

Research on the Influence of Executive Compensation Incentive on Company Growth

Lin Chen

School of Management, Shanghai University, Shanghai 200444, China

ABSTRACT. *Based on the panel data of GEM listed companies from 2014 to 2016, this paper studies the relationship between different executive compensation incentive methods and the growth of companies, and discusses how different executive incentive methods affect the growth of innovative enterprises. The results show that there is a significant positive correlation between executive compensation incentive, equity incentive and the growth of innovative enterprises. However, the compensation gap has no significant impact on the growth of innovative enterprises. It can be seen that compensation incentive and equity incentive can positively promote the growth of innovative enterprises, but the relationship between compensation gap and the growth of innovative enterprises has not been effectively verified.*

KEYWORDS: *executive compensation incentive, enterprise growth, compensation incentive, equity incentive*

1. Introduction

In recent years, the economic growth rate of countries around the world has slowed down significantly, and developed countries have shifted from being resource-oriented to technology-oriented. Statistics show that the economic value created by technological advances driven by innovative technologies has accounted for about 60-80% of the economic growth of European and American countries. In the international market, China gains trade advantages mainly through resource and population advantages. Nowadays, with the gradual emergence of China's aging population and environmental pollution, China's economic development needs to be driven by the transformation from the former resource-utilization type to the technology-leading type. Among them, the development of high-tech innovation-oriented enterprises is the basis of China's technology leading strategy. For the time being, in modern corporate governance, the incentive mechanism of senior executives plays an increasingly significant role. In addition to exerting a subtle

influence on enterprise innovation and R&D decisions, the incentive mechanism of senior executives also exerts an important influence on corporate growth.

In view of this, this paper will study the influence and function of the management incentive mechanism on the growth of enterprises and whether the influence of the executive incentive mechanism on the growth of innovative enterprises is significant. Based on the above research, this paper discusses whether different executive compensation incentives have the same impact and effect on corporate growth.

This article will start with the GEM, focusing on the relationship between the three types of executive incentives and corporate growth, to research the impact of executive incentives on the growth of the company. And then it will arouse the management department to scientifically consider the innovation input level, encourage enterprises to establish a sound executive incentive system, by the way of mobilizing the motivation of management department, cultivating innovative technology capabilities, so as to improve corporate performance and promote the enterprise to develop in a stable way, which will ultimately achieve the goal of promoting the advance of technology and industrial upgrading in our country. The innovations of this paper mainly include the following three points: first, by combining with the characteristics of GEM companies in China, this paper discusses the relationship between different executive incentive methods and corporate growth. Second, by dividing the executive incentive into three types, it analyzes the mechanism of executive incentive on the growth of the company, and discusses which incentive mode can better motivate the management to promote the development of enterprise innovation ability. Third, it provides evidence for regulators and other stakeholders for putting a more flexible GEM incentive into practice.

2. Literature review and research hypothesis

According to the principal-agent theory, it is the separation of ownership and management right that causes the conflict between the interests of shareholders and management. As a rational economic man, the management's nature of pursuing interests and the information asymmetry between the management and shareholders have led to the issue of principal-agent problems. External compensation will motivate rational executives to work hard to obtain more benefits. First of all, direct monetary compensation can ensure that executives are willing to take actions conducive to the growth of the enterprise in order to obtain continuous compensation. Secondly, equity incentive with long-term incentive orientation promotes the convergence of executives' own interests and corporate growth goals, which can effectively reduce managers' moral hazard and agency costs, and promote the management to pay attention to the long-term growth performance of the enterprise. In addition, the salary gap can mobilize the initiative of the management to establish a benign internal competition mechanism to promote the sustained, healthy and rapid development of the enterprise.

