A Global Outlook on Executive Compensation: A Comparative Exploration

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Abstract:
The global arena has become the battleground for organizations to find executives with human capital that can thrust high performance goals. Using an exploration of the extant literature, this paper focused on executive compensation from three different regional perspectives: The United States, European Union member-states, and China. The author sought to inquire about the pay-for-performance incentives and to evaluate both similar and dissimilar compensation structures across the globe by using three exemplars. In the same light, discussed are the various elements included in compensation. Provided is a review of global compensation structure, along with pay-for-performance as a main enticement for global executives. Frankly, this comparative paper identified that not all compensation plans were tied to pay-for-performance, while some were overtly tied to pay for performance due to the structure of the organizational risk-aversion and economic structure.

Keywords: Compensation, pay-for-performance, global compensation, human resource

This paper provides a comparative review of executive compensation in three geographical regions. Reference points used as exemplars in this document consist of the: European Union, United States, and China. These exemplars were chosen because they have a majority presence in the open exchange markets, and they are, to a degree, dissimilar in far as legal, environmental, and social aspects. The significance of this paper is to explain the differences in compensation in an attempt to show the advantages and disadvantages of the varying compensation structures, globally. Also to explore the role of pay-for-performance linked to executive performance. The presented compensation structures are reflections of culture, organizational performance, and the creation of motivating incentives to increase employee performance.

From a theoretical perspective, this paper seeks to fill the gap in the literature proposed by Phillips and Fox (1989) who asked what is the “impact of the compensation strategy on those most directly affected – employees” (p. 474). Secondly, Garhart and Fang (2013) proposed there is, “a second avenue of needed research is to more comprehensively define and measure PFIP [pay-for-performance] and study its consequences” (p. 10). And finally, Cooper, Gulen, and Rau agreed that, “There is surprisingly little research on this important [pay-for-performance] topic, given that current compensation should be linked to future performance if the correct incentive contracts are used,” which is the main reason this paper foci is on pay-for-performance and compensation concepts but on a global scale.

This paper seeks to fill in the gaps in the literature by clearly outlining the European Union, China, and the US compensation strategy and, to show if the executive compensation plans are diverging or converging based on performance-to-pay initiatives. The first section of this paper examined the Chinese compensation structure. The second section addressed the European Union member-states structure of compensation, and the final section explored the US based form of compensating executives. At the end of this paper a practical implication and conclusion of the comparative analyses of international executive compensation are provided.

Theoretical Framework
Peng, Sun, and Markoczky (2015) conceptualized compensation as a process by which organizational boards value CEO’s human capital. Executives, themselves, are intensely aware of their human capital value, and thus seek to capitalize on it when negotiating their compensation plans with the board of the prospective organization (see: Geletkyicz et al., 2001; Pandher & Currie, 2013; Peng et al., 2015). In a time of global expansion, it is only natural for firms to structure organizational compensation so that is fair and attractive in recruiting top talent. At the same time, the ideology of organizational managers has been to reduce costs and seek to expand globally; which both are diametrically opposed to one another (Soloman, 1995). Globalization is a strategic activity organizations use to become more competitive. Phillips and Fox (2003) both agreed with (Hax and Ohmae, 1989) that the, “success or failure of businesses in the twenty-first century will depend on effectively competing in world markets” (p. 465). Phillips and Fox elaborated further by suggesting that:

“Compensation strategies should facilitate the achievement of organizational objectives and, to be effective, must be in alignment with the strategic plan and be cost-effective in terms of input/output ratio; that is within a firm’s ability to pay increases in total compensation levels should be correlated with some measure of organizational goal achievement.
Compensation

Dessler (2009) pointedly focused on the compensation trends and how they are increasingly converging toward a global compensation system. These current trends are placing more emphasis on contribution, performance, and value on the business performance and not on seniority of employees. Dessler, went on to define compensation as, “the human resource management function that deals with every type of reward individuals receive in exchange for performing organizational task” (p. 294). To add further, Ivancevich (2010) outlined and explained how compensation is one of the major costs for organizations in conducting business. That is, employees trade labor in exchange for benefits, services, rewards, and recognition. As such, there are two broad categories of financial compensation: indirect and direct compensation (Ivancevich, 2010). Both of these compensation categories serve two different purposes in terms of their function. For example, indirect financial compensation consists of vacation days, child care services, elder care, and insurance. While, direct financial compensation consists of wages, salaries, bonuses, and commissions (Ivancevich, 2010). Both direct and indirect financial compensation is a payment plan based on employee competencies and skills-based knowledge. Organizational managers are aware of the pitfalls to implementing incentive plans into their direct or indirect compensation structure.

