
Title registration for a systematic review: Does executive compensation predict publicly traded firms' financial performance and inaccurate financial reporting?

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Submitted to the Coordinating Group of:

- Crime and Justice
- Education
- Disability
- International Development
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- Food Security
- Social Welfare
- Methods
- Knowledge Translation and Implementation
- Business and Management
- Other:

Plans to co-register:

- No
- Yes Cochrane Other
- Maybe

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Title of the review

Does executive compensation predict publicly traded firms' financial performance and inaccurate financial reporting?

Background

Chief Executive Officer (CEO) incentive compensation is intended to motivate chief executives to help their firms attain important business goals by aligning CEO interests with those of the firm's stakeholders, including investors, employees and others. Incentive compensation refers to formal contracts to provide a bonus or pay increase contingent on the firm attaining a performance target—a common feature of publicly traded firms. Targets may be short-term such as an annual increase in stock price, or long-term such as revenue growth over a period of years. Since CEOs negotiate their own contracts, they may bargain for terms more favorable to themselves than to the firm's other stakeholders. Moreover, incentives can have unintended consequences including the manipulation of accounting data in order to increase the likelihood of receiving promised incentives. Disputes regarding the efficacy of executive incentive compensation involve whether CEOs are paid too much relative to the salaries of rank and file employees or their contribution to the firm's success. One purpose of our review is to identify whether incentive terms in CEO contracts predict firm financial performance over time; a second purpose is to identify whether incentive terms in CEO contracts predict subsequent inaccurate financial reporting as manifest in restatement of accounting data due to errors or other distortions in reporting financial information.

Policy relevance

A sound executive compensation policy is a reflection of the quality of organizational governance, and executive boards are largely tasked with the responsibility of determining CEO compensation in publicly traded firms. Corporate governance is the system of rules, policies and practices whereby the organization's executives and managers make decisions. In publicly traded firms, boards are typically obligated to serve the interests of shareholders through transparent processes and record keeping. How well the interests of shareholders and other stakeholders of organizations are served by executive compensation practices is a key concern in corporate governance. At the same time observational studies suggest that executive compensation can be a political process shaped by ties between board members and the CEO (e.g., Kramarz & Thesmar, 2013). Thus, having a sound understanding of the outcomes CEO incentive compensation predicts can inform evidence-based governance practices in modern firms.

Objectives

We seek to answer two key questions:

1. To what extent do CEO incentive compensation practices predict the financial performance of publicly traded firms?
2. To what extent do CEO incentive compensation practices predict inaccurate financial reporting?

Existing reviews

We thoroughly scoped the literature for existing systematic reviews and protocols on the topic of CEO incentives and firm financial performance, including contacting several leading experts in the field. No systematic reviews or protocols were found, however, the following narrative reviews and meta-analyses are examples of some of the efforts that have been made to synthesize the literature on this topic, and will be useful in developing the introductory sections of our review.

Devers, C. E., Cannella Jr, A. A., Reilly, G. P., & Yoder, M. E. (2007). Executive compensation: A multidisciplinary review of recent developments. *Journal of Management*, 33(6), 1016-1072. (A narrative review highlighting inconsistencies in findings, suggesting the importance of the time frames over which incentives were allocated in relationships between CEO compensation and financial results.)

Tosi, H. L., Werner, S., Katz, J. P., & Gomez-Mejia, L. R. (2000). How much does performance matter? A meta-analysis of CEO pay studies. *Journal of Management*, 26(2), 301-339. (Meta-analysis of the reverse effect of firm performance on subsequent CEO pay.)

Frydman, C., & Jenter, D. (2010). CEO compensation. *Annu. Rev. Financ. Econ.*, 2(1), 75-102. (A narrative review of research from 1940s to 2000s finds evidence of relationships of CEO compensation with both financial performance and accounting restatements, but cannot determine their nature or strength.)

Intervention

The focus of our review will be longitudinal studies of publicly traded firms in the US and elsewhere. We will include studies that provide information on the terms of CEO incentive compensation contracts and at least one of the following: 1) the firm's subsequent financial indicators and/ or 2) inaccurate financial reporting including accounting restatements in the form of corrections to firm financial reports and changes in reported earnings. We define CEO incentive compensation as financial incentives contingent on organizational performance. By this definition we exclude non-contingent incentives and rewards such as base salary as well as non-financial remuneration such as subsidized residences, club memberships, etc.

A related concern will be moderating factors that affect the extent to which CEO incentive contracts predict outcomes 1 and 2. Such factors might include the existence of an independent board and CEO tenure as well as other variables.

Population

The population of firms targeted by our review are publicly traded companies listed on a stock exchange, for which longitudinal data on firm performance are available. We focus on publicly traded firms because of the standardized nature of reported outcomes, which allows for comparison of effects of different kinds of CEO incentives. We exclude private firms, non-governmental organizations (NGO), and non-profit organizations (NPO).

Outcomes

The first primary outcome we focus on is firm financial performance, which can take a variety of forms including stock price increase, growth in return on assets, and other financial indicators. The second primary outcome is inaccurate financial reporting, often indicated by accounting restatements. As a consequence of inaccurate or misrepresented financial reporting, accounting restatements occur when earlier financial statements need to be revised and a corrected restatement filed.

Study designs

Our review will focus on longitudinal studies that include CEO incentive contract data and subsequent indicators of 1) financial performance or 2) inaccurate financial reporting. A critical issue is whether the CEO incentive contract terms can predict outcomes 1 or 2. Thus our designs will be longitudinal with contract term data measured prior to outcomes 1 or 2. Studies that control for randomness in financial results will be highlighted but we will include all studies identified with longitudinal designs, regardless of type of controls.

References

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Roles and responsibilities

- Content: Denise M. Rousseau is a senior organizational psychologist knowledgeable regarding both the content and research methods related to executive compensation and performance measurement. Byeong Jo Kim is an organizational researcher familiar with study methods and compensation theory.

- Systematic review methods: Senior librarian Sarah Young has worked on review teams in the past in the natural sciences and medicine. Senior librarian Dona Beck has completed a Peer Review regarding search strategies for a Campbell protocol.
- Statistical analysis: Rousseau and Kim are knowledgeable in statistical methods.
- Information retrieval: Donna Beck, Sarah Young and Ryan Splenda are experienced librarians, knowledgeable regarding information retrieval practices.

Funding

We are volunteering our time in order to conduct this review.

Potential conflicts of interest

Please read the [Campbell conflict of interest policy](#) (October 2013). Ask each of your co-authors to fill in a conflict of interest form (available in the policy), then describe any potential conflicts here. For example, have any of the authors been involved in the development of relevant interventions, primary research, or prior published reviews on the topic? Please submit your forms with the title registration form.

Preliminary timeframe

- Date you plan to submit a draft protocol: 1 December 2018
- Date you plan to submit a draft review: 1 December 2019