2.1 Compensation incentive and growth of innovative enterprises

As compensation incentive is a guaranteed factor, short-term and direct compensation to senior executives is the basic guarantee of motivation. Existing researches support the positive effect of compensation incentive on corporate performance. In the 1920s, foreign studies on executive compensation incentive and corporate growth gradually emerged. Ciscell and Carroll (1980) studied more than 200 enterprises in the two periods of 1970-1971 and 1973-1976, and found that there was a positive correlation between the remuneration of senior executives and the growth of enterprise sales and profits. Abowd (1990) found through empirical research that the company's return on total assets, return on equity and market return have significant positive correlation with the currency compensation of senior executives. Chen Xiaohong et al. (2007) conducted an empirical study on 118 small and medium-sized enterprises in Shanghai and Shenzhen, and concluded that annual salary incentive mode and equity structure mode were positively correlated with growth. Based on the large differences in the various sectors of the market, Liu Lei (2013) conducted in-depth research on the GEM market and discussed the effect of executive compensation incentives. The growth score of GEM listed companies is constructed by factor analysis method to explore the effect of executive compensation incentive on enterprise growth. The results show that the currency compensation incentive and the proportion of senior executives shareholdings are positively correlated with the growth of GEM listed companies.

Some scholars believe that executive compensation has a negative correlation with the company's growth or their relationship is not significant. After studying the correlation between the growth of listed companies in China and the proportion of executive compensation, Bian Zhijing (2008) considered that the proportion has a significant correlation with the growth of companies. At the same time, it is found that the higher the shareholding ratio of senior executives is, the lower the growth rate of the company is. It is concluded that the key to the effectiveness of executive compensation incentive lies not in the shareholding ratio but in the improvement of the equity compensation ratio in the executive compensation structure. Fang Junxiong (2009) used empirical research to conclude that with the further deepening of the salary system reform, the executive compensation of listed companies in China has shown high sensitivity to performance, but the sensitivity between the two is asymmetric. There is a sticky characteristic that is the decrease in salary when performance is degraded is significantly lower than the increase in salary when performance is rising. It can be seen that the management of the company will be able to make decisions that are beneficial to the future development of the company under the incentive of the salary, so as to promote the better development of the enterprise in the future. Senior executives themselves have endogenous enthusiasm to maximize their annual salary and other benefits by improving the company's operating performance. So they will take actions that are conducive to the growth performance of the company.

Therefore, the following hypothesis is proposed. Hypothesis 1: salary incentive is significantly positively correlated with the growth of entrepreneurial enterprises

2.2 Equity incentive and growth of innovative enterprises

Equity incentives generally refer to the benefits of stocks and options with long-term and risk characteristics as incentives for management. This is a typical means of urging management and the company's interests to be consistent and avoiding agency problems.

Jensen and Meckling (1976) first studied the relationship between management stock ownership and corporate performance. They believed that the granting of management stock ownership would make management and shareholders achieve the same goal for their interests, thus greatly reducing agency costs and promoting the sustainable development of enterprises in the future. Zhou Jianbo and Sun Jusheng (2003) used the empirical evidence of listed companies in China to examine the relationship between the operator's equity incentives and the improvement of the company's operating performance. The research results show that for companies with higher growth rate, the improvement of the company's operating performance is significantly positively related to the number of shares held by the operators due to the increase in equity incentives. In addition, it is found that the operators have used the equity incentive mechanism to profit for themselves. Therefore, we should pay attention to the importance of equity incentive subject. Chen Xiaohong et al. (2007) confirmed that the growth of small and medium-sized companies has a significant positive correlation with management compensation and a significant u-shaped relationship with shareholding ratio, indicating that compensation incentive and moderate equity incentive have a positive impact on the growth of companies. Xu Juanjuan et al. (2016) took China's A-share listed companies from 2007 to 2013 as samples, further verified that there was a significant positive correlation between the implementation of equity incentives and CEO equity incentive intensity and company performance.