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<th>Incentive plan failure</th>
<th>Reasoning</th>
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<td>Performance pay can’t replace good management</td>
<td>Performance pay is to motivate workers; inadequate employee selection and training and other factors impede performance.</td>
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<td>You get what you pay for</td>
<td>An incentive plans need to reward quality and production which could create an atmosphere of motivation.</td>
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<td>Pay is not a motivator</td>
<td>Fredrick Herzberg says employers should provide adequate financial rewards, and then build other, more effective motivators.</td>
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<td>Rewards rupture relationships</td>
<td>Incentive plans have the potential for encouraging individuals to pursue self-interest at the expanse of teamwork.</td>
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Pay for Performance

Pay-for-performance has long been of interests to many scholars and practitioners. There is the lingering question that persists: does pay-for-performance promote higher executive performance. On the same note, pay-for-performance can be categorized into three levels of analysis: results-orientation, behavior-orientation, and individual employee-orientation (Gerhart & Rynes, 2003; Gerhart & Fang, 2013). This paper seeks to raise the concern as to how diverse cultures respond to pay-for-performance structured compensation. Executive compensation should be aligned with performance (see: Holmstrom, 1979; Grossman & Hart, 1983; Jensen & Murphy, 1990). Compensation can invite executives to practice short-term risky behaviour with little regard to long-term organizational goals (Cooper, Gulen, & Rau, 2010). With consideration of the agency theory (Holmström, 1979; Grossman and Hart, 1983) advised that the perfect blend of compensation elements is when risk-aversion is aligned with executives’ self-interests and linked to shareholders. On the same basis, Cooper Gulen, and Rau (2010) stated that, “surprisingly little research on this important [compensation] topic, given that current compensation should be linked to future performance if the correct incentive contracts are used” (p 7).

Links from performance to incentives

The Chinese compensation is starkly dissimilar when compared to the United States, and the European member-states (Kato & Lang, 2005; Wang & Xiao, 2011). Chinese organizations, despite the liberalization of some of its markets have private industries that are predominately state-majority owned (Wang & Xiao, 2011). The private sector of the government mandates that 40% or more of shareholders are government officials, who then, have a tremendous amount of
voting power. The majority ownership stipulation, for employees, managers, and executives, are driven by non-performance based incentives embedded within the compensation plans (Kato & Long, 2005). Thus, Chinese executive compensation plans are not reflective of the open exchange market philosophy; because of the ownership structure of China’s state-owned enterprises (SOE’s), which are the majority owners of private organizations. Chinese state-owned enterprise (SOE’s) compensation are controlled by government owned shares, despite the fact that, the conflict of interest between the controlling shareholders and minority shareholders affects the low levels of compensation rates. Because of the majority state-ownership, private enterprise executives do not have incentivized integrated compensation plans. Chinese organizations practice a modified version of “pay for performance” by providing some incentives as part of compensation planning, however, with minimum consideration of the impact as a result of increases in sales, market share, and upward fluxes in overall profitability (Kato & Long, 2005). Compensation variables controlled by the majority stakeholder [e.g. state government] are not seen as tools to strengthen compensation so that there is a link between executive pay and executive performance (Wang & Xiao, 2011). The existing compensation structure, due to the private sector being ‘piecemealed,’ is hurting the initiation of salaried pay with the addition of indirect compensation options for executives. Interestingly enough, Chinese executives are penalized for making negative profit, but are not penalized for declining profit or rewarded for rising profit (Kato & Long, 2005). The structure of the Chinese firm can be a major hurdle that foreign executives encounter when negotiating a comprehensive and performance-based compensation plan. The Chinese legal system is not at a point where it is able to control or prohibit the legal separation of controlling [shares] ownership of organizations (Wang & Xiao, 2011). While the Chinese private markets are relatively new, so is the legal structure that protects employees ability to negotiate compensation plans and the use of official mandates that specify what the organization must pay in [compensation] under defined contracted circumstances (Wang & Xiao, 2011).

