ESRC End of Award Report

For awards ending on or after 1 November 2009

This End of Award Report should be completed and submitted using the [grant reference] as the email subject, to reportsofficer@esrc.ac.uk on or before the due date.

The final instalment of the grant will not be paid until an End of Award Report is completed in full and accepted by ESRC.

Grant holders whose End of Award Report is overdue or incomplete will not be eligible for further ESRC funding until the Report is accepted. We reserve the right to recover a sum of the expenditure incurred on the grant if the End of Award Report is overdue. (Please see the ESRC Research Funding Guide for details.)

Please refer to the Guidance notes when completing this End of Award Report.

<table>
<thead>
<tr>
<th>Grant Reference</th>
<th>RES-061-25-0416</th>
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<tbody>
<tr>
<td>Grant Title</td>
<td>Executive compensation, incentives, and corporate debt</td>
</tr>
<tr>
<td>Grant Start Date</td>
<td>1 Oct 2009</td>
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<tr>
<td>Grant End Date</td>
<td>30 Sep 2012</td>
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<tr>
<td>Total Amount Expended:</td>
<td>£ 252,967.38</td>
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<tr>
<td>Institution</td>
<td>University of Exeter, Business School</td>
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<tr>
<td>Grant Holder</td>
<td>Grzegorz Trojanowski</td>
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<tr>
<td>Grant Holder’s Contact Details</td>
<td>Address</td>
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<tr>
<td></td>
<td>Xfi Building Rennes Drive Exeter EX4 4ST</td>
</tr>
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<td></td>
<td>Telephone</td>
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Co-Investigators (as per project application): Institution
NA

1. Non-technical summary

Please provide below a project summary written in non-technical language. The summary may be used by us to publicise your work and should explain the aims and findings of the project. [Max 250 words]

We examined the structure of executive compensation of UK firms. The project sheds some light on the effects these incentives have on managerial decision-making, in particular
risk-taking. The results are based on a mail survey of chairs of remuneration committees and on quantitative analysis of secondary data on a large panel of UK listed firms over the period of a decade. We find that executive compensation:

- is mostly used to align the interests of managers and shareholders;
- is used to retain managers;
- is not related to firms’ capital structure and is not shaped in response to the demands of firms’ creditors;
- plays only limited role in influencing risk-taking by managers;
- provides incentives with the horizon of up to 3-5 years;
- has recently become subject to clawback provisions;
- has to some extent been affected by the recent financial crisis and the ensuing recession.

Additionally, we find that managers’ international orientation influences perceptions of environmental uncertainties and that these perceptions impact strategic decisions (i.e. international acquisitions). We also document a positive relationship between the quality of board corporate governance and a firm’s performance and examine the drivers of governance choices made by firms. We also offer policy implications pertaining to the efficiency of the ‘comply-or-explain’ approach adopted by the UK Code of Corporate Governance.

Project findings have been presented at many international conferences and seminars, the outputs are currently at various stages of the publication process, while the grant research topic has been showcased during the one-day international conference held in 2012.

2. Project overview

a) Objectives
Please state the aims and objectives of your project as outlined in your proposal to us. [Max 330 words]

- Contribute to the base of knowledge in the areas of finance, management, corporate governance, accounting, and economics.
- Contribute to the regulatory debate on managerial remuneration.
- Provide up-to-date quantitative and qualitative evidence on current remuneration practices and promote good practice in the area to the corporate sector at large.
- Foster the interaction of various groups of research beneficiaries and make these groups aware of the issues being studied, of the project findings, and of a broader context of the most recent research and practice in the area.