It can be seen that equity compensation brings the interests of executives and shareholders into line, which greatly lays a foundation for improving the growth performance of innovative enterprises. On the one hand, for the management, while reducing the principal-agent problem, the equity incentive gives the senior executives some residual claims, and motivates the senior executives to consider the long-term interests of the enterprise and make more decisions and plans in line with the benign growth of the enterprise in the future. In addition, equity incentive is more effective in private enterprises. On the other hand, for innovation-oriented enterprises, the implementation of equity incentive for senior executives essentially gives them the promise of more future rewards. The construction of the optimal compensation contract is conducive to the sustainable development of enterprises in the future. In view of this, equity incentive can not only encourage executives to pay attention to the future interests of the enterprise, but also reduce the occupation of corporate liquidity and other resources, so as to promote the rapid, sustained and healthy growth of the enterprise.

Therefore, the following hypothesis is proposed. Hypothesis 2: equity compensation is significantly positively correlated with the growth of entrepreneurial enterprises.

2.3 Compensation gap and growth of innovative enterprises

Compensation gap refers to the difference between the top three executives' compensation and the average executive compensation. Tournament theory holds that it is very necessary to maintain the gap of executive team salary. The pay gap not only reduces the cost of shareholders' monitoring of managers, but also greatly motivates managers to work. For example, Leonard (1990) found that when expanding the internal pay gap of executives, business managers will work hard to ensure the future performance and growth of the enterprise. Xu Yixuan (2010) found a significant positive correlation between the relative salary gap and performance of listed companies in China. Wu Jizhong (2012) found that in enterprises supported by private equity funds (PE), the variance of management compensation and shareholding variance have a positive correlation with the growth of enterprises, which is consistent with the championship effect, and the gap of executive compensation can bring vitality to enterprises. Liu Zijun, Liu Zhiqiang and Liao Jianqiao (2011) discussed the gap and its impact on executive compensation in Chinese enterprises. The conclusion shows that there is a significant positive correlation between the salary gap and corporate performance. All the above papers support the championship theory.

The behavioral theory holds that the salary gap will play a negative role. For example, Zhang Zhengtang and Li Xin (2007) found in their empirical study that the salary gap has a negative impact on enterprise performance. By distinguishing the pay gap from the absolute and relative pay gaps, this article further examines the relationship between executive pay gaps and firm performance. Research shows that there is no significant difference between absolute and relative pay gap.

It can be seen that there are still some differences in the conclusion of the effect of salary gap on enterprise performance. At present, in China, years of market-oriented economy has increased the sensitivity of monetary compensation of senior executives to corporate performance. In addition, due to the differences between core executives and ordinary executives in terms of abilities and contributions, executive compensation gap can effectively promote the competitive consciousness and efforts of executives at different levels, and is conducive to the core role of core executives in promoting corporate innovation and entrepreneurship.

Therefore, the following hypothesis is proposed. Hypothesis 3: the salary gap is positively correlated with the growth of entrepreneurial enterprises.

3. Variable design and sample data

3.1 Samples and data sources

The research period of this paper is from 2014 to 2016. The screening criteria of the original data are as follows: (1) Select companies listed before December 31th, 2014. (2) Eliminate information disclosure and other reasons for the punishment of listed companies. (3) Eliminate the lack of relevant financial data listed companies.

A total of 668 gem companies were selected as samples in this paper. The financial data of this paper mainly comes from CSMAR database. Statistical analysis software Stata14 was used to process relevant data and conduct quantitative analysis.

3.2 Model

$$\text{GROWTH} = \beta \ln \text{GQ} + \beta \ln \text{CX} + \gamma \text{CXGAP} + \delta \text{LEV} + \varepsilon \text{SIZE} + \text{YEAR}$$

3.3 Variable design

(1) The dependent variable

Enterprise growth: it is mainly manifested in the expansion of enterprise scale, profitability and improvement of operating efficiency. By referring to existing studies, it measures enterprise growth by the growth rate of main business income.

