow, dividend yield, return on assets, and board meetings were found to have positive relationship with the director compensation. Director compensation was also found to increase with an increase in the proportion of professional directors.

Jaafar et al. (2012) used a sample of 537 Malaysian firms for the period 2007 to 2009 to examine the impact of the remuneration committees on the directors’ cash remuneration. Firm size, firm age, debt, and industries were used as control variables. The study found that remuneration committees and firm size were positively related to directors’ remuneration. The remuneration committee was found to be negatively related with director remuneration in family firms.

Scholtz and Smit (2012) examined the relationship between executive directors’ cash remuneration and company performance for a sample of 58 companies of South Africa for the period 2003 to 2010. Company sales, earnings before interest, tax, depreciation, and amortisation (EBITDA), total assets and share prices were used as indicators of company performance. All indicators of company performance, except EBITDA, were found to be positively related with executive remuneration. The study also concluded that even during the period of financial crisis from 2008 to 2010, a positive and significant link of total assets and company sales were found with executive remuneration.

Cordeiro et al. (2013) studied a sample of 1378 firms of China for the period 2001 to 2007 to examine the impact of accounting and market based measures on the average compensation of top three highest paid executives. Industry adjusted return on assets (ROA) was used to represent the accounting performance of companies and market performance was represented by industry adjusted stock returns. Board size, supervisory board size, the proportion of ownership by the largest shareholder, a dummy variable equal to one in case the ultimate owner is a foreign company, ratio of the variance of
stock returns to variance of ROA, firm’s growth opportunities, average shareholding of top executive team, firm size, firm age, and industry were taken as control variables. The results of fixed-effects panel data regression revealed that average top executive compensation was positively and significantly related to accounting as well as market performance. However, the coefficients of accounting performance were found to be significantly higher than stock returns’ coefficients. Board size, supervisory board size, foreign company, firm size and firm age were found to be positively related with top executive compensation. The study also concluded that firms located in high marketisation regions and firms with better governance relied more on stock returns to compensate executives, whereas state owned enterprises relied less on stock returns.

Hearn (2013) considered a sample of 51 IPO firms of West Africa for the period 2000-2011 to investigate the impact of board governance measures on the directors’ remuneration. Two measures of directors’ remuneration were used, i.e. total remuneration and base level salary. It was found that the proportion of independent non-executive directors and opacity of director earning led to increase base salary as well as the total remuneration of directors. Gray committees (a dummy variable taking value one if dominant insider group or CEO was involved in remuneration committee and zero otherwise), board size, and proportion of non-executive directors were found to have no significant influence in determining the total remuneration of directors. The presence of gray committees was found to be negatively associated with directors’ base salary, whereas board size and proportion of non-executive directors had no significant influence in the determination of directors’ base salary.

Theeravanich (2013) examined the relationship of firm performance, director ownership, family ownership, CEO duality, independent directors, directors’ age, and board size with total director cash compensation for a sample of 363 firms of Thailand for the period 2002 to 2008. Company size and leverage were used as control variables. Firm performance was represented by tobin’s q and return on assets (ROA). The study found a positive and significant link of tobin’s q, family firms, CEO duality, average age of directors, board size, and firm size with director compensation, whereas ROA and independent directors were insignificantly related with director compensation. Leverage and directors’ ownership were found to be negatively related with director compensation.
The study also reported a positive pay-performance relationship in family firms than for non-family firms. The positive relationship of CEO duality and board size with director compensation existed only in non-family firms.

Wu (2013) used a sample of companies listed on Taiwan stock exchange for the period 2007-2010 to examine how company boards with family ties affected board compensation. Two measures were used to represent board compensation. First is the adjusted board compensation measured by the difference of the average board compensation and the average industrial board compensation. Second proxy of board compensation is a dummy variable taking value one if average board compensation exceeds the average industrial board compensation. The proportion of board members having family ties with board members and officers of the firm was used to measure the impact of family ties on the board. One year lagged firm performance, firm size, leverage, firm age, research and development intensity, institutional ownership, independent boards and CEO duality were taken as control variables. The results of ordinary least squares regression and logit regression revealed that the proportion of board members having family ties was positively related to the adjusted board compensation and excess board compensation in all family firms and for firms with non-family CEOs. One year lagged firm performance, firm size, research and development intensity, and institutional ownership were positively related with adjusted board compensation. CEO duality was found to be negatively related with the adjusted board compensation. In case of excess board compensation, firm size and firm performance had positive coefficients; CEO duality and independent boards were found to have negative relationship with excess board compensation.

Chen et al. (2014) examined the influence of family control on the variable compensation of top management team for a sample of 6387 firm-year observations of Taiwanese companies for the period 2005 to 2010. Variable compensation was the proportion of the sum of cash bonus, stock bonus and option to the total compensation of top management team. A dummy variable taking value one if 50 percent or more of the board members were also family members and zero otherwise, was used to define a firm as family-controlled. Firm size, leverage, lagged stock market return, lagged return on assets (ROA), and stock return volatility were taken as control variables. The results of the
ordinary least squares regression revealed that family controlled firms offered less variable compensation to the top management team as compared to non-family firms and this effect was found to be stronger in electronics industry over non-electronics industries. Firm size, lagged ROA and volatility were found to be positively related with variable compensation, whereas firm leverage was found to have a negative link with variable compensation of top management team. The study also concluded that family-controlled firms facing central agency problems paid higher proportion of cash bonuses to their top management teams than family controlled firms not facing central agency problems.

