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Executive Compensation and Accounting Performance in French

Yamina Amarou [α] & Mohamed Bensaid [σ]

Abstract- **The empirical study carried out on 37 French companies listed on the SBF120 index over the period 2015 analyzes the relationship between the accounting performance and the level of executive compensation. Our analysis demonstrated that the level of cash compensation (wages and bonuses) is affected by the size of the firm. In addition, it appears that certain governance variables negatively affect the level of executive compensation. In addition, and contrary to expectations, our results show that the ROA's accounting performance does not affect compensation.**

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I. Introduction

Executive compensation is an essential part of the governance system, as it aligns the interests of shareholders with those of management. This link between the remuneration of managers and the performance of the company has been the subject of several studies which have produced contradictory results. Practically, existing empirical studies report contradictory evidence on the impact of corporate performance on executive compensation. Some studies have found a positive relationship between the level of executive compensation and performance (Crespi-Cladera and Gispert (2003)), others found no relationship between managerial pay and performance Dogan and Smith (2002), Makinen (2005), Broye and Moulin (2010). Others, however, found relationships varying according to the performance measure used (Antle and Smith (1986)).

In France, where most French listed companies have proved to be family-run and often confused between control and management (Boubaker, 2005), the results of these developments remain nuanced. On the one hand, Pigé's research (1994) has pointed out that the link is positive but of low magnitude. On the other hand, Poulain and Rehm (2000) and Albouy (2004) announced the absence of the link. Hence, the question of the explicit determinants of executive compensation and its implicit link with performance in listed French family businesses proves to be of enormous importance. In particular, the treatment of this link remains timidly addressed in this specific field (Finkelstein and Hambrick, 1989, Golderg and Idson, 1995, Ramaswamy et al 2000, Hirigoyen and Poulain-Rehm, 2000).

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The objective sought by this article is to present the theoretical aspects justifying the remuneration policies of the managers of the companies and to question the implicit link between the remuneration of these managers and the performance in these companies. It is then necessary to present the theoretical framework that justifies the remuneration allocated to managers and its relation to the performance of the company. Finally, we propose an empirical analysis during the year 2015 that concerns 37 French companies listed on SBF120.

II. Review of Literature and Formulation of Hypotheses

a) Agency theory

In 1776, Adam Smith understood that a conflict of interest could arise between the owners and the non-owners in the company. This conflict of interest has arisen between two (or more) parties when one of these two parties (non-owner) acts either on its own or as the representative of the other (owner). Berle and Means (1932) in their work "The Modern Corporation and Private Property" highlight the predominance of the managerial firm as a mode of majority organization of capitalism. This firm is characterized by its dispersed ownership and by professional managers ensuring its operational management. Jensen and Meckling (1976) extend this analysis and consider that the firm is a contracting nexus, associating the firm with all the different providers of resources indispensable to the organization's functioning. They model the agency relationship by representing the link between the agent (managers) and the principal (the shareholders).

Therefore, the principal-agent literature postulates that compensation should be based on appreciable results and that contracts should be designed to motivate agents of better performance, therefore there should be a positive relationship between executive compensation and performance of the company. In the theory of the agency, the problem is to create an incentive structure that aligns the interests of shareholders with the benefits of the managers. To achieve this objective, a compensation contract is generally offered to managers to increase the wealth of shareholders (J & M1990). In this context, performance improves.

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According to the agency's theory, if a compensation contract reduces agency costs, the adoption of a compensation system by the firm should result in an increase in the wealth of shareholders. Also the decisions of the governed remuneration taken by the manager should lead to an improvement of the performance of the company. Once manager receive adequate compensation, it assumes they work harder and contribute to the company's performance increase.

Nevertheless, the remuneration contract is incomplete because it is impossible to predict all the situations in which the managers will have the opportunity to act from a perspective contrary to the maximization of firm value. From an agency perspective, this means that other governance mechanisms need to be put in place to control the agency's relationship and to prevent leaders from diverting the wealth of shareholders by making decisions such as Over-investment in excess free cash flow (Jensen, 1986). From a political-contractual perspective, this implies that the remuneration contract must recognize both short-term and long-term performance, both accounting and market.

Many of the existing empirical research reported contradictory results when the relationship between performance and executive compensation starting with a survey by Lewellen (1970) suggests that there is a considerable correlation between performance and wage levels of the framework. Additionally, they find these long-term remuneration elements had little effect on that reward-performance bond. Lambert and Larcker (1987) show that compensation (salary + bonus) is positively and strongly related to the measure of accounting performance (asset return), but moderately related to the measure of market performance (stock returns)

A study by Gerhart and Milkovich (1990) found that the composition of remuneration was performance-related. The authors found that an increase of 1 percentage point in the return on assets (ROA) resulted in an increase in base salary of 0.2% ($ 142). Sloan (1993) the existence of a positive link between executive compensation and accounting indicators that contain less noise than stock market measures.

