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An International Perspective  
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Discussion of

**“Executive directors, pay disclosures and incentive  
compensation in Europe”**

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# Research Question

**How COMPENSATION POLICIES/PAY DISCLOSURE PRACTICES relate to EXECUTIVES SERVING ON BOARDS OF DIRECTORS (i.e. INSIDERS)\*\***



**(-)**

## **OPPORTUNISM HYPOTHESIS**

**When executives are more influential on company boards, companies would make less transparent pay disclosures and executive pay would be less sensitive to company performance**

**(+)**



## **CONTRACTING HYPOTHESIS**

**When executives are more influential on company boards, companies would make more transparent pay disclosures and executive pay would be more sensitive to company performance**

**\*\* COMPENSATION POLICIES = DISCLOSURE OF EXECUTIVE PAY AND SENSITIVITY OF EXECUTIVE PAY TO PERFORMANCE**

**INSIDERS INFLUENCE = PROPORTION OF TOP EXECUTIVES SERVING AS COMPANY DIRECTORS AND DUAL CEO/BOARD CHAIRS**

## **Main Findings**

- **Companies with a greater insider influence on their boards disclose more transparent pay information and have a higher pay-for-performance sensitivity**
- **The positive association between insiders influence and pay disclosure and pay-for-performance sensitivity is stronger in settings with stronger outside investors protection**
- **The paper interprets these findings in support of the contracting hypothesis vs. the opportunism hypothesis**

## Main points (1)

- **Unique cross-country data on compensation practices outside US**
  - Really interesting setting: European data, proprietary database (hand-collected data from the largest 158 European companies between 1999 and 2004)
- **Clearly positioned (i.e. agency theory)**
- **Very “transparent” and detailed**
- **Counter-intuitive findings**

**BUT...**

## Main points (2)

- **Need a clearer theoretical framework and more explanations: which story do you want to tell the reader?**
  - How to interpret the main findings? Why do we find results that are counter-intuitive given the prior empirical results in US settings?
  - One interpretation could be that in Europe, given the more liberal and diverse regulations, the presence of influential insiders might not be representative of opportunistic behavior *ex-ante*.
  - So European investors can not disentangle whether boards with influential insiders are good or bad.
  - The companies use pay disclosure and pay for performance sensitivity to “signal the type” of their boards to the investors.
  - How do you interpret the fact that the relationship get stronger in contexts “more similar” to the US setting?
  - Would you say that companies with influential insiders use both practices? How?
  - The lack of explanation is a lost opportunity to add to our knowledge (i.e. some tables –i.e. Table 3 “Executive compensation across countries” – are not commented)

## Main points (2)

- **Disclosure definition:**

“**Type of disclosure (TD)** measures whether company annual reports disclose base salaries and stock-based grants. TD is two if both types of pay are reported; one if either base salaries or stock-based grants is reported; and zero if neither type is reported.

**Amount of disclosure (AD)** measures the number of pay contracts disclosed in the company annual reports. AD is two if a company discloses more than two contracts; one if it discloses two contracts; and zero if it discloses average executive pay or the contract of one executive.

**Quality of disclosure (QD)** measures the extent to which company annual reports adequately discuss: (1) compensation policy and future determinants of compensation, and (2) details of executive compensation in the current year and in previous years. QD is two if a company discusses both of the above items; one if it discusses one of the items; and zero if it discusses neither item”

- **Assuming that the three items are correctly measured, are these really three different dimensions of disclosure?**

- **Given how they are computed seem to represent only quantity rather than quality/type**

- **Quality of disclosure (QD):** It is defined as a Likert-scale type variable but in practice it translates into a YES/NO check on the presence of information (1) and (2)

- **Interesting to have details about the level of mandatory and voluntary disclosure - proactive action of managers - across countries (also to address concerns about endogeneity). Mentioned at the end of the paper, why you did not do that?**

- **Disclosure measurement:**

- **Amount of disclosure (AD):**
  - **Why not a log of continuous variable?**
  - **Why cut-off point at two?**