To cite this output:
- Engage non-academic users of the findings.
- Enhance PI’s academic standing and research capacity by developing and enhancing his ability to manage an independent research project, to supervise research staff, to successfully combine quantitative and qualitative research methods, to effectively communicate the outputs, to engage with the users of the project findings.
- Widen PI’s professional network and be a starting point for his future collaborative research projects.
- Offer a research career opportunity at a postdoctoral level for an RA who can subsequently expect to secure future work in either academic or practitioner setting.
- Produce a unique database (containing extensive information about UK public firms and their senior executives) that could be employed beyond the project proposed (and, hence, will facilitate building future research capacity).
- Enhance the visibility of research conducted in the UK academic sector, and, specifically, at the University of Exeter Business School, among international audience of management researchers and practitioners.

b) Project Changes
Please describe any changes made to the original aims and objectives, and confirm that these were agreed with us. Please also detail any changes to the grant holder's institutional affiliation, project staffing or funding. [Max 200 words]

- During the life of the project the mentoring arrangements have changed (as agreed with ESRC). Following Ian Tonks’ departure from the University of Exeter, mentor’s duties were taken over by Alan Gregory for the 2nd and 3rd year of the grant.

c) Methodology
Please describe the methodology that you employed in the project. Please also note any ethical issues that arose during the course of the work, the effects of this and any action taken. [Max 500 words]

The grant research employs two main methodological approaches:

1. A mail survey of chairs of remuneration committees of UK listed firms was conducted. The survey was addressed to all 1175 active companies with full address data available in BoardEx database and for which the board of directors includes at
least one executive. 79 responses were received (corresponding to the response rate of 7%). Moreover, in 16 cases, companies responded explicitly declining to take part in the research, usually referring to company policies of not participating in any survey research. The survey responses have been analysed using descriptive statistical analysis and correlation analysis (see below). Importantly, given the relatively small sample size, it has been decided that ensuring confidentiality of responses prevents reporting individual responses in disaggregated form and instead only aggregated data has been disclosed in the outputs due to ethical issues.

2. The main body of analysis relies on quantitative analyses of the secondary data collected from commercially available databases and from internet sources. The principle database has been constructed as the intersection of BoardEx (for board information, director demographic and compensation information) and Thomson One Banker (in particular, Worldscope, Thomson Financials, and Datastream for company level financial data) databases. The starting point was an unbalanced panel of 11,712 firm-years (corresponding to 2,212 companies), yet availability of data for some financial variables restricts sample size further for some specific analyses. This data set thus covered the vast majority of market capitalization of the London Stock Exchange for the analyzed period (1999-2008). Subsequently, the database has been updated to 2011 (following the purchase of updated BoardEx files). For specific analyses, this information from this database has been merged with data coming from other sources, e.g. SDC Platinum (for data on mergers and acquisitions), Xfi database (for UK counterparts of Fama-French and Carhart factors), or the internet (mostly for cross-checking and validating information obtained from other sources). In some cases this matching procedure reduces the available sample size even further (e.g. the study on international M&A transactions discussed below examines a sample of 2,122 international acquisitions completed by 561 UK firms).

The data is examined using a range of econometric and statistical techniques such as regression-type models (e.g. panel data regressions, logit/probit models, Tobit models, multilevel models), portfolio performance analyses, cross-tabulations, etc. (see below), appropriate for a particular research question.

Finally, the grant research topic has been showcased by the one-day international conference where six academics presented their research on executive compensation and risk taking in international context to the (mostly academic) audience of 30+ conference participants. The full list of external speakers is provided below:

- Piotr Korczak (University of Bristol, UK);
- Evgenia Zhivotova (University of Mannheim, Germany);
- Kyeong Hun Lee (University of Iowa, US);
- Joseph Halford (University of Utah, US);
- Konstantinos Stathopoulos (University of Manchester, UK);
- Yuri Tserlukevich (Arizona State University, US).
d) Project Findings

Please summarise the findings of the project, referring where appropriate to outputs recorded on the ESRC website. Any future research plans should also be identified. [Max 500 words]

We examined the structure of executive compensation of UK firms and shed some light on the effects these incentives have on managerial decision-making, in particular risk-taking. Both the survey results and the statistical analysis of remuneration packages reveal a number of consistent patterns:

