Executive compensation as a corporate governance issue and factors determining executive compensation

A remuneração dos executivos como uma questão de governança corporativa e os fatores que determinam a remuneração dos executivos

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ABSTRACT
Executive Compensation refers to the monetary and non-monetary benefits provided to executives as a form of payment or recognition for their completed work. The topic of Executive Compensation is regarded as intricate and contentious, garnering the interest of numerous groups for additional investigation. This research employs a qualitative methodology, specifically utilizing a literature review. The findings of this study indicate that the primary objective of carefully crafted Executive Compensation is to effectively attract, retain, and incentivize top-level management while also addressing issues related to agency conflicts. Nevertheless, these incentives have the opposite effect, leading to the financial collapse of major corporations and giving rise to issues in corporate governance as executives exploit them for their own personal gain.

Keywords: executive compensation, corporate governance, company performance.

RESUMO
A remuneração de executivos refere-se aos benefícios monetários e não monetários oferecidos aos executivos como forma de pagamento ou reconhecimento por seu trabalho realizado. O tema da remuneração de executivos é considerado intrincado e polêmico, despertando o interesse de vários grupos para uma investigação adicional. Esta pesquisa emprega uma metodologia qualitativa, utilizando especificamente uma revisão da literatura. As conclusões deste estudo indicam que o principal objetivo da remuneração...
de executivos cuidadosamente elaborada é atrair, reter e incentivar a alta gerência de forma eficaz, além de abordar questões relacionadas a conflitos de agência. No entanto, esses incentivos têm o efeito oposto, levando ao colapso financeiro de grandes corporações e dando origem a problemas de governança corporativa, uma vez que os executivos os exploram para seu próprio ganho pessoal.

**Palavras-chave:** remuneração de executivos, governança corporativa, desempenho da empresa.

**1 INTRODUCTION**

In the contemporary global environment, corporate governance has emerged as a prominent and widely-discussed concern. Several companies have utilized Corporate Governance as a point of reference or framework in managing their organizations. In the face of expanding competition, companies must effectively and efficiently manage their business to ensure future growth and survival. As such, many companies are incorporating corporate governance into their business operations (Adilla, 2021). Hence, it is imperative to implement efficient corporate governance practices. Efficient corporate governance diminishes the influence of shareholders and creditors on managers, while enhancing the probability of managers making investments in projects that deliver positive net present value (Hrp et al., 2022). Efficient corporate governance diminishes the authority of shareholders and creditors in managing and enhances the probability of managers making investments in projects with positive net present value (Muda et al., 2018). Executives hold crucial roles within the company. This position is crucial for the company's viability, thus it requires a candidate who possesses exceptional qualifications. The success and viability of a company hinge greatly upon the capabilities and effectiveness of its leader. Executives must possess exceptional skills and expertise, and exercise caution when making decisions regarding the company's direction. Thus, the company persists in enhancing and advancing in accordance with its goals and objectives. Being a leader entails significant accountability towards the organization, which is also counterbalanced by the financial compensation and incentives offered by the company.

Compensation matters consistently garner substantial attention from all parties involved in a company. Compensation is derived from an individual's educational qualifications and expertise, and is a direct outcome of their contributions to their job. The discussion concerning executive compensation remains a contentious topic of discussion (Noviani et al, 2022). Since its inception as a topic of debate, it has
consistently been regarded as a significant matter in the corporate sphere. The primary cause for the extensive controversy surrounding executive compensation stems from the discrepancy between the excessive compensation received by executives and the associated company performance.

2 LITERATURE REVIEW

2.1 THEORY AGENCY

According to R.A.Supriyono (2018:63) agency theory refers to the contractual relationship between a principal and an agent. This relationship is established in a service arrangement where the principal offers the agent the authority to make decisions that will maximize the principal's interests, particularly by prioritizing the optimization of company profits. The purpose is to minimize various burdens, including tax burdens, through the method of tax avoidance.

