

The Impact of Executive Compensation on Corporate Performance: Evidence from Chinese Listed Firms

Mengyao Guo *

School of Henan University, Zhengzhou, China

* Corresponding Author Email: s8117938@live.vu.edu.au

Abstract. In the current market environment, enterprises are confronted with intense competition and rapidly changing market demands. Executive compensation plays a key role in influencing the development of enterprises. Therefore, studying the influence of executive compensation on enterprise performance holds important theoretical and practical significance. Using the data of Chinese listed firms from 2010 to 2024, this paper studies the relationship between corporate financial performance and different types of executive compensation. The research results show that executive compensation have a significant positive impact on the enterprise's profitability. The higher the executive incentive level, the higher the ROA of the enterprise. However, in terms of the long-term value of the enterprise, there exists a negative relation between equity-based compensation and Tobin's Q, whereas cash-based compensation exhibits a positive association. This paper speculates that the differences may be driven by the short-sighted behavior of executives. It provides valuable insights for companies when designing their compensation contracts.

Keywords: Executive compensation, equity compensation, corporate value, profitability.

1. Introduction

In the context of profound changes in the global economic landscape and the transformation of China's economy, one of the most significant challenges for improving core competitiveness is the invention of corporate governance processes. With the continuous deepening of market-oriented reforms, enterprises are confronted with increasingly complex operating environments and more intense market competition. The strategic decision-making capabilities and execution efficiency of senior management teams have an increasingly prominent impact on enterprise performance and digital adaptability more prominent [1]. The prevalent agency problem in modern corporate systems, namely the conflict of interests between the management and shareholders due to the separation of ownership and management rights, has become a significant bottleneck restricting the creation of enterprise value.

Human capital, particularly senior management skills, have grown in significance as strategic assets for businesses in the knowledge economy era. The senior management team undertakes the core functions of enterprise strategy formulation and resource allocation, and their decision-making behaviors directly determine the market competitiveness and sustainable development capabilities of the enterprise [2]. However, due to information asymmetry and incomplete contracts, senior managers may adopt opportunistic behaviors such as short-term performance manipulation, excessive risk aversion, or extravagant job consumption, which will seriously damage the long-term value of the enterprise [3].

To effectively alleviate the agency problem, modern corporate governance theory emphasizes the key role of incentive mechanisms. By designing scientific incentive-compatible mechanisms, it is possible to achieve the coordinated development of individual interests of senior managers and the enterprise's value. Existing studies find that appropriate compensation contract design, including fixed salary, performance bonuses, and long-term equity incentives, etc., can significantly influence the risk-taking level and strategic decision-making quality of senior managers, better coordinate the interests of shareholders and management, and enhance enterprise value [4].

Currently, China is in a critical stage of economic high-quality development. The innovation of corporate governance mechanisms is of great significance for enhancing total factor productivity.

Against this backdrop, in-depth research on the mechanism of the impact of senior management incentives on enterprise performance not only helps to enrich corporate governance theories but also provides scientific basis for the optimization of incentive mechanisms in practice. This study will systematically examine the heterogeneous effects of various types of executive compensation on enterprise performance, providing empirical evidence and policy implications for the construction of a modern enterprise governance system.

2. Hypothesis Development

2.1. The Impact of Equity-based Compensation on Corporate Financial Performance

The executive team, as the core entity of corporate strategic decision-making, is essential to in promoting the sustainable development of the enterprise. Equity-based compensation, as an important long-term incentive tool, effectively binds executives' interests with the long-term value growth of the company. It can effectively stimulate the strategic participation awareness and responsibility of executives and significantly enhance their organizational commitment. This mechanism prompts executives to regard the continuous development of the enterprise as their own responsibility, thereby effectively avoiding short-term opportunistic behavior and exerting more efforts to improve the long-term performance of the enterprise [5]. Prior papers have documented that the executive shareholding plan, by cultivating the 'owner's sense of responsibility', brings the interests of executives and shareholders into close alignment. On the one hand, it enhances the transparency and predictability of enterprise performance and strengthens investor confidence. On the other hand, it aids in luring outside funding and offers consistent encouragement for the enterprise's long-term growth [6]. Based on the existing literature, executive equity compensation promotes the improvement of corporate performance through the following channels. First, it stimulates the entrepreneurial spirit and responsibility awareness of executives. Second, it improves the transparency of enterprise governance and the quality of information disclosure. Third, it optimizes investor relationship management and reduces financing costs. Fourth, it effectively inhibits the short-sighted behavior of management. Thus, this study proposes the following research hypothesis:

Hypothesis 1: Equity-based compensation is positively related to corporate performance.