- Following the recommendations of the Combined Code of Corporate Governance, the design of executive compensation attempts to primarily align the interest of managers with those of shareholders. Survey results indicate that it is by far the most important determinant of remuneration packages.
- Compensation is often seen as a tool to retain managers as well.
- In contrast, the interests of other stakeholders play only marginal role in determining managerial incentive packages. In particular, firms’ capital structure and creditors’ interests do not influence the design of executive pay. Thus, the agency costs of debt and associated risk-taking behaviour are not fully recognised by the corporate world. Remuneration committee chairs do not even expect compensation to influence managerial risk-taking behaviour, questioning its potential efficiency in addressing the aforementioned problem. It may explain relatively infrequent incidence of defined benefit pensions or deferred cash pay as components of executive remuneration packages analysed.
- Fixed pay represents a substantial proportion of managerial compensation, although in 2/3 of the companies surveyed variable pay constitutes more than half of the total. Variable pay usually takes form of a cash bonus and/or stock or option LTIPs (with a horizon of 3 to 5 years).
- Although a possibility of clawback provisions in managerial contracts have only recently drawn broader attention, 28% of survey respondents indicated that they are used in their companies.

Additionally, Paper 1 indicates that the structure of compensation does not influence the riskiness of international acquisitions made, corroborating the finding of limited role that compensation plays in influencing managerial risk-taking behaviour. This paper also examines how TMT international orientation influences perceptions of environmental uncertainty and how these perceptions impact strategic decisions. It shows that TMT international orientation positively moderates the negative impact of cultural differences and host country risk on acquisition stakes. The results underscore the importance of considering decision-makers’ attributes due to their experiences at a young age, beyond their demographic characteristics or professional experience, in the context of strategic choices.
Paper 2 examines the link between corporate performance and the quality of a firm’s board of directors and investigates when and how firms use the flexibility offered by the Code in their governance choices. It documents a positive relationship between the governance index and a firm’s performance, and provides evidence of potentially opportunistic behaviour on the part of firms decreasing adherence to the Code recommendations and weakening the monitoring capacity of the board (in particular, of remuneration committees) in the wake of expected underperformance. The paper has important policy implications: while adherence to the Code can help curb agency problems, the flexibility offered by the ‘comply-or-explain’ approach adopted by regulators is not effective and can be misused. Paper 2 also stresses the importance of independence of key board monitoring committees.

e) Contributions to wider ESRC initiatives (eg Research Programmes or Networks)
If your project was part of a wider ESRC initiative, please describe your contributions to the initiative’s objectives and activities and note any effect on your project resulting from participation. [Max. 200 words]

Not applicable

3. Early and anticipated impacts

a) Summary of Impacts to date
Please summarise any impacts of the project to date, referring where appropriate to associated outputs recorded on the Research Outcomes System (ROS). This should include both scientific impacts (relevant to the academic community) and economic and societal impacts (relevant to broader society). The impact can be relevant to any organisation, community or individual. [Max. 400 words]

So far, the grant research resulted in two academic papers and two written pieces targeted at broader (mostly practitioner) audience. All the outputs will be uploaded to the relevant ESRC website once they reach their final publication stage and the relevant copyright permissions have been sought:

1. The first academic paper (“Twice as smart? The importance of managers’ formative-years international experience for their international orientation and foreign acquisition decisions”, co-authored with Dorota Piaskowska from University College Dublin) has been accepted for publication in British Journal of Management and should appear in print in 2013. Various versions of this paper have been presented...
internationally at a number of seminars and conferences, i.e. Academy of International Business UK & Ireland Chapter Conference (Edinburgh, UK, 2011), Academy of International Business Annual Conference (Nagoya, Japan, 2011), and Academy of Management Annual Meeting (Boston, US, 2012).

2. The second academic paper (“Board governance and corporate performance in the UK”, co-authored with Amama Shaukat from University of Exeter) has been revised following the invitation to revise and resubmit it from Corporate Governance: An International Review. It is to be resubmitted by February 2013. Various version of this paper have been presented at invited seminars at University of Bristol, University of Southampton, Indian Institute of Management Bangalore, Warsaw School of Economics and Warsaw University.

