Executive Directors, Pay Disclosures, and Incentive Compensation in Large European Companies

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Abstract

Using a proprietary database for the largest 158 European companies during 1999–2004, I find that transparency of executive pay disclosures and sensitivity of executive pay to performance increase with the proportion of top executives serving as company directors and with dual chief executive officer (CEO) and board chairs. These relations strengthen in countries with more protection for outside shareholders. The positive marginal effects of executive directors (i.e., insiders) on transparency of pay disclosures and sensitivity of pay to performance are not significant when (1) insiders already have the numerical majority on boards, (2) CEOs are board chairs, and (3) pay levels and company ownership of executives are relatively high. Overall, the evidence supports the optimal-contracting argument over the rent-seeking argument. Specifically, companies mitigate agency costs associated with the existence of company executives on boards through transparent pay disclosures and incentive compensation. However, such actions are limited to companies with strong country-level investor protection and significant representation of independent directors on company boards.

Keywords: International Corporate Governance, Executive Compensation, Board of Directors, Company Disclosure