

CEO COMPENSATION STRUCTURE AND FIRM PERFORMANCE

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CERTIFICATE OF AUTHORSHIP / ORIGINALITY

I certify that the work in this thesis has not previously been submitted for a degree, nor has it been submitted as part of requirements for a degree, except as fully acknowledged within the text.

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Anna Wright

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ABSTRACT

Many academic studies investigate CEO compensation practices [Murphy (1999)], and the subject is also widely discussed in the popular press. However, the academic literature to date has concentrated on settings where CEOs are typically offered equity-based compensation, and these equity awards are relatively similar in terms of characteristics. To date, CEO compensation practices have not been investigated in a setting where firms in similar industries concurrently use either cash only or cash and equity to compensate their CEOs, and where the characteristics of the equity grants also differ across firms. This thesis researches CEO compensation in such a setting.

The objective of this thesis is to provide evidence on the use and performance consequences of different CEO compensation structures. Specifically, the thesis first determines whether the use of the different compensation structures is linked to different firm characteristics. Second, the thesis examines the relation between firm performance and the use of the different compensation structures, and third, the thesis investigates the performance consequences of deviations from an estimated “efficient” compensation structure.

Using large Australian firms reporting in the 1999 to 2001 financial years, Chapter Two provides descriptive evidence on the variation observed in Australian CEO compensation structures, and finds that around one-third of large Australian firms offer their CEO only cash based compensation, while the remaining two-thirds use some level

of equity-based compensation. Chapter Three provides some explanation for the observed variation by demonstrating that firms using the different compensation structures have significantly different economic characteristics. Chapter Four examines the performance consequences of compensation structure choice. This Chapter first finds little evidence of systematic differences in firm performance across the two compensation structures. Then this Chapter models an “efficient” compensation structure based on firm characteristics, and tests the performance consequences of deviations from this efficient structure. Chapter Four finds some (although weak) evidence that firms using an inefficient structure have lower firm performance compared to firms using an efficient structure.

This thesis makes contributions to the literature in number of areas. First, the thesis shows that it could be efficient for firms with different economic characteristics to use different compensation structures. Second, the thesis finds that firm performance is not necessarily related to the use of one or other of the different compensation structures, but rather that lower firm performance is a consequence of incorrect compensation structure choice. Overall, this thesis provides important new insights into the use of different CEO compensation structures.