(2) The independent variable

The definition of senior executives by Wang Aiguo and Xu Xiangzhen (2015) is adopted. In addition to the general manager, deputy general manager, chief financial officer and secretary of the board stipulated in the company law, it also includes Board of Supervisors and Board of Directors. Executive compensation can be expressed by the total annual salary of chairman, supervisor and executive. For equity incentives, it is the ratio of the total number of managerial holdings to the total number of shares in the company. Regarding the compensation gap, the absolute difference method is adopted to measure the difference between the average compensation of the top three executives and the average compensation of the senior executives.

Table 1 Variable design

CX	Executive compensation incentive	Equity incentive (GQ)	the total number of management shares disclosed in the annual report/the total number of shares of the company, taking the logarithm
		Compensation incentive (CX)	the logarithm of the total compensation of the management disclosed in the annual report, take the logarithm
		The CXGAP	the average compensation of the top three executives/ the average compensation of the senior executives
GROWTH	Growth	Rate of main business revenue Year-end operating income / operating income at the end of the previous year - 1	
LEV	Financial leverage	Asset-liability ratio (control variable)	
SIZE	Business scale	Natural logarithm of total assets at the end of the year (control variables)	
YEAR	Year	Virtual variable	

4. Empirical results analysis

4.1 Descriptive statistics

The following table shows the mean and standard deviation of the main variables, which basically meet the requirements of statistics and economy. Growth data of GEM are mostly stable between 0.3-0.5. The total salary data show a state of increasing year by year, which reflects the trend of increasing the compensation incentive amount of gem executives year by year. Equity incentive is mostly negative due to logarithm. However, the salary gap is quite different due to the different salary of each company.

Table 2 Descriptive statistics of main variables

Stats	Growth	CX	GQ	CXGAP	Size	Lev
Max	5.570	17.00	-0.254	1.423e+06	4.140e+10	0.843
Min	-0.911	13.20	-12.28	-1.942e+06	1.720e+08	0.0293
Mean	0.327	15.08	-1.666	-134127	2.580e+09	0.301
p50	0.207	15.05	-1.058	-97417	1.650e+09	0.277
Sd	0.563	0.565	1.599	267727	3.360e+09	0.163
N	918	1099	1059	1099	1099	1099
Stats	year					
Max	2016					
Min	2015					
Mean	2016					
p50	2016					
Sd	0.498					
N	918					

4.2 Correlation analysis

It can be seen from the following table that the growth index of innovation-oriented enterprises has a positive relationship with salary incentive and equity incentive. The correlation coefficient of growth index to equity incentive is significantly higher than that of growth index to salary incentive, which reflects that the incentive effect of equity incentive is significantly higher than that of salary incentive. However, the compensation gap has a negative relationship with the growth of innovative companies.

Table 3 Pearson correlation coefficient matrix

	Growth	CX	GQ	CXGAP	SIZE	LEV	YEAR
Growth	1						
CX	0.0286	1					
GQ	0.0526	-0.0176	1				
CXGAP	-0.0117	0.0087	-0.0366	1			
SIZE	0.2379	0.3523	-0.0375	0.0607	1		
LEV	0.21	0.0834	-0.1299	0.0525	0.3195	1	
YEAR	-0.006	0.0472	-0.0241	0.0724	0.1076	0.0087	1

4.3 Multiple regression results

When testing the relationship between executive compensation incentives and the growth of innovative enterprises, the robust standard error regression was added to solve the heteroscedasticity problem the following table is the results of multiple regression before and after ROBUST.

