行政院國家科學委員會專題研究計畫 成果報告

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Abstract

While most literature regarding compensation concentrates on executive compensation, compensation of other insiders is mostly ignored. This study intends to examine the impact of corporate governance on compensation to the board of directors and executives for the NASDAQ high-tech firms and the TSEC high-tech firms. This study has two major objectives. First, this study intends to investigate governance mechanism and insider compensation for high-technology firms listed in NASDAQ. Most studies of corporate governance and compensation focus on large firms, such as Fortune 500 or S&P 500 firms, in which company stocks are held dispersedly. On the contrary, the high-technology firms listed in NASDAQ are smaller with higher ownership concentration. Second, the study will be extended to a comparison between the NASDAQ high-tech firms and the TSEC high-tech firms. The major reason to compare the relation of corporate governance and insider compensation between the NASDAQ high-tech firms and the TSEC high-tech firms is due to the similar firm characteristics in business operation and corporate control.

This study provides a framework to examine whether the insiders, especially the board of directors, influence the compensation policy for their own interests when they are also the guards of company’s governance mechanism. Through the compensation between the NASDAQ high-tech firms and the TSEC high-tech firms, we can better determine whether the insiders of Taiwanese firms are reasonably compensated, and we can assess the value of corporate governance under different regulations. Finally, we can better determine whether a company’s corporate governance mechanism is really well-designed to protect the rights of capital provider.
1. Motivation and Objectives

The topics of managerial compensation have discussed for decades, among which the determinants of compensation and the relation between compensation and firm performance are mostly examined (e.g., Murphy, 1985; Jensen and Murphy, 1990; Mork et al., 1998; Himmelberg et al., 1999; Denis et al., 2000; etc.). The common goals of these studies are to examine whether managerial compensation enhances the value of firms and the wealth of shareholders.

While the understanding of the economic intuition of managerial compensation is increased through a series of theoretical and empirical studies, the goals of interest-aligned compensation contract do not seem really achieved (e.g., Jensen and Murphy, 1990; Palia, 2001; Ittner et al. 2003; etc.) A good reason of such unfavorable outcome could be attributed to such unique, non-financial characteristics of firms as corporate governance mechanism. Even though a firm’s governance mechanism highly depends on the legal system of the country where the firm is located, company culture and attitude of insiders and shareholders play significant roles (e.g., Mehran, 1995; Core et al., 1999; Brick et al., 2003; etc.). A firm’s governance mechanism has a great impact on its major polices which in turn influence its value. The impacts of a firm’s governance mechanism are not only on how its managerial compensation is determined but also on the effectiveness of such interest-aligned compensation contract in enhancing the value of the firm. Therefore, it is necessary to examine the direct influence of corporate governance on determining managerial compensation as well as the impact of corporate governance on firm performance which in turn influences the level of managerial compensation.

While the studies of compensation are centralized on managerial compensation, the compensation of other insiders such as the board of directors is less discussed. In most frameworks regarding agency problems, the interest conflicts between shareholders and
managers receive great attention, the study of which assumes that the interests of the board of directors and other shareholders are consistent. However, such assumption may not be appropriate especially to the firms in countries where many firms are controlled by some individuals or families and common shareholders are not legally well-protected (e.g., Claessens et al., 2000; La Porta et al., 2000; etc.). In these firms, directors hold a higher power in determining strategies and managing firms, and put a higher human capital on firms. As a result, the impacts of directors’ behavior on firms’ value could be more essential than the impact of managers’ behavior on firms’ value. In addition, the level of director compensation affects the dollar return to shareholders since it decreases earnings available to common shareholders. Yet, the director compensation is less discussed and examined.

Furthermore, the phenomenon that a firm’s managers serve as directors is commonly observed in many firms (eg., La Porta et al., 1999; Classens et al., 2000; Chen and Jaggi, 2000; Ho and Wong, 2001; Yeh and Woidtke, 2003; etc.). It in theory should be an effective way to improve corporate governance, but it in practice could enlarge firm, founders are usually executive directors since they have better incentives to promote firm value and to protect the firm from some hostile investors. Executive directors have both control and management power, which enable them to increase the efficiency of policy making and thus to mitigate the conflicts between board of directors and managers. However, while the firms become bigger and older, especially becoming family controlled forms, the generous intention in promoting firm value may become the consideration of private benefit. Hence, the compensation of executive directors should be discussed separately, which, in contrast, is mostly included in the analyses of CEO compensation.