Agency theory refers to the entrusting of authority by a company owner (shareholder) to the company management, enabling them to execute company operations as per the agreed contract. If both parties share a mutual objective of enhancing the company's value, the management will act in alignment with the interests of the company owner (Saragih et al., 2021). Investors perform a role in an agency relationship, where the principal possesses comprehensive knowledge about the company, particularly due to the exclusive access to information held by the management acting as an agent.

Agency problems are most prone to arise in large corporations in which there is a separation between ownership and control of the company. Shareholders are the proprietors of the company, while the board of directors assumes the responsibility of managing the decision-making process on behalf of the shareholders. Executives, on the other hand, are accountable for supervising the day-to-day decision-making process. Nevertheless, it does not eliminate the possibility for executives to employ company resources to enhance their own personal lifestyles. Essentially, they utilize their authority to satisfy their individual requirements. To mitigate trust conflicts initiated by a manager, it is advisable to demonstrate transparency and accountability towards shareholders and other stakeholders.

2.2 EXECUTIVE COMPENSATION

Executive compensation refers to the reward provided by company owners to company executives in recognition of their performance, which can take the form of both
financial and non-financial rewards (Widjayanti, 2017). This service reward is bestowed by the company owner to acknowledge and incentivize exceptional performance, serving as a powerful means to enhance executive effectiveness. Compensating company managers based on their roles and responsibilities is believed to be an effective approach, as it incentivizes managers to enhance their performance and optimize their skills and resources.

According to Scott (2015) executive compensation plan as an agency contract that aims to align the interests of company owners and managers. The following is achieved by linking manager compensation to their performance in the company's operations, determined through one or more indicators. Compensation is a service that the company owner provides to its management. Executive compensation is a means of providing executives significant feedback on their performance through the provision of salaries, allowances, or other forms of compensation, depending upon by an agreement between management and shareholders Michael C. Jensen (1976)

The objectives of granting compensation (Hasibuan, 2017: 121-122) incorporating :

1. Mutual connection
2. Satisfaction with the position one holds
3. Efficient Acquisition
4. Incentive
5. Workforce Flexibility
6. Independence
7. Impact of Trade Unions
8. Government Intervention

The prominent forms of compensation in corporate settings typically encompass salary, allowances, and incentives. However, there continues an inequitable distribution of these compensatory measures among employees, prompting many to question the efficacy of these rewards in enhancing performance. Issues of focus may include employment, talent retention, cost control, including regulatory compliance. Companies can enhance employee performance, motivation, and satisfaction by providing rewards and recognition. The executive compensation provided by a company is contingent upon the level of responsibility, risk, and effort performed by top executives, which significantly impacts the performance or otherwise of the company. The amount of compensation varies based on the scope of the company.
2.2.1 Factors Determining Executive Compensation

The compensation provided to executives of a company is contingent upon their performance, responsibilities, and contributions towards the growth of the business. The subsequent factors can exert an influence on executive compensation:

a. Executive's age
b. Duration of executive employment
c. Ownership of shares
d. The personal motivation or reason
e. Qualifications and competencies
f. Structure of the board of directors

2.2.2 Fundamentals of Executive Compensation

The subsequent elements comprise Executive Compensation, including:

a. Supplementary Benefits
   Executives obtain additional compensation in the form of company profits as a result of their work.

b. Supplementary Advantages
   Supplementary advantages offered to staff members. Examples include corporate vehicles, supplementary healthcare benefits, and vacation packages.

c. Deferred Compensation
   Long-term incentives are specifically formulated to incentivize senior executives to actively advance the company's long-term expansion and success.

d. Annual incentive
   The annual bonus scheme is designed to incentivize the near-term performance of managers and executives, thereby driving company profitability.

2.3 CORPORATE GOVERNANCE

Corporate Governance is defined as a framework of checks, balances, and incentive structures that a company implements in order to effectively reduce and handle conflicts of interest that may arise between individuals within the company and external shareholders. The purpose is to prevent the acquisition of cash flows and assets of one or more groups by another group. Corporate governance is a systematic approach implemented within a company to optimize outcomes and generate optimal value for the benefit of investors. It is founded in relevant legal frameworks (Marini & Marina, 2017).
Corporate governance is a system designed to effectively manage risk, guide, and oversee a company's operations to achieve the objectives established by the company in fulfilling its obligations to stakeholders. Corporate governance performs an essential role in preventing against as well as inhibiting fraudulent financial reporting by management. While inadequate corporate governance can result in fraudulent activities, effective corporate governance can serve as a preventive measure against fraudulent practices in financial reporting.

