Designing an effective CEO Compensation Plan

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Abstract: This study provides an overview of the factors involved in effective designing of CEO compensation plan. Executive compensation is a complex topic and has been extensively researched. The CEO compensation plan should not only be confined to monetary terms, but it needs to also involve conditions where top executives can be a part of charity or CSR wing of the organization. This study shall focus on the differences between monetary and non-monetary compensation. Qualitative study has been conducted in order to understand the views of top executives regarding involvement of former CEO in CSR activities of a company. The results obtained will be correlated with theoretical evidence to determine negative implications of just monetary compensation, and benefits of involving CEO skills within social responsibility activities.

1. Introduction

The CEO compensation plan is often regarded as a debatable topic. There are various parameters involved in designing a CEO compensation plan. A certain percentage of CEO’s compensation is offered in cash; however this percentage is strongly linked with fluctuating market conditions. The compensation plan designed for a CEO can be correlated with firm’s performance. It is witnessed that compensation of executives is positively influenced with increasing performance standard of a company [2]. The executive compensation plan comprises of various divisions such as basic pay, share percentage, fringe benefits, etc [7]. As per 2014 statistics, the average compensation offered to CEOs in some large-scale enterprises was approximately $16.3 million. However, effectiveness of such compensation plan can be evaluated through determining payback from CEO [9]. This study focuses on CEO compensation, even after job tenure, in terms of promoting CSR activities of an organization.

2. Research aim & objectives

The research aim revolves around effective designing of a compensation plan. This study will outline key components for increasing effectiveness of the CEO compensation plan. The research objectives can be categorized as:

- To evaluate the effectiveness of CEO compensation plan
- To determine parameters which can enhance effectiveness of the compensation plan
- To link the CEO compensation plan with overall firm’s performance
- To predict the importance of social work within the CEO compensation plan

The major research question for this study will be – “what factors lead to designing of an effective CEO compensation plan?” This question shall form the basis for selecting appropriate data collection tools.

3. Literature Review

As per Ellis (2013), since early 1980s, extensive research has been conducted on managerial compensation. This form of compensation is referred to as an incentive mechanism, which is being offered to the management by shareholders. The structure followed for managerial compensation enables to resolve any form of principal-agency problem. A firm’s performance is closely knitted with designing of managerial compensation plan. This form of relationship suggests that pay-for-performance is highly insignificant in case of both legal entity and government controlled firms [4]. According to Murphy (1998), those CEOs who are politically connected, within privatized firms, adversely affects first-day stock return. It is usually argued that board members constitute bureaucrat directors, with more politically-connected CEOs in comparison to directors possessing relevant professional backgrounds [12]. As stated by Bebchuk and Fried (2003), performance-based remuneration structure for the top management can be correlated with enhanced shareholder value of companies. In economics, risk sharing research, has given rise to the agency theory. This theoretical framework comprises of two main entities such as principal and agent [1]. As per Sigler (2011) an agency problem is witnessed to take place when agent or the CEO possesses conflicting goals in relation to the board or principal. The varying level of CEO salaries can be...
considered as an outcome of uneven board control levels [14].

4. Data Collection Tools

The qualitative data collection tool will be used for addressing research objectives. An interview session was conducted with board members and major shareholders of a company, to determine key factors increasing effectiveness of the compensation plan design [13]. There were approximately 10 to 12 respondents interviewed for identifying the compensation parameters even after the job tenure of a CEO. The major interview question was significance of CSR activities within the CEO compensation plan. Board members were questioned regarding the approval of offering certain percentage of company’s profits to CEOs, after the job-tenure [11]. An effective compensation plan is designed based on agreed parameters.

5. Analysis & Findings

Return on investment is an important aspect to evaluate effectiveness of the CEO compensation plan. This aspect has been evaluated through conducting an interview session [10]. The major interview question asked to shareholders was – “what kind of compensation can be offered to a CEO, after leaving the job position?” Maximum shareholders replied that involvement in CSR activities would be a suitable approach. On the basis of such involvement, CEOs can be offered a certain percentage of overall company’s profits [6]. This interview session even denoted that executive bonuses constituting 25% of base salary shall be provided to CEOs. The top management clearly specified that CEO skills are eventually upgraded when an individual starts participating in CSR activities [15]. There was another interview question asked on – “what parameter would decide effectiveness of CSR activities being performed by former CEO?” The corporate reputation of an organization would be analyzed by obtaining feedback from clients [3]. These results can be used for structuring profit percentage, which would be offered to CEO. Another vital question was – “factor denoting the CEO compensation amount to be offered, after retirement or leaving the job designation”. The shareholders stated that overall performance of a CEO during job tenure would decide compensation amount to be paid, after leaving the job position [5]. These parameters are essential for designing an effective compensation plan for CEO. Hence, an effective remuneration plan would comprise of performance-based pay during and after job tenure, motivation for top executives to be a part of CSR wing, etc [16]. A well-balanced compensation plan is one which not only involve monetary benefits for CEO after retirement or when they leave job, but a more fulfilling, high calling life with significant contribution towards societal development.

6. Conclusion

This paper has described various parameters involved in designing an effective compensation plan. The job responsibilities of a CEO is not only restricted to enhancing company’s performance, but they are even responsible for executing required CSR activities. These aspects will be considered in compensation plan design for CEOs. The necessary factors will be percentage of company’s profits offered to CEO, after retirement or when they leave the job position. This profit percentage would be higher for those CEOs who have performed well in their job tenure. On the other hand, there will be a performance evaluation scale for CEOs who are actively indulged in the CSR wing of a company, after they leave their job designation. It is clearly evident that monetary compensation tends to initiate greed within individuals [8]; however, sense of ownership feeling will eliminate such negative influential force.

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8. References

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