This study has two major objectives. First, this study intends to investigate governance mechanism and insider compensation for high-technology firms listed in NASDAQ from year 1992 to 2003. Most studies of corporate governance focus on larger firms, such as
Fortune 500 or S&P 500 firms, in which company stocks are held dispersedly. On the contrary, the high-technology firms listed in NASDAQ from year 1992 to 2003 are smaller firms with higher ownership concentration. Other than different ownership structures, big firms have many different characteristics in corporate governance from small (technology) firms. The empirical evidence of existing studies may not be suitable to explain the issues faced by these small (technology) firms and their shareholders. Even though the aggregate market value of the small firms accounts for a relatively low proportion of total market value, the small (technology) firms play an important role in explaining the high stock price volatility in 1999 and 2000. Therefore, it would compete the studies of corporate governance to investigate governance mechanism and insider compensation for high-technology firms listed in NASDAQ from 1992 to 2003.

Second, the study will be extended to a comparison between the NASDAQ high-tech firms and the TSEC high-tech firms. The major reason to compare the relation of corporate governance and insider compensation between the NASDAQ high-tech firms and the TSEC high-tech firms is due to the similar firm characteristics in business operation and corporate control. Most of these technology firms have business connection with others in different geographic areas. They are mostly founded by the technology experts who also have significantly influential power in decision control and decision management. In addition to founders’ initial investment, there usually exist other major initial investors to sponsor the initial development of these firms. Such starting shareholders may hold the stock for short run (like venture capital) or for a longer period (like large corporation). Therefore, after investigating the governance and insider compensation for NASDAQ high-tech firms, the evidences could then be used to compare and contrast the governance and insider compensation of the TSEC high-tech firms. By doing so, we can avoid the possible bias in applying the existing literatures, focusing on large firms, to explain the similar issues by the
shareholders of Taiwanese firms.

2. Summary of Empirical Results

This research intends to investigate the impacts of corporate governance on insider (executives and the board of directors) compensation for technology sector of the NASDAQ and to compare and contrast such issue between the NASDAQ high-tech firms and the TSEC high-tech firms. For the NASDAQ high-tech firms, samples are selected based on the SIC code. The corporate governance data and compensation data are disclosed in firms’ proxy statements. Investor Responsibility Research Center (IRRC) is the major provider of corporate governance data. All firm data, such as accounting returns, invested capital, book-to-market value of equity ratio, firm size, cash and short-term investment, fixed assets, total assets, and others are collected from Compustat database. In addition, the data used to estimate stock volatility will be collected from CRSP database. All company data, including corporate governance factors and compensation, of the TSEC firms are collected from the database of Taiwanese Economics Journal (TEJ).

The empirical results shows that: first, for the NASDAQ high-tech firms, higher managerial ownership requires less incentive pay, and for the TSEC high-tech firms, executives in family controlled firms receives less incentive pay than non-family controlled firms. Second, for the NASDAQ high-tech firms, the existence of the founder CEO is negatively related to CEO cash compensation and positively related to CEO option compensation, because the founder would accept low cash compensation and higher option compensation in order to convince shareholders of managerial commitment and future profitability; for the TSEC high-tech firms, non-family controlled firms pay higher compensation to professional managers and executive directors than executives in family controlled firms, because the latter don’t need to eliminate agency cost. Third, for the NASDAQ high-tech firms, the independence of the compensation is positively related to
option compensation to insider; for the TSEC high-tech firms, independent director ratio has positive relationship to divided policy in family controlled firms than non-family controlled firms, implying that family controlled firms can improve firm value by employing more independent directors to improve board independency.

3. Contribution

This study contributes the existing literatures by the following two sections. First, this study would complete the current governance study by examining the impact of governance mechanism on insider compensation for technology firms listed in NASDAQ. Second, this study investigates the validity of insider (executives and directors) compensation of Taiwanese firms by comparing and contrasting the impact of governance mechanism on insider compensation between the NASDAQ technology firms and the TSEC technology firms.

The ultimate purpose of governance mechanism is to protect the rights of capital providers when company value is maximized. In theory, compensation is one of the mechanisms to enhance a firm’s corporate governance. A company’s governance mechanism should not be easily influenced by any insiders. So, the best example is the adoption of independent directors who may not be really able to influence the decision control-management process. This study provides a framework to examine whether the insiders, especially the board of directors, influence the compensation policy for their own interests when they are also the guards of a company’s governance mechanism. Through the comparison between the NASDAQ technology firms and the TSEC technology firms, we can better determine whether the insiders of Taiwanese firms are reasonably compensated, and we can assess the value of corporate governance under different regulations. Finally, we can better determine whether a company’s corporate governance mechanism is really well-designed to protect the rights of capital provider.


La Porta, R., F. Lopez-de-Silanes, and A. Shleifer (1999), ”Corporate ownership around the world,” Journal of Finance, 54, 471-517.