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CEO compensation, director compensation, and firm performance: Evidence of cronyism?

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Abstract

We model CEO and director compensation using firm characteristics, CEO characteristics, and governance variables. After controlling for monitoring proxies, we find a significant positive relationship between CEO and director compensation. We hypothesize that this relationship could be due to unobserved firm complexity (omitted variables), and/or to excess compensation of directors and managers. We also find evidence that excess compensation (both director and CEO) is associated with firm underperformance. We therefore conclude that the evidence is consistent with excessive compensation due to mutual back scratching or cronyism. The evidence suggests that excessive compensation has an effect on firm performance that is independent of the poor governance variables discussed by previous studies.



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JEL classification

G30; G34

Keywords

Director compensation; CEO compensation; Firm performance; Cronyism

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