2.2. The Impact of Executive Cash-based Compensation on Corporate Financial Performance

Existing literature indicates that different forms of compensation incentives have differential impacts on enterprise performance. Cash Bonus can significantly enhance the work enthusiasm of senior executives, thereby positively promoting enterprise performance [7]. It is worth noting that there is a clear double-threshold effect in cash bonus, and their incentive effects are significantly constrained by the level of incentives [8]. In the process of resolving the principal-agent problem, enterprises need to carefully balance the complex relationship between the incentive level, agency costs, and moral hazard. On the one hand, an excessively low cash-based compensation is difficult to effectively mobilize the enthusiasm of senior executives; on the other hand, an excessively high cash-based compensation may induce short-term behavior, damaging the long-term value of the enterprise. In conclusion, this study proposes the following research hypothesis:

Hypothesis 2: Cash-based compensation is positively related to corporate performance.

3. Research Design

3.1. Data Sources and Sample Selection

In 2009, the Ministry of Human Resources and Social Security of the State issued the "Salary Cap Regulation" to regulate the income of senior executives. In 2024, the salaries of senior executives in the banking industry generally decreased due to the narrowing interest rate spreads and intense competition among the same industry. This paper obtains data from CSMAR database on A-share

listed companies from 2010 to 2024. ST companies are also excluded as their financial metrics tend to be outliers and they may engage in unusual activities to avoid delisting. Firms in financial industry are also excluded, as China has specific regulations on the compensation of senior executives in the financial industry. Then the paper excludes sample with missing variables and conducts tail trimming.

After processing, the final sample includes 37,633 observations in total. The source of the data is the CSMAR Database.

3.2. Variable Definitions

3.2.1. Dependent variable

The financial indicator Return on Assets (ROA) is a metric used to assess an organization's performance. It is computed as the net profit scaled by the total assets.

3.2.2. Independent variables

Overall, executive incentives include equity-based compensation and cash-based compensation. In this paper, the proportion of senior management's shareholding is used as the proxy for the equity-based compensation. The total compensation of the top three executives is taken as Cash-based Compensation.

3.2.3. Control variables

When constructing the regression model, in addition to considering the influence of key variables on the dependent variable, this paper also controls for other factors that may have an impact on the dependent variable. The specific definitions are shown in Table 1. Year and industry fixed effects are added to account for the time trends and unobservable industry-specific factors.

Table 1. Variable definitions

Type	Name	Symbol	Definition
Explained variable	Enterprise performance	ROA	Net profit/Total assets
Explanatory variable	Executive compensation	Econ Eq	The shareholding ratio of senior administrators
		Econ Sal	The top three executive salaries
Control variable	Enterprise size	Size	The natural logarithm of total assets
	Asset Turnover Ratio	ATO	Operating income/Total assets
	Shareholding concentration	Top10	The shareholding ratios of the top ten shareholders
	Board Size	Board	Number of directors
	Asset-liability ratio	Lev	Total liability/Total assets
	Degree of shareholder Checks and Balances	Balance	The shareholding ratios of second to fifth largest shareholders/The shareholding ratios of the largest shareholder
	The proportion of independent directors	Indep	Number of independent directors/Total number of directors
Dummy variable	Year	Year	Year dummy variable
	Industry	Ind	Industry dummy variable

4. Model Establishment

To test the two hypotheses section 2, this paper runs two regression models below.

