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The effect of institutional shareholders on the level and mix of South African chief executive officers' compensation

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Abstract

Agency theory would predict that, given the presence of large or powerful shareholders in a company, agency costs would be reduced. Excessive executive compensation can be regarded as being an externality problem that stems from the agency problem. Agency theory would also then predict that executives in companies with large shareholders would receive less compensation and a larger proportion of long-term incentive-based compensation than companies with smaller shareholders.

The validity of these two hypotheses has been tested using a unique cross-sectional, time series dataset and two statistical techniques. The first set of tests involve the construction of multiple regression models in order to provide evidence as to whether Chief Executive Officer (CEO) compensation is affected by institutional shareholders. The second method, using statistical tests of differences between means, involves separating the sample into two sub-samples, namely management- and owner-controlled firms, to ascertain whether these two groups remunerate their CEOs differently to each other, thus testing the hypotheses in an alternative manner to the regression models.

This report examines whether the presence of institutional shareholders affects the level and mix of CEO compensation for 50 companies listed on the JSE Securities Exchange over the five-year period 2002-2006. Original findings on the value of share options awarded to CEOs are presented, along with the trends in the level and mix of CEO compensation. Further research findings also include trends in the level of institutional ownership of listed companies over this period.

The results of both the regression models and tests for differences of means provide statistical evidence in support of the assertion that the presence of institutional shareholders do not have an effect on either the level or mix of CEO compensation. Suggested reasons for this result range from shareholder apathy, to not considering executive remuneration to be a significant enough issue for institutional shareholders, and finally to the suggestion that institutional shareholders perceive the level and mix of compensation paid to South African CEOs to be a fair reflection of their value to their company.