The influence of family firms on the relationship between CEO compensation and a firm's performance

Master thesis research by Roy Franssen

In June 2017 Roy Franssen graduated from the Tilburg School of Economics and Management at Tilburg University. Roy followed the Master Strategic Management and wrote his master thesis about family firms and CEO Compensation. The following text is a summary of the MSc thesis.

In recent years, there has been upheaval regarding the compensation of the Chief Executive Officer (CEO). CEO compensation is seen as an important remedy for conflicting interests between the managers and owners. However, based on the extant academic literature, it is questionable whether higher CEO compensation would result in better firm performance. The debate on this topic is ongoing due to different outcomes. Therefore, it is relevant and necessary to gain new insights into these phenomena. Besides the amount, also the structure of CEO compensation can vary. This study examined the relationship between both non-equity and equity CEO compensation and firm performance. It was expected that more equity (stock options and long-term incentives plans) and non-equity (base salary and bonuses) would lead to a better firm performance. In addition, Roy tried to bring clarity to this debate by studying whether the relationship between the compensation components and firm performance would be different in a family firm context, compared to a non-family context. The interest of owner are more likely to be aligned in family firm, therefore altering impact of compensation on firm performance.

To properly answer the problem statement, data from the year 2015 are gathered from 343 large publicly listed firms, located in the United States. Firm performance was measured by the Return on Assets, which is derived from the Orbis database. The independent variables within this study are non-equity- and equity CEO compensation. Non-equity compensation consists of a base salary and bonuses and equity compensation contains stock (options) purchase programs, and long-term incentive plans. Both are retrieved from Execucomp. Based on the percentage of ownership, Roy labelled the firm as family or non-family firm.

The results support a positive relation between equity and non-equity CEO compensation and firm performance. Thus, the more compensation the CEO receives, the better the firm performs. This implies that in some instances, compensation might be a proper tool to incentivize CEOs. However, no differences were found between family and non-family firms. A possible explanation for these results, is the relative small amount of family firms in the sample. Nevertheless, a remarkable finding was the difference in average compensations between the two types of firms. The average non-equity compensation is higher for managers within family firms, whereas equity compensation is higher for managers in non-family firms. This points to fact that different types of firms might require tailored compensation packages and opens up an interesting area for future research.

If you are interested in the master thesis, you could contact the Tilburg Institute of Family Business via tifb@tilburguniversity.edu and request the pdf file.