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Are Directors Remunerated for Corporate Performance?

Kudzanai Matowanyika*, Norbert Hosho, Tendai J Mabvure and Martin Dandira
Department of Accounting Science and Finance, Chinhoyi University of Technology, Private Bag 7724 Chinhoyi,Zimbabwe
*E-mail of the corresponding author: kudzaimatowanyika@gmail.com

Abstract
Key corporate stakeholders in Zimbabwe contest the directors' remuneration and incentive systems. The study sought to find out if directors' remuneration is aligned to corporate performance as reflected by corporate share prices. Secondary data was gathered from detailed annual reports of the companies listed on the Zimbabwe Stock Exchange whose directors' remuneration data information could be accessed. Samples of nine companies in 2009 and thirteen companies in 2010 were used. Correlation Coefficients, Regression Analysis, Chi Square Tests and Averages were used to analyse data for discussion. Results indicated a weakening positive correlation between directors' remuneration and corporate performance over the two years. The research concluded that Directors' remuneration in Zimbabwe is not linked to corporate performance and that good corporate governance is lacking in most of these companies as suggested by the dearth of information on directors' remuneration. The research recommended the central determination of directors' remuneration based on agreed corporate performance measures / indicators. Individual directors' fees need to be disclosed in the ZSE Handbooks. Further research with an increased sample size is encouraged.
Keywords: Directors' remuneration, firm performance, share price

1. Introduction and Background of the Research Problem

A study by Gregg et al (1992) in the United Kingdom noted that the growth rate of directors' remuneration was extra high and weakly linked to corporate performance. The claims that executive incentives are not aligned to corporate performance in Zimbabwe are common in both public and private institutions. The Herald (13 March 2012) reported that a team appointed by the Government to revive Chitungwiza Municipality was reportedly costing council thousands of dollars in salaries and allowances. This abuse of office by claiming exorbitant and unsustainable allowances by the resuscitation team triggered threats of industrial action by workers who had gone for months without pay. In The Herald (13 March 2012), workers alleged that a member of that team was getting US$26 525 in salaries and allowances per month. The chairperson of the team was allegedly getting US$4 175 in allowances after every ten days and council was also allegedly forking out US$2 000 weekly for his hotel bills. He reportedly got US$1 000 for other necessities as part of the allowances and one hundred litres of fuel weekly. The paper alleged that the allowances were higher than what the minister directed on their appointment. In the Herald (13 March 2012), the minister was quoted as saying, "Following the appointment of the resuscitation team effective 27 January 2012 for a period of three months, I hereby direct council to pay the following fees to the resuscitation team on monthly basis until expiry of their term of office — chairperson (US$12 000), ….."

Petra et al (2007) noted that there has been an increasing gap between CEO compensation and average employee wages, where as Gregg et al (1992) observed a disappearing relationship between directors' remuneration and corporate performance.

Such directors' compensation debates have not spared Zimbabwe. Studies by Dandira (2011), noted that investigations done by the Labour and Economic Development Institute of Zimbabwe (LEDRIZ) revealed that most company CEOs are taking home salaries which are above US$15000 per month in addition to other perks which include children's education allowances of US$2500 per child per term for a maximum of three (3) children, cell phone allowances of US$500 per month, housing allowances ranging between US$300 and US$2,500. Some executives are also entitled to entertainment allowances as per executive request, although others receive flat fees between US$100 and US$1200, one hundred percent medical coverage, fully funded pension and some even have daily allowances of US$40 for lunch. Dandira ibid noted that some of these companies are struggling to survive and that there is an increasing gap between the poor and the rich with workers earning between $90 and $140 per month and companies declaring deadlocks in salary negotiations. The same executives were rewarded or paid huge severance packages when they were forced to leave their offices due to poor performance or any challenge before the end of their contracts.

