

# A Review of the Research on the Influence of Executive Compensation Contract on Enterprise Performance

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**Keywords:** executive compensation, corporate performance, monetary compensation, executive shareholding

**Abstract:** The salary incentives for company executives have always been the core issue in the field of corporate governance, but the research literature in this field is very complicated, and it is necessary to systematically sort out. This paper focuses on the basic theory of executive compensation and summarizes the related literature on the impact of executive compensation contract on corporate performance. The research direction of future executive compensation is prospected from the perspective of comprehensive agency issues, executive compensation structure and research methods. This paper not only helps to grasp the research status of executive compensation, but also looks forward to the future research direction. It also has practical significance for proposing theories and methods that help executive compensation incentives.

## 1. Introduction

The characteristics of the separation of the two powers in modern enterprises have produced agency problems. There is a contradiction between management and shareholders' interests. Therefore, designing effective executive compensation contracts has become the core problem to be solved in modern enterprise management. In recent years, along with the increasing daily salary of executives, many scholars have paid more and more attention to executive compensation, and more and more research on executive compensation has been made. Based on many previous scholars' research, this paper summarizes the relationship between executive compensation contract and corporate performance, to provide some reference for subsequent research.

## 2. Basic theory

Upper Echelons Theory holds that traditional research on managers focuses on the relationship between CEO and corporate strategy, while ignoring the role of the entire executive team in organizational strategy and decision-making. To a certain extent, the entire executive team shared and shared the tasks and powers assigned by the organization. Its basic view is that organizational behavior reflects top management, and organizational outcomes (strategic choices and performance) can be effectively predicted by the demographic characteristics of senior managers, and these quantitative statistical features can be used as an alternative. Variables come to executives' cognitive abilities and values. The core view of Upper Echelons Theory is that corporate executive characteristics play an important role in corporate performance.

The classical Principal-agent Theory believes that the conflict of interest between the principal and the agent can be coordinated through the supervision and incentive mechanism, thereby reducing the agency cost and making the principal and the agent's goal consistent. The key to solving the agency problem is to establish an effective constraint incentive mechanism. The constraint incentive mechanism here is of course including the contract, but also includes other mechanisms such as residual incentives. In his article, Zhang Yueping and Liu Jingmin summarized the method of entrusting agency theory in solving agency problems in the past nine years. They believed that there are two kinds of incentive methods: explicit incentive and implicit incentive. The method of

motivating the operator by assigning the remaining ownership between the principal and the agent in a certain proportion through the contract is called the explicit incentive method. This paper believes that the money income mentioned by Lu Jianxin should also be a kind of explicit incentive, and executive stock holding is a kind of implicit incentive.

Incentive theory emerged in the 1950s. The behavior of executives needs to be effectively motivated, and effective incentives cannot be separated from correct theoretical guidance. With the development of the times, the motivation theory is continuously enriched and improved. According to different levels of research, the motivation theory can be divided into two types: content-based incentive theory and process-based incentive theory. The content-based theory aims to identify specific factors that motivate employees to work hard. The theory focuses on the needs of people and how to meet the needs of the problem, also known as the need theory. It mainly includes Maslow's hierarchy of needs theory, Herzberg's two-factor theory (incentives - health theory), Alderf's ERG theory, and McClelland's acquired needs theory (three needs theory). Process-based motivation theory focuses on the generation of motivation and the psychological process from the generation of motivation to the adoption of specific behaviors. It mainly includes reinforcement theory, goal setting theory, expectation theory, and fairness theory.

### **3. Research on the Structure of Executive Compensation and Compensation Contract**

With the establishment of the modern enterprise system, ownership and management rights are gradually separated, and there is a principal-agent relationship. Due to the asymmetry of information, there is a potential conflict of interest between management and shareholders. To this end, an executive compensation contract is signed between shareholders and managers to mitigate this potential conflict of interest. The executive compensation contract clearly defines the executive's powers, obligations, and salary structure. It can effectively encourage and restrict executives to select and implement economic activities that increase shareholder wealth, thereby controlling the presence of executives. Moral hazard to achieve the goal of reducing agency costs. The executive compensation contract has therefore become an important contractual arrangement for controlling the principal-agent problem.