Table 4 Multiple regression results before Robust

	Growth
CX	0.0586*
	(0.0349)
GQ	0.0265**
	(0.0109)
CXGAP	-5.97e-08
	(6.90e-08)
size	3.54e-11***
	(5.98e-12)
lev	0.539***
	(0.117)
year	-0.0270
	(0.0366)
_cons	55.32
	(73.80)
N	894
R2	0.087
adj. R2	0.081

Standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 5 Multiple regression results after Robust

	Growth
CX	0.0586*
	(0.0388)
GQ	0.0265***
	(0.00949)
CXGAP	-5.97e-08
	(7.33e-08)
size	3.54e-11**
	(1.45e-11)
lev	0.539***
	(0.124)
year	-0.0270
	(0.0358)
_cons	55.32
	(72.23)
N	894
R2	0.087
adj. R2	0.081

Standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

In the above two tables, company size and financial leverage are significantly positively correlated with the growth of innovative enterprises, which is in line with statistical and economic significance. As can be seen from table 4, the growth of the company is significantly positively correlated with salary incentive and equity incentive, while the growth of the company is not significantly correlated with salary gap. The regression coefficient of executive compensation incentive and innovation-oriented enterprise growth is 0.0586, which is significantly positively correlated. ($p < 0.1$). The regression coefficient of executive equity incentive and innovation-oriented enterprise growth is 0.0265, which is significantly positively correlated ($p < 0.05$). However, there is no significant correlation between executive compensation gap and innovation-oriented enterprise growth. After joining the Robust standard error regression to solve the heteroscedasticity problem, the significant effect of equity incentive on the growth of innovative enterprises increased. ($p < 0.01$).

In conclusion, it indicates that executive compensation incentive and equity incentive can improve the growth of innovative enterprises, while the salary gap has not been verified. Therefore, hypothesis 1 and 2 are valid, while hypothesis 3 is not.

4.4 Multicollinearity

In order to avoid pseudo-regression problems, multicollinearity test is needed. The criteria for judging multicollinearity are as follows: First, the largest vif is bigger than 10.; Second, the average vif is greater than 1. When both criteria are met, the multi-collinearity is assessed. The test found that the VIF values of the main variables were all less than 3, indicating that there is no multicollinearity.

Table 6 Variance expansion factors

Variable	VIF	1/VIF
size	1.28	0.783009
CX	1.14	0.874816
Lev	1.13	0.882200
GQ	1.02	0.982485
year	1.01	0.987040
Mean VIF	1.12	1.01

5. Research conclusions

In view of this, the incentive mechanism of the management has a positive effect on the growth of the company, which fully conforms to the essence of the incentive theory, indicating that whether it is senior executives or ordinary employees, compensation incentive is an important and necessary way to improve the enthusiasm of the management. Both compensation incentive and equity incentive have significant incentive effects, and the introduction of equity incentive will greatly improve the incentive effect and reduce the agency cost. Therefore, a reasonable salary incentive structure can effectively promote the growth and development of innovative enterprises. Meanwhile, the combination of long-term and short-term incentives will be a sharp tool to solve the principal-agent problem. However, the impact of salary gap on the growth of the company is not significant, and there may be problems in the selection of indicators.

6. Management inspiration

Under the background of China's deep economic transformation, innovative enterprises play an indispensable role. To strengthen internal corporate governance, innovative enterprises can improve the incentive effect of executives through scientific and reasonable executive compensation contracts, and promote the growth and development of enterprises. In terms of the content of the compensation contract, it can follow the principle of combining the short-term incentive effect of compensation with the long-term incentive effect of equity incentive. On the one hand, it should follow a good performance appraisal system and pay attention to the direct material incentive such as annual salary or bonus. Besides, we should use the benefit driving effect of stock options to perfect the long-term incentive mechanism.

Furthermore, when formulating executive compensation contracts, the company must effectively adjust the focus of compensation and equity. We should focus on equity compensation with long-term effects and weaken the short-term role of compensation incentives, so as to avoid increasing the annual salary of management and occupying a large amount of cash and other resources. This is not conducive to achieving the purpose of incentives, but also limits the effective implementation of corporate competition strategies. In addition, more attention should be paid to optimize the internal promotion mechanism and supervision mechanism to avoid the adverse effects of excessive competition.

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