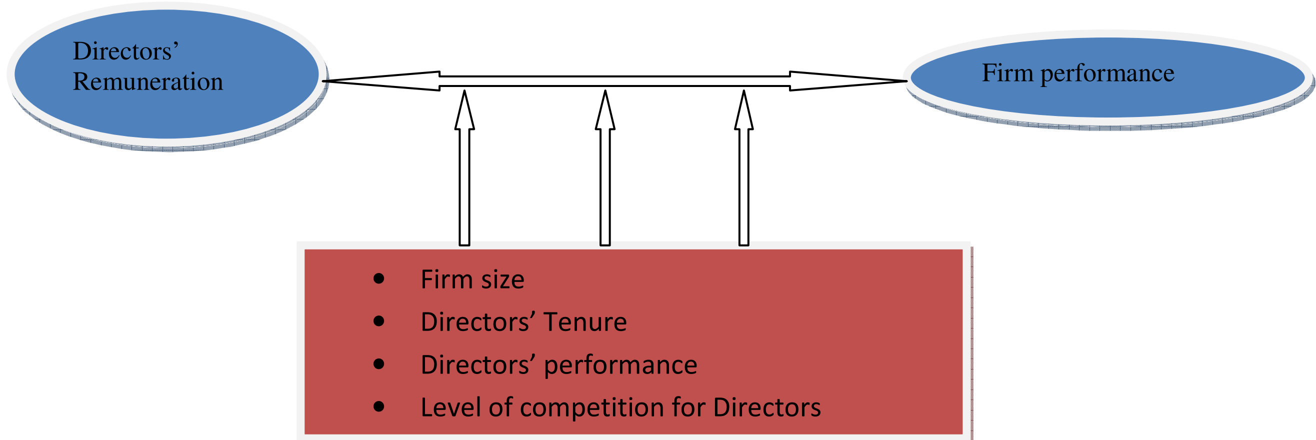
Aduda (2011) noted from other studies that accounting-based contracts reduce non-outcome related noise. The writer suggests the use of accounting measures of performance to award directors. Ann Lau and Ed Vos (2004) say that authors of a number of empirical studies in The United States of America failed to establish a meaningful link between determinants of managerial pay and firm performance. There are no similar studies on

the general trend of CEO compensation in relation to corporate performance in Zimbabwe, hence the need for the study to close this information gap.

2. Statement of Research Problem and Objectives

The study sought to find out if there is a positive relationship between directors' remuneration and corporate performance. Are directors' fees in Zimbabwe consistent with corporate performance as reflected by share price?

3. Conceptual Framework



Based on work by Matowanyika K etal (2013, 62)

4. Research Hypothesis

Directors' fees and corporate performance

H_1 - Changes in directors' fees are not positively related to changes in corporate performance (share price).

5. Theoretical and Empirical Literature Survey

Directors' Remuneration and Corporate Performance

Studies by Doucouliagos et al (2007) indicate that pay is an important mechanism for soliciting effort, rewarding productivity and ensuring compliance with owners' interests. Doucouliagos ibid said that the dearth of information on the directors' pay-performance association in Australia is quite surprising especially given the amount of publicity in Australia regarding the remuneration of senior personnel.

Bender (2007) says that:

> "…pay structures were designed to attract and retain executives with the potential of large earnings; to focus their efforts in the direction agreed by the board; and to demonstrate fairness. Importantly, the variable pay was seen as a symbol of the director's success, both internally and to his or her peers in other companies." (p.01)

This therefore means that higher pay structures should be linked to bigger and better performing companies.

Farrer et al (1998) examined if there is a positive relationship between director share ownership and corporate performance in Australian companies. The results were to some extent inconclusive but suggested a link between director share ownership and corporate performance. Farrer ibid suggests that listed companies encourage their directors to increase personal shareholdings. This persuades the directors to be a bit considerate when advocating for increased incentives as they will be shareholders as well.

Jones and Burch (2008) say that in recent years, retention grants have been common and in certain circumstances they can be very effective in companies recognising their very top performers and lock them in to the extent possible. Retention awards can provide security and help stabilise an organization in the midst of turnaround or a major strategic transition. Jones and Burch go on to say that Compensation Committees should not feel pressured to provide retention awards broadly just because incentive awards are not paying out, instead, they should take the opportunity to explore the underlying reasons for and circumstances surrounding non-payment. Jones and Burch say that the Compensation Committees should try to answer the following questions:

- Has the company underperformed its peers?
- Is the current management team responsible for these results?
- Were performance goals set based on realistic assumptions?

- Have there been factors beyond management's control that have affected results, but management has actually taken actions that have minimized potential damage?

Bebchuk and Grinstein (2005) found that in an effort to avoid morale and prestige issues, a company may be forced to maintain the directors' incentives at par with equally large companies, leading to some directors' remuneration failing to be aligned to corporate performance. Main (1991) quoted in Gregg (1994) says that the principal-agent framework has become a widely used theoretical model to explain the remuneration of high level management and chief executives. The study says that according to the typical agency framework shareholders delegate decision making authority to managers whose interests potentially diverge from those of the shareholders. Gibbons and Murphy (1990) say that the contract offered typically ties the reward received by the manager to a variable that the principal is interested in such as company performance or shareholder returns.