**Incentivized compensation plan**

American companies have long been acknowledged as having the highest compensated executives, especially, when compared to other countries (Abowd & Bognanno, 1995; Murphy, 1999). American executive compensation is structured in a way that is linked to the performance of the executive in the organization. Four elements of the American compensation plan that links to performance are: base salary, stock options, long-term incentive plans, and annual bonuses. These compensation items are used as mechanisms to find and retain the most attractive talent to lead organizations. Murphy (1999) noted that executives negotiate their compensation plans in tandem with the organization board by creating a “broad-based” set of plan options. Once the options are agreed upon, they are then set to blossom overtime, thus, creating a heavier compensation package (Abowd & Bognanno, 1995). On that same note, Abowd and Bognanno continued to explain how the base salary is a key component of the American compensation plan. Within the base salary, organizations offer bonuses as an additional item to an executive’s compensation. American executives receive bonuses as part of their compensation, which, often times is a percentage of the base salary, and is paid to the executive every annum. Bonuses are intended to motivate executives to achieve organizational strategic goals; to be stewards of organizational resources, and to protect the assets of the organization. Thus, bonuses are not paid to executives if they do not reach the agreed performance matrix. Executives who reach or exceed their performance goals are given a sum of either cash and or indirect compensation as a percentage of performance goals. Abowd and Bognanno (1995) specified how bonuses are an integral portion of an executive’s compensation that serves to bolster executives’ performance goals. The bonus can also be related to the size of the organization. The executive leading an organization can expect a compensation plan that reflects the size of the organization, with consideration to the executive performance matrix.

United States compensation plans are created and discussed by either a compensation committee or board of directors; that is, to ensure separation between agency and ownership (Murphy, 1999). The plans created by committee and board of directors are said to have never been market analyzed; rather, decision makers procure the best talent with a deeper focus on gaining a competitive edge (Murphy, 1999). Included in the discussions between board members are related stock options, term of compensation, and additional incentives. The preferred stock options are tied directly to industry and market movements, thereby, allowing executives to participate in ownership of the organization. The idea of committees discussing plans is to anticipate the profitability of the organization, and thus the stock can act as a value-added mechanism to increase executive performance and for retention efforts when the organization is profitable. The preferred stock options, as part of compensation, are a direct link to executive wealth (Murphy, 1999).
Therefore, American organizations link stock options and stock ownership to the pay-for-performance plan. The American executive compensation plan has options that are tied to personal performance and organizational market performance. The logic of this system is based on the assumption that if the organization produces more, gain market share, and increase product or sales offerings, so does the executive (Murphy, 1999).

**European Union member-states compensation plan**

The European Union member states compensation arrangement is in some ways similar to that of the United States plan, but there are stark differences that should be noted. The European member states, collectively, have come to the realization that executive compensation is overly bonus heavy, and is structured in ways where the executive receives a bonus regardless of goal attainment (Aluchna, 2013). Festing and Sahakiants (2011) conducted a compensation study that focused on three of the European Union newest member-states such as: Czech Republic, Hungary, and Poland. These are the largest CEE economies to join the European Union member states, and planned to reformulate their existing compensation practices to align with the rest of the EU members. Organizations in these regions practice share-based compensation plans with an included bonuses option. The bonus addition to the compensation plan has been seen by policy makers as “risky” and encourages risk-taking behaviours by executives. That is to say, executives can try to increase their bonus potential with little attention to organizational performance. In combating executive risky behavior, the European Union policy makers, are aimed at aligning compensation policies with the size of the organization, with end-of-year performance data, and adjusting the variable component (e.g. bonus) by adding in a fixed variable. By counterbalancing these compensation variables it adds to the stability of the organization and decrease risky executive behaviour.

