

# *Fair Results and Fair Rules—Based on the Influence of CEO's Military Experience on Salary Distribution*

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**Keywords:** Military experience; Pay gap; Pay Stickiness gap

**Abstract:** Taking Chinese A-share listed companies from 2007 to 2017 as samples, this paper empirically tested the influence of CEO's military experience on pay gap and pay stickiness gap respectively. The study found that the military experience of CEOs was significantly negatively correlated. The study found that the military experience of CEOs was significantly negatively correlated with the pay gap and the pay stickiness gap, indicating that the military experience of CEOs could narrow the pay gap and reduce the pay stickiness gap. The conclusion remained unchanged after the use of propensity score matching. The implication of this paper is that the psychological quality, sense of social responsibility, ethical awareness, and values of managers with military experience are different from those of managers without military experience. They can play a role in suppressing the pay gap and the pay stickiness gap by virtue of their unique advantages. Managers with military background are conducive to better internal corporate governance mechanisms.

## 1. Introduction

Reasonable salary distribution is an important manifestation of social fairness. Since the reform and opening up, China has emphasized efficiency-first distribution policies, which has effectively promoted rapid economic growth and injected strong impetus into China's social development. With the in-depth reform of the economic system, while production efficiency has been improved, the social phenomenon of unfair salary distribution has become more and more serious, becoming an important factor hindering China's economic development.

Experiencing military life will have a huge impact on soldiers' values, ways of thinking and behavioral habits. For CEOs with military experience, military life is a unique experience for managers and a valuable stage in their life development. The tough training environment sharpens the will of the soldiers, and the strict discipline of the army cultivates the habits of strict prudence and the quality of fairness and justice. Franke (2001) [1] found that military school students showed stronger patriotism and collective consciousness than non-military students. There is no doubt that a CEO's military experience will have a profound impact on the company's management decisions. In the context of the widespread phenomenon of unfair salary distribution in listed companies in China, can CEO's military experience have an impact on the fairness of salary distribution?

## 2. Literature Review and Research Hypotheses

### 2.1 Literature review

Some scholars explore the impact of managers' military experience on their decision-making from the perspective of risk preference, but the research conclusions are controversial. On the one hand, some scholars have found that managers with military experience are more aggressive in corporate decision-making. Malmendier et al. (2011) [2] believe that managers with military experience prefer high-risk choices in corporate financial decision-making. But on the other hand, some scholars have found that managers with military experience are more conservative in company decision-making.

In addition, there are also literatures that study the impact of military executives on corporate governance from the perspective of soldiers having integrity, self-discipline, fairness, and impartiality. Benmelech et al. (2015) [3] concluded that companies managed by military executives have fewer violations, which reflects that managers with military experience value collective honor and have higher moral principles. In terms of charitable donations, Luo et al. (2017) [4] believe that corporate charitable donations are a strategic behavior for company development and are not truly ethical behaviors. They are represented by the amount of corporate charitable donations governed by executives with military experience. Lower, indicating that managers with military experience have the character of fairness and justice and do not hope to achieve the purpose of the company's development strategy through donations.

### 2.2 Theoretical analysis and research hypotheses

#### 2.2.1 CEO military experience and the pay gap

On the one hand, the fine traditions of the army have fostered a high moral standard and the principle of collective interest in soldiers. In the army, soldiers are educated with the ideology of fairness and justice, and collective interests are greater than individual interests, which is deeply imprinted in their hearts. When the military personnel join the business world after discharge, they are likely to inject these ideas into corporate governance. Oi (1962)[5] points out that in a completely frictionless labor market, labor can move freely among different firms, and the wage of labor should be equal to the marginal output of one unit of labor. However, in reality, in real capital markets, the supply of labor tends to be larger than the demand for labor, which results in the bargaining power of the labor side of the labor market being weaker than that of the capital side as well. In order to reduce the cost of labor, the company will suppress the salary of employees. In contrast, according to equity theory, CEOs with military experience will pay more attention to maximizing company value rather than maximizing personal interests, and in order to enhance the company's sense of collective honor, maintain the sense of fairness of ordinary employees, and improve the work motivation of ordinary employees. So that the company can create greater value. They are more likely to formulate a scientific employee compensation plan, maintain the relative fairness of the compensation system, and reasonably narrow the pay gap.