Baixauli-Soler and Sanchez-Marín (2015) examined the impact of majority shareholding on the variable pay of executives for a sample of 119 firms of Spain for the period 2004 to 2011. The average proportion of variable pay of CEO, director, manager and top management team was used to measure variable pay of executives. Two variables were used to measure the influence of ownership concentration. First was the presence of an external majority shareholder, measured by a dummy variable taking value one if the major shareholder is an external. Second is the link of the majority shareholder with subsidiary companies, measured through the percentage of indirect shares owned divided by the total ownership of the external majority shareholder. Proportion of independent outside directors on the board, board duality, proportion of independent outside directors on the compensation committee, ownership concentration, firm performance, and firm size were taken as the control variables. Generalised method of moments (GMM) approach was employed and the study reported that the presence of an external dominant shareholder increased the variable pay of executives, whereas the proportion of dominant shareholder ownership was found to be insignificant in explaining variable pay. The percentage of indirect shares held by external majority shareholder had a negative and significant influence on the variable pay of executives. Thus, the study concluded that only external majority shareholders not linked to subsidiary companies granted higher proportion of variable pay for executives.

Deschenes et al. (2015) investigated the impact of board characteristics on the remuneration of top management in a sample of 291 firm-year observations of Canadian companies from 2005 to 2010. The proportion of independent directors, board size, board
of directors’ total remuneration, ratio of equity-based remuneration to total remuneration of board of directors, tenure years of CEO, average number of tenure years of directors, and the proportion of shares outstanding held by directors were taken to represent board characteristics. Firm revenues, firm total assets, and return on assets were taken as control variables. Hierarchical regression was employed and the study showed that total remuneration of the board of directors and average number of tenure years of directors were found to have a positive and significant impact on the top management remuneration. Firm revenues and firm total assets were found to be positively related with the top management remuneration, whereas ROA, the proportion of independent directors, board size, ratio of equity-based remuneration to total remuneration of board directors, tenure years of CEO, and the proportion of shares outstanding held by directors had no significant impact on the top management remuneration.

### 2.5 Excess Managerial Remuneration and Future Corporate Performance

Agency theory states that shareholders try to motivate directors to attain the goal of wealth maximisation by linking the remuneration of directors with their performance (Bender, 2007). However, it is seen that remuneration to top executives is higher in companies with weak corporate governance mechanisms (Core et al., 1999; Basu et al., 2007). This gives rise to greater agency problems which adversely affects the company performance. This section analyses the impact of excess remuneration related to ownership and governance variables on the future corporate performance. Directors who are paid well, are generally supposed to be the rich contributors towards the success of the organisation. Thus, the performance of the organisation depends upon the managerial remuneration also (Carpenter and Sanders 2004; Kubo, 2005). The literature on the impact of the remuneration paid to the board members on performance is scanty in nature. Few studies have examined the causality of the managerial remuneration and corporate performance.

Yermack (1997) examined 620 stock option awards to CEOs of Fortune 500 companies between 1992 and 1994 and found that the timing of awards had significant association with favourable movement in company stock prices and concluded that this could be a case of cause and effect relation between incentive compensation and company market
performance. Another explanation offered was that managers who expected increase in company stock prices might have influenced their compensation committees to award them more stock options.

Core et al. (1999) calculated ‘predicted excess compensation’ related with board and ownership variables in excess of the standard economic determinants of CEO compensation and presented a negative relation with subsequent operating and stock performance of a company for a sample of 205 publicly traded US firms over a period of three years (1982 to 1984).

Hayes and Schaefer (2000) examined the impact of unexplained CEO compensation by the current firm performance on future firm performance for the period 1974 to 1995 and found that the unexplained variance in CEO compensation was significantly linked with the future firm performance. Further, It was stated that unexplained variance in current compensation was more closely linked with the future performance when the variances of both market and accounting returns increased, employee to sales ratios were higher, and when product development cycles were longer.

Fatemi et al. (2003) examined leading and lagged values of company performance to study whether compensation serves as a reward for past performance of directors or an incentive to enhance future performance in US for the years 1992 to 1995. The findings revealed that executives are not only rewarded for the efforts they made to create economic and market value of the firm but the compensation they receive also acts as an incentive for creating additional market value in future.