Doucouliagos and Hoque (2005) found a positive association between pay and performance in the firm, Clarkson, Nichols and Walker (2006) find a positive association for 336 Australian firms for the period 1998-2004. Similarly, Dardour and Husser (2014) found a positive relationship. While Broye and Moulin (2010) demonstrated that the company's financial or stock market performance does not affect the remuneration of French executives for the year 2005. And others have found a negative relationship between executive pay and the ROA's accounting performance, for example (B et al., 2006), its study was based on 174 Japanese firms from 1992-96.

Generally, the empirical results that link pay to performance, even positive and significant, are insufficient to consider that performance can play an important role in determining executive compensation. Based on these studies, we propose that:

Hypothesis 1: The relationship between executive compensation and the company's accounting performance is positive.

III. Description of the Sample

Our initial work sample is made up of 37 companies listed on the French constituting the SBF120 index for the year 2015, it is limited to operating companies, mainly in industrial sectors and services. The choice of companies in our sample was random and simple. Data on variables are collected from the annual reports and reference documents of these firms.

a) *Defining Variables*

In the framework of the model that we wish to develop, we start from the same theoretical postulate, namely that there is a relation between the remuneration of the managers and the accounting performance of the company, we want to justify our hypothesis and know Nature of this relationship. But first, we identify the dependent and independent variables of our model.

i. *The dependent variable*

Since the Breton Act of 26 July 2005, listed companies have been obliged to publish the remuneration of corporate officers. Prior to this date, a similar obligation was imposed by the NRE law of 15 May 2001, but most companies were content with this global information, thus not making public the remuneration received individually for each proxy.

The total amount of compensation received by the managers during the reference year 2015 was obtained from the analysis of the annual reports, in our subject we use the normal log of executive compensation calculated by (Ln REM)). This amount of remuneration is understood to include the fixed part (salary) and the variable part (bonus, benefit in kind) of remuneration that have been disclosed in the annual reports and do not include so-called long-term incentives such as Allocations of free shares or stock options. First, we want to follow the work of Piketty (1997) and Landais (2007) on the effect of performance on pay (wage + bonus) irrespective of the long-term incentives. Compensation is due to the absence of observable annual data. The available data are indeed estimates made on the option values, with the Black-Scholes method generally; these estimates may deviate from the values that will actually be realized at the end of

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the option, this may have been particularly true for options granted prior to the 2008 crisis and whose underlying capital gains have fallen.

ii. *Independent variables*

For the construction of our model, we used an independent variable and four control variables drawn from empirical studies to date.

The first of the independent variables to which we are interested in designing this model is the company's performance. We follow the study of Larker (2002), and Makinen (2005) in the measure of accounting performance, that they adopt the ROA as measure of this performance.

iii. *The control variables*

Based on the existing literature, four control variables were selected:

In France, the influence of a controlling shareholder is in particular terms, since a large number of listed companies are controlled by a majority shareholder. In addition, numerous Anglo-Saxon studies confirm that a higher shareholding held by the control blocks has a negative influence on the CEO's remuneration (Lambert et al., 1993 Cordeiro and Veliyath 2003; Ozkan 2007).

Ownership of majority shareholders (CONCEN) is owned by shareholders owning more than 5% of the company's capital. We chose 5% as do several researchers, such as Mehran (1995). Therefore, we have chosen the majority shareholder shareholders with more than 5% voting rights.

The size variable is an element traditionally taken up in the literature inherent in this research theme and must also be taken into account when describing executive compensation (Jensen and Murphy, 1990; Tosi et al., 2000; Albouy 2004). For the measurement of this variable, Crespi-Cladera and Gispert (2003) adopt the logarithm of the total turnover. So we measure the size (SIZE) by the logarithm of turnover.

In addition, the company's growth opportunities should also affect executive compensation. To the extent that managers are responsible for developing growth opportunities, they should be rewarded when these opportunities are indeed high (Smith and Watts 1992). The relationship between growth opportunities and the level of compensation should therefore be positive. We measure growth opportunities (MTB) through the market to book ratio, which measures the ratio between the company's market capitalization and the book value of its equity.

According to Jensen (1986), the debt policy is also a mechanism of control exercised by shareholders. Indeed, an executive who would have a significant recourse to the indebtedness would be sanctioned in his remuneration. It is introduced as an observable risk measure in a study by Harjoto and Mullineaux (2001) and as a determinant of the remuneration of company executives. The measure of indebtedness (LEV) in our study is the ratio of Debt = total debts / total assets.

IV. Research Methodology

In the light of the studies of (Basu et al. (2006), Menon et al. (2006), the methodology adopted in our study is based on the multiple regression model. For this we used the following model:

$$REM = \alpha 0 + \alpha 1\ ROA + \alpha 2\ CONCEN + \alpha 3\ MTB + \alpha 4\ SIZE + \alpha 5\ LEV + \xi$$

V. Results

Table 1 presents descriptive statistics for our sample. Over the period of 2015, the SBF120 managers received an average annual total remuneration of € 2001 million with a range of € 118 million to a maximum of € 35,000 million. It consists of 45% in average base salary and 41% in average annual bonus, with the remaining 15% consisting of exceptional remuneration, attendance fees and / or benefits in kind. It can be seen that in most of the companies selected in our sample the bonus value is equal to the salary value but the payout is monthly whereas the bonus payment period remains according to the context of the company. It should be noted here that a number of managers do not receive variable compensation, either in the form of an annual bonus or stock options.