2.3.1 Good Corporate Governance

Good Corporate Governance incorporates a solid and competent board of directors. The board is anticipated to consist primarily of independent non-executive directors. Furthermore, directors are prohibited from possessing any other business affiliations that are connected to the company or its auditors. An independent board has the potential to mitigate the likelihood of improper related party transactions or comparable activities. (Noviardhi & Hadiprajitno, 2013).

Meanwhile, (Sukrisno Agoes 2011:101): "Corporate governance is a regulatory framework that oversees the interactions between the Board of Commissioners, the Board of Directors, shareholders, and other stakeholders”. Good corporate governance is associated with a transparent procedure for establishing company objectives, accomplishing them, and evaluating their efficacy.

2.3.2 Good Corporate Governance Principles

National Committee on Governance specifies five principles of Good Corporate Governance (GCG), these are:

1. Transparency

In order to uphold impartiality in managing a business, companies must furnish crucial and pertinent information in a format that is generally accessible and comprehensible to stakeholders. Companies should proactively disclose not only information that is legally required, but also information that is crucial for shareholders, creditors, and other stakeholders to make informed decisions.

2. Responsibility

Companies are required to provide a clear and equitable explanation of their performance. Hence, it is imperative to manage the company proficiently and quantifiably, aligning with the company's objectives, while also considering the concerns
of shareholders and other stakeholders. Accountability is a crucial requirement for attaining sustained success.

3. Independency

For a company to ensure its long-term business continuity and establish a positive reputation as a responsible corporate entity, it is imperative to adhere to legal regulations and fulfill obligations towards society and the environment.

4. Fairness

In order to effectively implement Good Corporate Governance (GCG) principles, it is crucial for companies to maintain independent management, ensuring that each legal entity remains autonomous and free from external interference.

5. Equity and Equality

Companies must prioritize the concerns of shareholders and other stakeholders, ensuring fairness and equality in their actions.

3 METHOD

The research methodology applied to this study is qualitative, specifically utilizing a literature review approach. This involves gathering data by comprehensively examining and analyzing theories from various relevant sources. Data collection requires the systematic search and compilation of information from diverse sources, including books, journals, and existing studies. The analysis method employs both content analysis and descriptive analysis techniques. Library materials sourced from diverse reference sources are thoroughly and systematically reviewed to substantiate recommendations and theories.

4 RESULT AND DISCUSSION

4.1 EXCESSIVE COMPENSATION FOR EXECUTIVES

The executive's personal interests, including executive manifestation, contribute to the recurrence of excessive compensation. Hence, exorbitant remuneration is indeed a consequence of executives prioritizing their own interests. Overly generous remuneration will not only detrimentally impact the interests of investors but also result in inequitable distribution of income. Multiple studies assert that overcompensation poses a challenge in the realm of corporate governance.

The practice of granting excessive executive compensation has faced significant backlash due to its perceived impropriety and its tendency to promote risk-taking
behavior without delivering enhanced business results. Ethan Rouen (2020) in Przychodzen & Gómez-bezares (2021) studies has shown that excessive executive compensation, coupled with a perception of injustice among employees, has an adverse effect on company performance.

Companies are required to provide complete and transparent information about their compensation, including specific details about bonus circumstances and stock option agreements. This allows analysts to evaluate the levels of compensation in comparison to other companies and to understand the incentives provided through these plans to potentially manipulate financial outcomes.

4.2 EXECUTIVE COMPENSATION AND CORPORATE PERFORMANCE

Establishing a policy to determine executive compensation is an effective method to incentivize improved performance. In this scenario, the executive's primary duty is to enhance the financial gains of the owners or shareholders. As a result, the executive will be remunerated based on the terms outlined in the contract. Company owners anticipate that executives can enhance performance through the implementation of suitable remuneration strategies.