On the other hand, the fine tradition of the army also fosters a high sense of responsibility and the value of loyalty in military personnel. Responsibility is the basic requirement of military schools for their cadets, and the army instills the education of responsibility ideology in military personnel and cultivates their behavioral habit of faithfully fulfilling their responsibilities. According to the analysis of tournament theory, when the principal supervises the agent with difficulty or high cost, the agent may behave lazily, and giving the agent pay incentives can reduce the opportunistic behavior, improve the work motivation, and alleviate the principal-agent problem. In order to

reduce the agency cost, companies will tend to implement pay incentives to agents to promote the alignment of the interests of the principal and the agent. Even excessive pay incentives are given to executives, which prompts executives to put more effort into their work and bring good economic consequences, which in turn improves the company's performance. This makes the inequality of pay distribution between executives and ordinary employees of the company gradually expand. CEOs with military experience are more responsible and loyal to shareholders with high standards of professional conduct than other CEOs. This helps to reduce agency costs and alleviate agency conflicts, thus inhibiting the widening of the pay gap.

In addition to this, military experience is conducive to forging ethical behavior and an aversion to wrongdoing in the military. Therefore, CEOs with military experience will tend to abide by the law. The promulgation of the Law of the People's Republic of China on Labor Contracts, the Guiding Opinions on Further Regulating the Remuneration Management of the Heads of Central Enterprises and other relevant documents protect the legitimate rights and interests of workers, control the excessive growth of executive compensation, strictly regulate the distribution of executive compensation, and standardize the order of income distribution. CEOs with military experience avoid actively violating laws and regulations and will strictly abide by them, thus reducing the pay gap.

Based on the above analysis, the following hypotheses are proposed in this paper:

H1: Other things being equal, CEO military experience has a significant negative effect on the pay gap.

### **2.2.2 CEO military experience and pay stickiness gap**

Equity in pay distribution rules is manifested in the pay stickiness gap between executives and rank-and-file employees. Paying stickiness refers to the fact that salaries are more sensitive to firm performance when firm performance rises than it is to firm performance when firm performance falls. The pay stickiness gap refers to the fact that rank-and-file employees receive less favorable treatment in pay distribution rules compared to executives. Rule fairness implies two meanings: on the one hand, everyone is equal before the rules without privileges and exceptions; on the other hand, the content of the rules is fair and equal. It is difficult to achieve equality for everyone between company executives and ordinary employees in front of the rules, and the rules of remuneration for ordinary employees are set by executives, who have greater rights in the system of remuneration rules, resulting in the bargaining power of ordinary employees being at a disadvantage. This inequality is tacitly recognized by the capital market and has become a normal phenomenon in company management. From the point of view of the fairness of the content of the rules, according to the theory of equity, the amount of personal income should be consistent with the size of the contribution made. Under normal circumstances, executives exercise the functions of planning, organizing, coordinating, leading and controlling the company, and the contribution of executives to the good performance of the company is greater than that of ordinary employees. Therefore, when the company's performance rises, it is reasonable that the executive's compensation rises more than that of ordinary employees. However, when the company's performance declines, the executives' remuneration does not decline or even rises, but the responsibility that the executives should bear should not be smaller than that of ordinary employees. Therefore, it is unfair that the stickiness of executives' pay is much greater than that of ordinary employees.

From the point of view of fair rewards and punishments and strict discipline in the army, the basis for the army's rewards and punishments for soldiers is extraordinarily rigorous and fair. To date, the Disciplinary Regulations of the Chinese People's Liberation Army (for Trial Implementation) have been revised seventeen times, with stricter and more detailed explanations of rewards and punishments to ensure that rewards and punishments are clearly defined. Through

ideological education, the military is able to cultivate and modify the habits of individuals, thus exerting a continuous and profound influence on their later behavioral choices and decision-making preferences, and demonstrating self-restraint and responsibility. Early military experience will affect the individual's moral cognition, and later become the CEO of the company's military personnel, military life experience "brand" influence will permeate the company's management. From the CEO's point of view, a decrease in salary is not only a decrease in direct income, but also a decrease in personal status and social influence. Therefore, CEOs have a strong incentive to refuse to accept the penalty of pay cuts. In contrast, CEOs with military experience will be brave enough to take responsibility when facing a decline in company performance, without deliberately defending their pay, and even take the initiative to ask for a just punishment. Thus, CEO military experience reduces the pay stickiness gap.