Bhagat and Jefferis (2002) argue that managers are disciplined through the managerial labour market as superior performers are suitably rewarded with high wage offers whereas inferior performers receive low offers. Gibbons and Murphy (1992) say that the discipline in the managerial labour market assumes that managers improve their outside options by effort which is congruent with maximising shareholder wealth. Dogan and Smyth (2002) found no association between board remuneration and firm performance in publicly listed Malaysian companies whilst Crespi-Cladera and Gispert (2003) established a positive relationship between changes in company performance and board remuneration within Spanish listed companies. In Australia, Izan et al (1998) in their study used data on a sample of ninety nine Australian firms for the period 1987 to 1992 and found no link between CEO pay and performance. Defina et al (1994) used cross-sectional data for eighty nine firms for 1990 and could not find a pay-performance link. Similar results were found by Evans and Stromback (1994) for the 1990 - 1991 period, and Fleming and Stellios (2002) for eighty six firms for 1998.

According to Fraser (2003) the corporate council of the Australian Stock Exchange (ASX) says that corporate entities are required to ensure that the level and composition of executive remuneration is sufficient and reasonably linked to performance level of directors. Crespi-Cladera and Gispert (2003) note that the principal-agent model can be represented as: $y= f(e, g)$; where the firm's performance, y, is a function of managerial effort (e) and a set of variables (g) that are randomly distributed and not under managerial control. The researchers say that managers' compensation should be based on observable outcomes and that contracts should be designed to motivate the agents' best performance so as to result in a positive relationship between the executives' remuneration and firm performance.

Baker and Hall (2004) quoted in Frydman et al (2010) suggest that the measure of CEO incentives be linked to how CEO behaviour affects firm value. Shah et al (2009) echoed the same, saying that firm performance is considered to be the significant determination of CEO compensation. Shah et al (2009) suggest that Return on Equity (ROE) be used as a measure of firm performance. They argued that profit is a better indicator of CEO compensation than sales as indicated by Bebchuk and Grinstein (2005) and DeAngelo. H et al (2009). Frydman et al (2010) say that the value of equity is the right measure of director incentives as its effect scales with firm size.

Studies by Finkelstein and Hambrick (1989) and Deckop (1988) quoted in Shah et al (2009) found out that firm profitability was positively related to executive compensation and Return on Equity (ROE) was unrelated to salary but positively related to bonuses. Miller (1995) complains that:

> "It is disturbing that, in the last 70 years, studies have yielded either no empirical evidence that increases in CEO pay are tied to performance or have had significant results but explained less than 10 percent of the variance in change in CEO salaries, presumably because of the methods used. At the same time, corporations are adamant in their defence of their directors' remuneration and the notion that salary increases are based on firm performance." (p.1362)

These controversies result in the lack of reliability and confidence on the various research findings, thereby limiting their practical applicability.

These writers argue that CEO Directors are more willing to award the CEO a higher compensation or are more reluctant to challenge the excess level of CEO compensation. They say that outside CEO Directors are more willing to reward the CEO for good performance, but less willing to penalise the CEO for poor performance, relative to non-CEO outside directors. These studies then expect the presence of outside CEO Directors to increase (decrease) the pay-for-performance sensitivity during periods of good (poor) firm performance and decrease the pay-for-performance sensitivity during the periods of poor performance. A study by Fich (2005) however shows a positive stock price reaction to the appointment of outside CEOs to the board. This means that the appointment of outside CEOs will improve the firm's performance and subsequently the CEO compensation is expected to improve.

Dandira M (2011) says that the earning structure is supposed to be equitable and that there was supposed to be

some science that determines the differentials. The researcher sees a need to revamp the directors' contracts so that there is equitable pay structure. Conyon (2000) recommended that executives purchase company shares in the future at current prices thus giving them every incentive to raise share price. This could be a way of ensuring that the CEOs work to improve the company performance.

Some researchers have come up with proposed ratios of remuneration between the top and the bottom. Plato (1991) quoted in Kakabadse et al. (2004) says that the right ratio between the top and bottom is 5:1 while Drucker quoted in Wagner (1999) says it should be 20:1. Kakabadse and Kakabadse (2001) say that in Continental Europe and Japan the CEO remuneration is fifteen (15) to eighteen (18) times that of the bottom worker. The researcher says that in the USA the gap between executive pay and average pay is continuously increasing. Wagner and Minard ibid, supported this when they said that the CEO of AT&T earns four hundred (400) times what the lowest-paid employee earns. Dandira ibid says that Africa has the same scenario as USA as CEOs in parastatals earn around two hundred times (200) times or more what the lowest employee is paid. Dandira M (2011) says that it has become more common for director reward to outstrip company performance in terms of shareholder return. This view is supported by Kennedy (2000) who expressed concerns about the £2.8 million payment to Bob Ayling for quitting as CEO of British Airways in the wake of slump in profits. Kennedy (2000) further says that pay of executives in the utilities sector rose one hundred and six percent compared with total shareholder return for the year of thirty percent.