Hanlon et al. (2003) examined a sample of 2627 firm-year observations in US for the period 1998 to 2000 to know whether the Black-Scholes value of executive stock option grants was linked with future operating income. ESO grant values was decomposed into three components, i.e. ESO grant values attributable to economic determinants, ESO grant values attributable to governance characteristics, and a residual component. It was found that predicted component of executive stock option grant value attributable to economic determinants as well as governance factors was positively and significantly related with the future earnings. Positive operating income was found to be associated with residual executive stock option grants. Thus, the overall results found support for incentive alignment perspective.
Carpenter and Sanders (2004) examined the impact of the top management team (TMT) compensation on the subsequent company performance for a sample of 224 US multinationals companies. The compensation of the four highest paid members of the top management team excluding the CEO was taken as a measure of TMT compensation. The ratio of market to book value was used as a measure of subsequent firm performance (dependent variable) and TMT pay level, long term incentive pay structure, and CEO-TMT members pay gap, were taken as independent variables. Firm size, firm diversification, prior firm performance, CEO compensation, TMT size, effect of board vigilance, board outsiders, R&D intensity and the industry were used as control variables. The findings revealed that subsequent company performance was more greatly enhanced by high TMT member compensation and TMT pay structure. CEO-TMT members pay gap was found to have a negative effect on subsequent market performance.

Kubo (2005) examined the impact of pay-performance sensitivity on company performance for a sample of 210 listed Japanese companies from 1993 to 1995. Profit and return on capital were used as measure of company performance. Sensitivity was calculated by dividing the percent changes in directors’ pay with the percent change in company’s performance. The results indicated a negative relationship between pay-performance sensitivity and company performance and it was concluded that firms with highly sensitive pay packages were less likely to improve performance.

Brick et al. (2006) examined the relationship between firm performance and CEOs and directors’ compensation in a sample of 1441 US firms for the period 1992 to 2001. Firm performance is represented through excess holding period returns from the end of year t to the end of year t+1 derived either from a one factor market model, or a three-factor Fama-French model. It was submitted that if CEOs and directors were paid more than suggested by firm, CEO and other governance characteristics, this negatively affected the firm’s future excess equity returns. It implies that over payment to CEOs and directors was not due to more firm complexity, rather it was a symbol of firm’s agency problems.

The predicted excess pay related to ownership and monitoring mechanism was found negatively related to future accounting performance only and not significantly associated with future stock return performance.

Barontini and Bozzi (2011) examined the impact of board excess compensation on the firm’s future performance for a sample of the companies listed on the Milan Stock Exchange in Italy from 1995 to 2002. The yearly market stock return and ROA were used as measures of company performance. No significant impact of the excess compensation on future firm performance was observed and stated that it might be the premium for the hidden characteristics of the board. For the family firms, the presence of the founder was found related with higher levels of board compensation and higher compensation was found to negatively affect subsequent firm performance. It concluded that an inefficient compensation policy was implemented when the founder was on the board.

Bebchuk et al. (2011) examined CEO pay slice (CPS) and performance for a sample of US public firms for the period 1993 to 2004. CPS was defined as the fraction of top five executives’ compensation captured by the CEO. It was found that higher CPS was associated with lower tobin’s q, lower accounting profitability, and less favourable stock market reactions to acquisition announcements.

Kwak and Lee (2012) examined the impact of the performance based and power based compensation of the top managers on the organisational performance during 1998-2003 in companies listed on the Korea stock exchange. Performance based compensation includes; salary, bonus, extra perks, and stock options. Power based compensation includes; retirement benefits, welfare support, training support, vehicle support, and an external budget for out-of-firm businesses. Sales revenue was used as a measure of organisational performance and the value of total assets was used to represent firm size. Two dummy variables representing the two-digit Standard Industrial Classification (SIC) codes and number of years, were used. No link between performance based compensation and organisational performance was established. Power based compensation was found likely to exert positive effects on the organisational performance.

Banker et al. (2012) investigated the impact of current compensation of CEOs on future firm performance for a sample of 2,498 firms in US from 1993 to 2006. Feasible
Generalised Least Squares (FGLS) estimation was used and found that current salary of a CEO was positively and significantly associated with future ROE. However, current bonus of a CEO was not found related with future ROE.

Balafas and Florackis (2014) investigated how CEO pay affected the future shareholder return and future operating performance of a company for a sample of 1787 companies listed on the London stock exchange from 1998 to 2010. Return on Assets (ROA) and Return on Capital Employed (ROCE) were taken as two proxies of operating performance of the company. Excess incentive pay of a CEO was found negatively associated with future shareholder return and future operating performance of a company.

Aggarwal and Ghosh (2015) explored the impact of directors’ remuneration on the intrinsic and extrinsic value of 34 Indian companies. Earning per share (EPS) and profit after tax (PAT) were taken as the indicators of intrinsic value of the company and extrinsic value was represented through the stock return and tobin’s q. The study found that an increase in the remuneration of directors had a positive impact on the intrinsic value of the company. However, directors’ remuneration had no significant impact on the extrinsic value of the company.

The review of literature reported in this chapter reveals that the studies carried out about disclosure of managerial remuneration are limited. Most of the studies available have considered the disclosure of stock option grants and factors affecting the disclosure of information regarding the stock option grants. It indicated the need to examine how companies disclose the detailed information about managerial remuneration in their governance reports and also need to know the factors affecting disclosure of this information. This chapter also helped to identify various factors which affect the determination of managerial remuneration across the companies and countries and a set of factors has been examined for their impact on determination of managerial remuneration among Indian companies. A less researched concept of ‘predicted excess remuneration’ related with board and ownership structure variables emerged during the process of review and the same is being examined in the present study.