Based on the above analysis, the following hypotheses are proposed in this paper:

H2: All else being equal, CEO military experience has a significant negative effect on the pay stickiness gap.

### 3. Research design

#### 3.1 Sample selection and data sources

In this paper, A-share listed companies in Shanghai and Shenzhen are selected as samples from 2007 to 2017. The data come from CSMAR database and CCER database.

#### 3.2 Definition of variables and model selection

The variable codes and variable definitions are shown in Table 1.

Table 1: Definition of variables

Variable Code	Variable name	Variable Definition
PG1	pay gap	Average executive compensation - logarithm of average employee compensation
SPG1	Pay stickiness gap	Executive pay stickiness - take the logarithm of the absolute value of employee pay stickiness plus 1
CEOARMY	General Manager's military experience	1 for military experience, 0 otherwise.
Size	Enterprise size	Natural logarithm of total assets of the enterprise at the end of the year
Lev	financial leverage	Gearing ratio of the enterprise for the year
Growth	Corporate Growth	Business revenue growth rate
Indir	Proportion of independent directors	Percentage of independent directors on the board of directors
Board	Board size	Natural logarithm of the number of board members
Isdual	double-hatting	1 if the chairman of the board of directors is also the general manager, otherwise 0
TOP	shareholding concentration	Shareholding of the largest shareholder
Magsh	Executive Shareholding Ratio	Executive Shareholding Ratio
ROA	profitability	Return on total assets of the enterprise for the year
Year	year	Annual dummy variables
Ind	sector	Industry dummy variables (keep the first two codes for manufacturing and the first code for other industries)

#### 3.3 Modeling

To test the effect of executives' military experience on pay stickiness, we constructed the following regression model:

$$PG1 = \beta_0 + \beta_1 CEOARMY + \beta_2 Size + \beta_3 Lev + \beta_4 Growth + \beta_5 Indir + \beta_6 Board + \beta_7 Isdual + \beta_8 TOP + \beta_9 ROA + \beta_{10} TOP + \beta_{110} Ind + \beta_{12} Year + \varepsilon \quad (1)$$

$$SPG1 = \beta_0 + \beta_1 \text{ CEOARMY} + \beta_2 \text{ Size} + \beta_3 \text{ Lev} + \beta_4 \text{ Growth} + \beta_5 \text{ Indir} + \beta_6 \text{ Board} + \beta_7 \text{ Isdual} + \beta_8 \text{ TOP} + \beta_9 \text{ ROA} + \beta_{10} \text{ TOP} + \beta_{11} \text{ Ind} + \beta_{12} \text{ Year} + \varepsilon \quad (2)$$

## 4. Empirical analysis

### 4.1 Descriptive statistics

Table 2 reports the descriptive statistics results of the relevant variables. From the table, it can be seen that the standard deviation of pay gap is large, respectively 0.862 and 6.59, indicating that there are some differences in the pay gap of listed companies in China. The mean value of CEO's military experience is 0.006, which indicates that the CEO's military experience of listed companies in China is not a common phenomenon. In terms of corporate governance, 24.6% of the samples have the situation that the chairman and general manager hold two positions at the same time, and the proportion of independent directors is 36.9%, which meets the requirement of the Securities and Futures Commission that independent directors should account for at least one-third of the board of directors of listed companies. The dispersion of other variables is also relatively stable, as shown in Table 2.