Gregg (1992) says that a lot of theoretical work has stressed the need for a contract in which shareholders are able to monitor the performance of top executives and award them pay increases that are concomitant with their work effort. Gregg ibid, says that a great deal of United State of America (USA) empirical work has been amassed to support a positive but very small relationship between top executive pay and shareholder returns. This study sought to investigate if in Zimbabwe there is a relationship between directors' remuneration and corporate performance.

6. Methodology

Research designs: The research used a quantitative research design. The design sought to answer the research questions pertaining to the research objective by providing quantitative data in the form of numerical findings that could be generalized and make use of statistical tests which provide conclusions on the research objective.

Data collection approaches: Secondary data was collected from the detailed annual reports prepared possibly for shareholders of the various companies. These annual reports were very scarce to come by. The information on directors' fees could neither be found in the publicly published financial statements, ZSE Handbook nor from internet sources.

Population and sample: The study population consisted of seventy eight Zimbabwe Stock Exchange listed companies. Convenient samples of nine companies in 2009 and thirteen companies in 2010 were drawn. Due to the scarcity of data on directors' remuneration the research only considered companies whose information could be accessed.

Data analysis procedures: Correlation coefficients, Chi square tests regression analysis and averages were used for data analysis.

7. Findings and Discussion of the Hypothesis

The 2009 results reflect a fairly weak positive correlation between directors' fees and corporate performance (share prices) of twenty five comma eight percent, and the 2010 results show a very weak positive correlation of six and a half percent. The results show that the positive correlation between directors' remuneration and corporate performance decreased sharply within the two years studied. The results highlight that in 2009 twenty five comma eight percent of the directors fees could be explained by the corporate performance. This figure dropped to six comma five percent in 2010.

The results of the 2009 and 2010 simple regression showed the following model results:

$y = 245\ 599 + 2\ 114x$ and

$y = 483\ 667 + 1\ 083x$ respectively.

From the equations above, US$245 599 of the 2009 directors' fees could not be explained by fluctuations in share prices whereas in 2010 the figure that could not be explained by share price changes rose to US$483 667. The amount the directors would get regardless of the changes in share price rose by ninety seven percent between 2009 and 2010 when the average share price decreased by six comma nine percent during the same period. There was a positive relationship between directors' fees and corporate performance (share price) in 2009 as shown by the coefficient of 2 114. This positive relationship weakened by forty nine percent in 2010 as shown by a reduced positive coefficient of 1 083. The results show that the rate of increase of directors' fees as share price increases decreased by forty nine percent between 2009 and 2010. As noted from the research results, the directors' fees increased two hundred and fifty five percent regardless of the six comma nine percent fall in

average share price. The research noted that some other factors besides movement in share prices could have influenced the sharp rise in directors' fees.
The null hypothesis which says that changes in directors' fees are positively related to changes in corporate performance (share price) was rejected. The relationship between directors' fees and corporate performance (r^2) was noted to be weak and was even getting weaker. The figure of directors' fees which is independent of changes in corporate performance almost doubled (ninety seven percent) between 2009 (n = 9) and 2010 (n = 13). The research findings showed that the rate of change of directors' fees with changes in corporate performance dropped by almost forty nine percent between 2009 and 2010. The Chi Square Test results (at 5% significance level) however indicated that the differences in the research sample sizes used in the two years under review could have influenced the research findings.

8. Conclusions and Recommendations

The research concluded that Directors' remuneration in Zimbabwean listed companies is not linked to corporate performance and that good corporate governance is lacking in most of these companies as suggested by the scarcity of information on directors' remuneration. The researchers recommend that directors' remuneration should be centrally determined and controlled probably by a board like the Institute of Directors of Zimbabwe (IODZ). The institute should rank directors' fees in accordance with agreed measures which may include corporate size and performance, directors' qualifications and success history among other variables. Directors should get less fixed fees; much of the directors' fees should be determined by certain corporate performance measures. The ZSE should assist by insisting on the disclosure of the figures of the total and individual directors' fees in the ZSE Handbooks for listed companies. It should also consider delisting companies that do not comply and those that do not have a consistent measure or determinant of directors' fees. The Registrar of Companies should consider deregistering companies that do not have a consistent rewarding system for directors. Further research on this topic is encouraged.

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