$$ROA = \alpha_0 + \alpha_1 \text{Econ Eq} + \alpha_2 \text{Size} + \alpha_3 \text{ATO} + \alpha_4 \text{Lev} + \alpha_5 \text{Top10} + \alpha_6 \text{Board} + \alpha_7 \text{Balance} + \alpha_8 \text{Indep} + \alpha_9 \text{Size} + \alpha_{10} \text{Year} + \alpha_{11} \text{Industry} + \varepsilon \quad (1)$$

$$ROA = \alpha_0 + \alpha_1 \text{Econ Sal} + \alpha_2 \text{Size} + \alpha_3 \text{ATO} + \alpha_4 \text{Lev} + \alpha_5 \text{Top10} + \alpha_6 \text{Board} + \alpha_7 \text{Balance} + \alpha_8 \text{Indep} + \alpha_9 \text{Size} + \alpha_{10} \text{Year} + \alpha_{11} \text{Industry} + \varepsilon \quad (2)$$

5. Empirical Analysis

5.1. Descriptive Statistics

Table 2 reports the summary statistics of the variables. The standard deviation of asset return rate is 6.52%, with the minimum value being -26.18% and the maximum value being 19.75%, indicating large variations in profitability among different companies. The standard deviation of equity incentive is 20.98%, but the median is only 8.56%, suggesting that a few companies have a high intensity of equity-based compensation. The standard deviation of cash-based compensation is extremely large, indicating that different enterprises may have differences in management compensation due to differences in enterprise scale and compensation policies. The standard deviation of the proportion of independent directors is 5.26, and the standard deviation of the size of the board of directors is 1.56, suggesting that the equity structure of A-share listed companies is not similar.

Table 2. Descriptive Statistics

Variable	Mean	SD	P50	Min	Max	N
ROA	0.036	0.065	0.039	-0.261	0.197	37,633
Econ Eq	18.460	20.981	8.561	0.0001	70.380	37,633
Econ Sal	2861149	2460283	2160000	386900	1.54e+07	37,633
Indep	37.728	5.268	36.360	33.330	57.14	37,633
ATO	0.594	0.392	0.507	0.081	2.424	37,633
Board	8.333	1.561	9	5	13	37,633
Balance	0.826	0.626	0.669	0.042	2.854	37,633
Size	9.609	0.540	9.523	8.643	11.322	37,633
Lev	0.399	0.204	0.387	0.048	0.899	37,633
Top10	58.030	15.111	59.070	22.69	88.807	37,633

5.2. Correlation Analysis

Table 3 presents the correlations among the variables. It provides important information about the relationships between each variable and the enterprise performance. The results indicate that as these variables change, the enterprise performance also changes, but the direction may be positive or negative. Further examination of the correlation coefficients in the table reveals that the correlations between equity incentives and compensation incentives and the enterprise performance are all positive. The absolute values of the correlation coefficients in the table are all less than 0.8, indicating that the probability of collinearity among the regression variables is relatively small. It is considered that the selected variables are relatively independent and can provide a reliable foundation for model establishment.

Table 3. Correlation Analysis

ROA	1								
Econ Eq	0.167**	1							
Econ Sal	0.109**	-0.138**	1						
Indep	-0.0180**	0.0755**	0.00404	1					
ATO	0.147**	-0.0706**	0.101**	-0.0223**	1				
Board	0.0171**	-0.229**	0.0842**	-0.544**	0.0405**	1			
Balance	-0.0133*	0.178**	0.0705**	-0.0271**	-0.0639**	0.0194**	1		
Size	-0.00848	-0.407**	0.453**	-0.00227	0.0966**	0.261**	-0.104**	1	
Lev	-0.362**	-0.347**	0.0991**	-0.0148**	0.190**	0.160**	-0.110**	0.508**	1
Top10	0.276**	0.332**	0.0139**	0.0430**	0.0516**	-0.0493**	0.0261**	-0.0305**	-0.184**

* $p < 0.05$, ** $p < 0.01$

5.3. Regression Analysis

Table 4 reports the effects of executive compensation on enterprise performance, as measured by ROA. Column (1) reports the effects on equity-based compensation, and Column (2) reports the effects on cash-based compensation. According to Model 1 and 2, both cash-based and equity-based compensation have a significant positive correlation with enterprise performance, supporting Hypotheses 1 and 2.