Table 2: Descriptive statistics

Variant	Observed value	Average value	Standard deviation	Minimum value	Upper quartile	Maximum values
PG1	12061	12.81	0.862	10.37	12.83	14.95
SPG1	12061	0.949	0.859	0.0100	0.702	4.220
CEOARMY	12061	0.006	0.0750	0	0	1
Isdual	12061	0.246	0.431	0	0	1
Magsh	12061	0.0620	0.131	0	0	0.600
Growth	12061	0.162	0.516	-0.970	0.119	3.043
TOP	12061	0.355	0.152	0.0430	0.339	0.758
Lev	12061	0.417	0.203	0.0410	0.416	0.848
ROA	12061	0.0500	0.0380	0.00200	0.0420	0.198
Size	12061	22.03	1.243	19.81	21.85	25.82
Indir	12061	0.369	0.0510	0.300	0.333	0.571
Board	12061	2.159	0.199	1.609	2.197	2.708

### 4.2 Correlation analysis

This paper analyzed the correlation coefficients of the main variables, and the results are shown in Table 3.

Table 3: Correlation analysis

	PG1	SPG1	CEOARMY	Isdual	Magsh	Growth	SOE	TOP	Lev	ROA	Size	Indir	Board
PG1	1												
SPG1	0.024***	1											
CEOARMY	-0.022**	-0.021**	1										
Isdual	0.018**	-0.026***	0.029***	1									
Magsh	-0.050***	-0.024***	0.017*	0.476***	1								
Growth	0.051***	0.00700	0.0100	-0.034***	-0.074***	1							
TOP	-0.061***	-0.025***	-0.015*	-0.079***	-0.075***	-0.00800	-0.216***	1					
Lev	0.113***	-0.036***	-0.00200	-0.167***	-0.315***	0.175***	-0.306***	0.086***	1				
ROA	0.122***	0.042***	0.0100	0.040***	0.111***	0.064***	0.131***	0.055***	-0.365***	1			
Size	0.433***	0.0120	-0.039***	-0.177***	-0.280***	0.136***	-0.331***	0.178***	0.524***	-0.108***	1		
Indir	0.00900	0.040***	0.00600	0.118***	0.087***	0.018**	0.083***	0.040***	-0.0130	-0.030***	0.019**	1	
Board	0.093***	-0.031***	-0.0100	-0.180***	-0.154***	-0.00700	-0.284***	0.026***	0.163***	-0.00500	0.258***	-0.457***	1

### 4.3 Regression analysis

Table 4 examines the effect of CEO military experience on pay gap and pay stickiness gap

respectively. Where CEO military experience (CEOARMY) in regression (1) gets a significantly negative regression coefficient at the 10% level and CEO military experience (CEOARMY) in regression (2) gets a significantly negative regression coefficient at the 1% level. This suggests that listed companies with CEO leadership from military experience attenuate the pay gap and listed companies with CEO leadership from military experience narrow the pay stickiness gap compared to other companies. Thereby H1 and H2 are validated.

Table 4: Effect of CEO's military experience on pay gap, pay stickiness gap

	PG1 (1)	SPG1 (2)
CEOARMY	-0.161*	-0.262***
	(-1.85)	(-4.51)
Indir	0.094	0.486**
	(0.66)	(2.83)
Board	0.201***	-0.161***
	(5.03)	(-3.23)
Lev	-0.097**	-0.244**
	(-2.03)	(-4.29)
ROA	4.600***	0.500**
	(20.97)	(2.17)
TOP	-0.576***	-0.215***
	(-12.95)	(-4.02)
Magsh	-0.100*	-0.132**
	(-1.84)	(-2.01)
Size	0.304***	0.042***
	(39.17)	(4.75)
Growth	-0.058***	0.016
	(-3.93)	(1.10)
Isdual	0.118***	-0.045**
	(6.92)	(-2.25)
Constant	5.351***	0.713***
	(30.14)	(3.23)
Year	control	control
Ind	control	control
N	12061	12061
R <sup>2</sup>	0.325	0.023

Note: t-values corrected for White's heteroscedasticity are in parentheses; \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% levels, respectively.

## 5. Conclusions and insights

This paper empirically examines the impact of CEOs' military experience on pay gap and pay stickiness gap for Chinese listed companies from 2007 to 2017. The findings show that (1) CEOs' military experience has a dampening effect on the pay gap, indicating that CEOs with military experience will pay more attention to the outcome fairness of the company's pay distribution. (2) CEO experience from the military has a weakening effect on the pay stickiness gap, suggesting that CEOs with military experience will pay more attention to the rule fairness of the company's pay distribution.

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