Executive compensation contracts typically represent a combination of incentives such as salary contracts, bonus plans, and equity incentives. If these specific incentives are regarded as sub-contracts included in the compensation contract, the relative costs of each sub-contract will change with the changes of the internal and external environment of the company, and the entire contract collection will reach equilibrium at different levels. Many studies have shown that different compensation structures are closely related to different performance outputs (Steve & Stephanie, 2004), and there are also interactions between compensation components. Therefore, companies need to rationally design the compensation contract structure to achieve the optimization of portfolio incentives. In the emerging and transitional economies of China, the above problems also exist. Many studies have shown that the executive compensation contract structure has a significant impact on enterprises, and plays an important role in executive risk and company performance. Therefore, the combination compensation contract has become the main content and realistic choice of the modern enterprise salary system. Usually, salary incentives include monetary compensation and equity incentives. Benmelch (2010) pointed out that monetary compensation and equity incentives can consider the characteristics of short-term and long-term, liquidity and deferral, and are the best compensation proposal arrangements. Therefore, in the structure of the compensation contract, we should comprehensively consider short-term and long-term incentives and establish a reasonable salary structure, which is also an important way to improve the incentive effect and improve the performance of the enterprise.

## **4. Research on the Influence of Executive Compensation Contract Structure on Enterprise Performance**

### **4.1 The impact of executive monetary compensation on corporate performance**

Effective executive compensation mechanism is of great significance for reducing transaction costs and improving corporate value. The issue of executive compensation is the core issue of corporate governance and has always been valued by the theoretical and practical circles. Monetary compensation is undoubtedly a large part of executive compensation. Many domestic and foreign literatures on executive compensation and performance are measured by monetary compensation. Relevant research results show that financial means such as bonuses and deferred payments can improve the company's performance. Yang Qing et al. (2010) confirmed that there is indeed a positive relationship between executive monetary compensation and company performance. Some scholars' research has reached the opposite conclusion. They believe that there is no positive correlation between executive monetary compensation and company performance, that is, irrelevant, negative correlation or presentation. Other relationships. China's scholar Gao Hui (2006) clearly stated in the article "Research on the relationship between CEO compensation and performance in the listing department" that the efforts of senior executives are not only motivated by the salary and bonuses, especially the risk preference. The executives of China's listed companies as a main way to motivate the CEO are the benefits of control. Duffhues and Kabir (2008) used the data of the Dutch company's 1998-2001 executive monetary compensation, empirically studied the correlation between monetary compensation and company performance, showing that there is no positive correlation between the two. relationship. Zuo Jingjing and Tang Yuejun (2010) and Core (1999) also have the same or similar conclusions. The company's performance and executive compensation incentives are not only positively linear, but also related to the relationship of left low and high right.

### **4.2 The impact of executive shareholding on corporate performance**

When most scholars study the relationship between equity incentive and corporate performance, they need to measure equity incentive, which will be measured according to the number of shares or the incentive strength. There are three theoretical hypotheses in the study of the relationship between the two. The interest convergence hypothesis holds that the increasing number of executives' holdings makes the executive's governance objectives and shareholders' interests gradually converge. The opposite management's self-defense hypothesis is that executives hold excessive shareholdings. Will weaken the shareholder's binding force on the executives, thereby increasing the motives and possibilities of the executives to deviate from the company's interests to maximize their own interests, and will constrain the executives from market competition by reducing the possibility of market mergers. The reduction of power is more likely to damage the company's interests; combining the above two theoretical hypotheses, the interval effect hypothesis is that when both above two occur simultaneously, the executive shareholding has a nonlinear relationship with the company's performance. The above three views subdivide the relationship into positive correlation, negative correlation and nonlinear correlation.