Table 4. Effects of executive compensation on ROA

VARIABLES	(1) Model 1	(2) Model 2
Econ Eq	0.000264*** (3.50e-05)	--
Econ Sal	--	2.50e-09*** (6.25e-10)
Indep	-0.000148 (0.000105)	-0.000140 (0.000115)
ATO	0.0430*** (0.00625)	0.0407*** (0.00632)
Board	0.000251 (0.000526)	-0.000180 (0.000543)
Balance	-0.00324*** (0.000637)	-0.00304*** (0.000639)
Size	0.0328*** (0.00170)	0.0238*** (0.00226)
Lev	-0.158*** (0.00523)	-0.157*** (0.00559)
Top10	0.000619*** (5.89e-05)	0.000723*** (5.92e-05)
Constant	-0.275*** (0.0203)	-0.194*** (0.0199)
Observations	37,611	37,611
R-squared	0.312	0.313
Industry FE	Yes	Yes
Year FE	Yes	Yes

Robust standard errors in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

5.4. Robustness Test

To validate the findings, the paper performs a robustness test following Li et al. [9]. The variable measuring corporate performance, ROA, is replaced by Tobin's Q to measure the value of the company. The market value of the company is multiplied by the cost of replacing its assets to determine the Tobin's Q. Tobin's Q can reflect both the company's performance and its value. According to Table 5, in Model 4, the coefficient of Econ Sal is positive with a significance level of 1%. The positive correlation suggests that the conclusion obtained from Hypothesis 2 is relatively robust. However, in Model 1, the coefficient of Econ Eq is negative with a significance level of 1%. The negative correlation between equity-based compensation and corporate value contrasts the conclusion drawn from Hypothesis 1. Such differences may arise from the fact that ROA, as an accounting indicator, reflects the short-term efficiency of the firm; while Tobin's Q, as a market indicator, captures the long-term growth. Equity-based compensation may increase corporate performance in the short term by stimulating the enthusiasm of senior management. However, in the long run, according to Edmans et al. (2017), senior management may sacrifice long-term investment, such as R&D and brand building, to pursue a short-term increase in stock price, resulting in long-term damage to the company's value, and thus reflecting a negative correlation between corporate value and equity incentives [10].

Table 5. Effects of executive compensation on Tobin's Q

	(3)	(4)
VARIABLES	Model 3	Model 4
Econ Eq	-0.00826*** (0.000834)	--
Econ Sal	--	7.10e-08*** (7.51e-09)
Indep	0.00598* (0.00309)	0.00598* (0.00329)
ATO	0.193*** (0.0484)	0.151*** (0.0473)
Board	-0.00460 (0.00849)	0.00201 (0.00957)
Balance	0.0168 (0.0168)	-0.0351** (0.0177)
Size	-0.668*** (0.0436)	-0.751*** (0.0357)
Lev	-0.358*** (0.124)	-0.161 (0.121)
Top10	-0.00165** (0.000838)	-0.00527*** (0.00103)
Constant	8.484*** (0.421)	9.067*** (0.379)
Observations	37,611	37,611
R-squared	0.264	0.264
Industry FE	Yes	Yes
Year FE	Yes	Yes

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

6. Conclusion

This paper uses the sample of Chinese A-share listed companies from 2010 to 2024 to examine the effect of executive compensation on corporate performance and shows that the main methods of executive incentives are cash-based compensation and equity-based compensation. Among them, both types of compensation significantly improve the performance and short-term efficiency of the firm. However, Cash-based compensation exhibits a positive impact on the firm's long-term value, whereas equity-based compensation shows a negative relation. The reason for this might be the short-sighted behavior of executives during their tenure. This indicates that the salary structure of executives is mainly dominated by wages, bonuses, and other forms of compensation, and there are not significant differences among enterprises in this aspect. Further, when enterprises deal with the agency problem, they need to balance the incentive level with agency costs and moral hazards to ensure that the behavior of executives aligns with its long-term goals. The design of compensation contracts is of vital importance. An appropriate salary level and compensation structure can effectively stimulate the enthusiasm of executives, attract and retain outstanding talents, and promote the development of the enterprise.

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