The European Union member-states bonus structure is based on rigid contracts between executives and compensation committees, despite deteriorating company results that are often overlooked. Therefore, compensation boards have called for more transparency of compensation plans in the European Union countries (Aluchna, 2013). That is to say, most European executive compensation plans are based heavily on two variable components (e.g. annual bonuses, and stock options) with little balance between these components. European Union compensation structure has built in mechanisms where executives are not paid-out in cash and executives’ bonuses are deferred overtime. This allows for executives and shareholders to reflect on firms performance relative to executives performance (Aluchna, 2013, p. 12). This coincides with the European mandate for executive compensation disclosure, which was an act initiated in 2004 to change the compensation designs so to align with the rest of European member regulations on compensation (Festing & Sahakiants, 2011).

Organizational managers and the European Union legal environment initiated the “say on pay” policy where shareholders are able to exert influence on the details of executive compensation (Aluchna, 2013). The “say on pay,” initiative allows shareholders to vote either to adopt or reject compensation policies that are deemed ineffective or financially risky. Although, “say on pay” is not legally binding, it forces organization compensation committees to formulate and publish executive compensation policies, making this data more transparent. However, this initiative has a “claw back” provision where a portion of compensation is returned if certain targets set out in the compensation agreement are not met by a specified timeframe.

**Practical implications**

There is a growing demand for executive managers who are able to bring forth their experience and human capital to the global marketplace. Due to this global initiative, there are acute reasons why global compensation systems need to be conducive to a more global market-based structure as most multinational and global organizations seek to expand, there should be consideration for compensation elements that serve to cast a wider net in seeking to recruit executives who could be major catalysts in the global market. With multinational organizations seeking to collaborate with business units globally, compensation systems must reflect these changes. While in the compensation literature there is not enough discussion on the how-to in terms of developing a global system that has elements based on market-based philosophies. Could converging global compensation systems assist in meeting this global demand? Perhaps, instead of compensation being based on the balance sheet (Watson and Signh, 2005) there is another methodology that provides guidance and support for organizational board members and potential executives could negotiate in a global context. That is taking into consideration culture, organizational structure, and incentive options. Is it possible there is too much divergence from a possible center? Pay- for-performance and say on pay are both factors that could change executives’ behavior? The convergence of pay systems therefore means a convergence of organizational values and cultural fusion, which could overburden the process. However, there is much need research in this area to delineate if pay-for-performance has an effect on executive performance, and to look toward
the future of converging compensation system to meet the rapid pace of globalization.

CONCLUSION
This review outlined compensation plans and structure in China, European Union member-states, and the United States. Compensation plans, as is seen in this paper, showed that organizations and executives are not in agreement as to what is important to growing and driving executive performance that truly equate to organization goals linked to performance. The Chinese example explained how increased levels of government ownership involving executive compensation could have adverse effect on executive motivation to execute long-term performance goals. Compensation could influence the drive to meet organization goals when there is no variable incentive on growth measures directly related to executive performance. On the other end of the spectrum, EU member-states organizational managers have found that their compensation plans were overly bonus heavy. As a consequence, it creates a substantial amount of risk on both the organization and executive. The American compensation plans are inextricably linked to the pay-for-performance system, but what was explained in this relation was how executive compensation effects performance and behavior both long and short-term.

When implementing a new compensation plan for executives, the performance to pay structure seems to be the most viable, and is motivating for executives in achieving organizational goals by linking these two variables [pay and performance] together to create less risk for the organization, and it defers executives’ variable pay until agreed goals have been met. Another element to add is the European “say on pay” where organizational members (shareholders) have a voice in whether to accept or reject an executive’s compensation plan. The premise of this study should be continued in identifying the effect that executives’ pay for performance has on the executive realm of employees. Is there an inverse effect on employee performance when the executive takes short term risk? As this concept showed not be isolated to the American compensation structure; rather, this is a global inquiry to find a link connecting global pay-for-performance to organizational goals and long-term success.

REFERENCES