Employers provide generous remuneration to their employees in order to maintain their motivation, enhance productivity, or attain exceptional levels of performance. Management assumes responsibility for enhancing performance when compensation is significant. Management strives to consistently enhance company performance. The fundamental principle underlying most executive compensation programs is that executives should receive rewards in the context of the company's profits and value experiencing growth over a specified period of time.

Executive compensation is essentially identical to employee compensation in its fundamental components, encompassing basic salary, bonuses, incentives, facilities, and allowances. The distinguishing factor resides in the presence of a unique form of remuneration known as stock options.

4.3 THE RELATIONSHIP BETWEEN EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE

Corporate executives or other stakeholders possess the ability to convert assets for their personal use or to obtain personal benefits. Improper utilization of corporate resources, such as monetary funds. Through the use of related party transactions, whether
the transactions are complex or simple, it is frequently feasible to obtain assets at a reduced cost from the affiliated client. In this scenario, funds are extracted from the company and the activity is camouflaged as a different commercial transaction, such as settling expenses or procuring inventory or equipment. Nevertheless, in the presence of inadequate corporate governance, there is a higher probability of exploitation and asset expropriation.

The primary objective of corporate governance should be to ensure transparency in company management for stakeholders. However, this objective may not be achieved due to a deficiency in transparency. By implementing this Good Corporate Governance concept, it is anticipated that the transparency of management performance will be effectively maintained, leading to a boost in the company's profitability.

Transparent companies can offer precise and reliable disclosures to circumvent any manipulative accounting practices. Transparency necessitates that companies furnish stakeholders with appropriate, precise, and comprehensive information.

4.4 CRITICISM OF EXECUTIVE COMPENSATION

Executive compensation is a varied and deeply emotive topic. The remuneration, including salaries, bonuses, and incentive packages, provided to top-level executives in public corporations is closely examined in today's business landscape. This scrutiny might make things difficult for the general public to comprehend and often leads to feelings of anger and distrust. Perceptions regarding executive compensation have shifted in response to the financial crisis. There has been a rise in public awareness regarding the disparity between employees and employers in the past decade.

Currently, there exist substantial gaps between upper-level management and the entire workforce, as well as between executive remuneration and individual achievements. This disparity leads executives to exclusively prioritize their personal interests, disregarding the concerns of shareholders, consequently inflicting significant damage to the company's sustainability and the overall economy.

Based on Economic Policy Institute in Neokleous (2015), The average CEO salary at the 350 most prominent corporations in 2018 amounted to $17.2 million. The compensation of CEOs significantly exceeds the salary of the average employee, with a ratio of 278 to 1. In the period ranging from 1978 to 2018, CEO compensation experienced a significant surge of 1,007.5 percent, whereas the overall compensation of employees witnessed a mere increase of 11.9 percent.
The existence of such disparities is widely deemed unacceptable, as many argue that CEOs receive compensation excessively in comparison to the average worker. Nevertheless, it is crucial to conduct a thorough analysis of these matters, considering the evolving nature of work and employee expectations. It is imperative to revamp the compensation system at all levels to align with these changes.

5 CONCLUSIONS

The primary objective of developing an executive compensation plan is to incentivize employees to increase their efforts, retain top-level executives, and prevent conflicts of interest between company management and owners. An example of these conflicts of interest is the issue of exorbitant compensation for executives. When executives prioritize meeting their personal needs, it represents a challenge to corporate governance.

Executive compensation additionally influences the performance of a company. Enhanced compensation incentivizes executives and employees to assume accountability for enhancing performance in alignment with assigned duties. Stock options, as specified in the contract with the company owner, can be used to distinguish the compensation given to executives and employees in this scenario.

Given the present economic circumstances, the deficiencies of prominent corporations, and accusations of incentivizing failure and a lack of openness, there has been considerable focus on executive remuneration and corporate governance. The issue of executive compensation, which cannot be completely resolved through corporate governance practices, is highlighted by criticism from different perspectives.

To further improve the company's quality, it is imperative to incorporate effective corporate governance and ensure transparency. This enhances the company's long-term viability and prosperity, as well as enabling it to secure international clients.
REFERENCES