3. The article “Executive compensation: Aligning the interests of managers and stakeholders” appeared in ESRC-published annual magazine Britain in 2012 (pp. 54-55) targeting a broad audience interested in findings of the research funded by the Council.

4. The article “International orientation in top management teams” (co-authored with Dorota Piaskowska) targets practitioner audience. It has been submitted to Chartered Management Institute Library and to a joint Chartered Management Institute and British Academy of Management Top Management Article competition and gained wide coverage in broadsheet press, business news outlets, and practitioners’ publications.

Moreover, a successful grant-funded international conference was held at University of Exeter in September 2012 where six academics (2 UK-based and 4 overseas ones) presented their research on executive compensation and risk taking in international context to the (mostly academic) audience of 30+ participants. The grant funding also helped to raise research profile of the PI and to build his research capacity for future projects. Finally, the grant-related work enhanced the professional standing of the RA appointed and boosted research skills required for her current job of a researcher for the European Commission.

b) Anticipated/Potential Future Impacts

Please outline any anticipated or potential impacts (scientific or economic and societal) that you believe your project might have in future. [Max. 200 words]

- In addition to the papers aforementioned above, it is expected that the results of the survey and of the descriptive analysis of executive remuneration in the UK will be written up as an academic paper and submitted to a quality journal. Together with paper (2) above, these findings are likely to be of interest to policy makers (in particular, regulators).
- Upon publication of the academic papers resulting from the grant research, the PI in
conjunction with the School’s press officer and PR representatives will attempt to interest quality media in the outputs of the project. This should enable further outreach to non-academic audience and help publicising the findings of the research.

- The grant funding has been instrumental in building research capacity of the PI. In particular, the database built during the project is to be kept updated and employed in his subsequent research projects, beyond the scope of the current grant topic. Two of such projects are already in their early stages (one on market perception of international M&A deals and another on gender and double standards in managerial remuneration). Both should reach journal submission stage in the coming months.

You will be asked to complete an ESRC Impact Report 12 months after the end date of your award. The Impact Report will ask for details of any impacts that have arisen since the completion of the End of Award Report.

4. Declarations

Please ensure that sections A, B and C below are completed and signed by the appropriate individuals. The End of Award Report will not be accepted unless all sections are signed. Please note hard copies are not required; electronic signatures are accepted and should be used.

A: To be completed by Grant Holder

Please read the following statements. Tick one statement under ii) and iii), then sign with an electronic signature at the end of the section (this should be an image of your actual signature).

i) The Project

This Report is an accurate overview of the project, its findings and impacts. All co-investigators named in the proposal to ESRC or appointed subsequently have seen and approved the Report.

ii) Submissions to the Research Outcomes System (ROS)

Output and impact information has been submitted to the Research Outcomes System. Details of any future outputs and impacts will be submitted as soon as they become available.

or

This grant has not yet produced any outputs or impacts. Details of any future outputs and impacts will be submitted to the Research Outcomes System as soon as they become available.
iii) Submission of Data

Data arising from this grant have been offered for deposit with the UK Data Service. ✗

or

Data that were anticipated in the grant proposal have not been produced and the UK Data Service has been notified. ✓

or

No datasets were proposed or produced from this grant. ☐

Signature: 

Name: Grzegorz Trojanowski  

Date: 20 December 2012  

Revised: 18 February 2013

B: To be completed by Head of Department, School or Faculty

Please read the statement below then sign with an electronic signature to confirm your agreement.

This Report is an accurate overview of the project, its findings and impacts.

Signature: 

Name: Richard D. F. Harris  

Position: Director, Xfi Centre for Finance and Investment  

Date: 20 December 2012

C: To be completed by Finance Officer of Grant-Holding Research Organisation

Please read the statement below then sign with an electronic signature to confirm your agreement.

ESRC funds have been used in accordance with the ESRC Research Funding Guide. All co-investigators named in the proposal to ESRC or appointed subsequently have seen and approved the Report.

Signature: 

Name: Paul Jenkins  

Position: Research Accountant  

Date: 20/12/2012