On average, accounting performance is very low compared to financial performance 15.11% (Table 2), which leads us to conclude that the companies in our sample are based on the allocation of shares on the stock exchange.

As is known to French companies, the concentration of property shown in Table 1 is relatively low. The average percentage of capital held by the concentrated majority shareholders is equal to 42% (42% of the voting rights). The standard deviation of this variable is 0.268, which shows that this variable is somewhat volatile compared to the others. This result confirms the particularity of the French context, namely a grouping of capital around a few shareholders (La Porta et al., 1999). Indeed, the absence of the majority shareholder in French companies increases the level of remuneration of the leaders.

According to the table, size as an important factor influencing the level of executive compensation is noticed very volatile with a standard deviation of 3.78%. We also note that the level of debt held by companies is about 27.8%, indeed the dispersion of this variable is important since it extends from 2% to 85.8% (Table 2), and this implies that the companies we have chosen rely on external means (indebtedness) on average 27% in financing its investments.

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Finally, we note that more than half of the companies making up our sample are in the industrial sector 54% and the rest of these companies are specialized in the services sector.

Table 1: Descriptive statistics of dependent variables (numerical)

	N	MINIMUM	MAXIMUM	MEDIAN	SD
SALAIRE	37	597000,00	12810891,200	600814,22286	21773849,4615
BONUS	35	,00	12800000,000	514321,95714	21789581,9504
REM	37	118380,00	35000000,000	2001872 ,31429	71683982,6864
N valide (listwise)	37				

Table 2: Descriptive statistics of explanatory variables (numerical)

	N	MINIMUM	MAXIMUM	MEDIAN	SD
ROA	37	,01230	1,0681	,15114	,20648
MTB	37	,00068	10,4483	1,69553	2,21804
CONCEN	37	,01370	,99200	,418929	,268070
SIZE	37	3,6546	25,0663	20,5010	3,78152
LEV	37	,02166	,85896	,278309	,190778

a) Compensation and Performance

This section analyzes the test results of our research hypothesis on the impact of the company's accounting performance on total executive compensation, the results of the regression of our model are given in Table 3.

The results of the compensation estimate indicate that the model applied to our study sample is globally significant, its coefficients of determination are R^2 = 26.30% and the Fisher F statistics are significant at the 5% threshold for this model.

Thus, the adjusted R^2 value is 0.145 indicates that 14.50% change in total compensation is explained by the variation in the explanatory variables used in this model. And the presence of a significant constant at the 1% threshold with a very high positive coefficient (13.76) implies that the level of total compensation is explained by other governance variables that we have not used.

The coefficient of performance is negative and not significant (-0.52), this leads us to say that the accounting performance has no relation with the compensation of the managers in the companies of our sample. This result confirms previous studies by Menon et al. (2006), Makinen (2005), Broye and Moulin (2010) that there is no correlation between total compensation and accounting performance.

Whereas, we find more studies that found that the change in compensation was explained by the change in accounting performance (Ramasway et al. (2006) and Ghosh (2003), Dardour and Husser (2014).

Statistical results show that the size of the firm, as measured by the logarithm of total assets, positively and significantly affects the relationship between total compensation and performance, these findings corroborate the work of Leonard (1990), Yermack 2004), Kubo and Kato (2006), which indicate that the level of total compensation increases significantly with the size of the firm. Thus the other control variables specific to the firm (debt, ownership structure) are all non-significant.

Moreover, the review of statistical tests, allows us to refuse our underlying assumption that executive compensation has no relation to the accounting performance.

Table 3: Compensation and performance

VARIABLES	COEFFICIENTS	TEST-STUDENT
constante	13,768	7,69***
ROA	-0,528	-0,393
MTB	-0,353	-1,745**
CONCEN	-0,474	-0,410
SIZE	0,077	1,034*
LEV	-1,564	-0,923*
R^2=0,263 R^2ajust=0.145Fish=2,218**		

**** significant at the threshold of 1%, ** significant at the threshold of 5%, * significant at the 10% threshold.*

VI. Conclusion

This article was devoted to empirically studying the relationship between accounting performance with executive compensation policies.

The study in question is based on a sample of 37 French companies included in the SPF 120 index over a period of one year. This method was conducted using a multiple regression technique to capture the

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relationship between executive compensation and corporate performance.

From this study, we have shown the contradiction of previous studies for the impact of the accounting performance on the total remuneration of the managers In addition, this study indicates that the level of the total remuneration of the managers (salary and bonuses) is relatively unrelated to improved performance.

Regarding control variables only the size of the company has a favorable effect on the level of remuneration.

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