Jensen & Meckling (1976) first studied equity incentives and company performance. The increase in the number of shares held by managers strengthened the interests of managers and shareholders. The goal of interest tends to be consistent. The opportunistic motivation of managers is significant. Inhibition, which in turn increases the value of the company, and proposes a "consumption of interest convergence." Palia & Lichtenberg (1999) found that increasing the shareholding of executives during equity incentives can significantly reduce the short-sighted decision-making behaviors made by executives in the corporate governance process, thus effectively increasing the company's long-term value. Zhang Junrui et al. (2009) believe that when listed companies choose to motivate employees with equity incentives, the accounting performance indicators of listed companies will increase significantly in the year after implementation. Xu Juanjuan et al. (2016) empirical research found that equity incentives on the one hand encourage managers to work hard to improve company performance by exerting their incentive effects, and on the other hand, they will stimulate managers to implement earnings management to obtain equity returns to improve

performance. These scholars believe that there is a positive correlation between equity incentives and company performance.

The scholars who agree with Fama&Jensen's "dumping self-defense hypothesis" put forward different views on the relationship between the two through research. Liu Hao and Sun Wei (2009) believe that if the grantees, especially the executives, have a strong influence on the incentive price and have the power to re-price, the equity incentives will easily lose the ability to restrain the executives. Executives gain the tools to control their rights and interests, and the incentive system will not promote the company's performance growth. Sheng Mingquan et al. (2011) believe that the higher the incentive intensity for executives or core backbones, the more negative the company's performance will be for most sample companies. In general, these scholars believe that higher than a certain percentage of executives' holdings will increase their control over the company. Currently, executives have the ability to transfer their own interests through equity incentives and damage the company's collective interests, namely equity incentives. The grant ratio is negatively correlated with company performance.

Stulz (1988) combines the effect of interest convergence and encroachment, and uses a theoretical model to verify that there is an interval effect or curve relationship between executive stock holdings and firm performance due to the simultaneous existence of the two effects. Morck et al. (1988) found that there is an N-type relationship between managerial shareholding and firm performance. Hermalin & Weisbach (1991) conducted an empirical study of 134 companies listed on the NYSE, and found that the managerial shareholding has an M-curve relationship with Tobin's Q value. In addition, Mc Connell et al (1990) obtained a positive and negative relationship between the internal shareholding ratio and the Tobin's Q value. Domestic scholars Wang Hua et al. (2006) and Fan Hejun et al. (2013) have empirically proved that there is an inverted U-type relationship between equity incentives and corporate performance, and that different holding ranges have different relationships, and for synergistic effects and encroachment. The effect was verified.

## 5. Conclusion

For modern enterprises, an important cause of agency problem is the separation of ownership and management. How to effectively stimulate the operators has become the focus of the theoretical and practical circles, and has produced a series of theories. And empirical research. The research on the structure of executive compensation contract has achieved fruitful results. Most scholars believe that executive compensation has a certain degree of incentive for performance, but there are still some areas to be improved, and further exploration is needed in the future.

(1) Too much emphasis on the study of the single form of executive compensation structure. The compensation structure is to solve the problem of balance between various components. In the past, scholars mainly studied the relationship between individual components such as monetary compensation and executive stock holdings and corporate performance, but less studied the composition or proportion of these reward components. Balance can help improve the performance of enterprises and promote the long-term development of enterprises.

(2) Lack of research on the mechanism for determining the structure of executive compensation. The executive compensation contract structure has a significant correlation with corporate performance. This is the consensus of most scholars. However, the research on how to determine the compensation structure of the company's executives can help improve the performance of the company, but it is almost blank, leading to the company's executive compensation. The lack of effective theoretical guidance for the determination of structure, resulting in disorder and confusion of the salary structure, is an important issue that needs to be solved.

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