DOES BOARD OF DIRECTORS' REMUNERATION AFFECT BANKS' PERFORMANCE? A BROAD EMPIRICAL ANALYSIS IN THE US BANKING SYSTEM

Paolo Capuano *

* Department of Business and Management, LUISS University, Rome, Italy

How to cite: Capuano, P. (2022). Does board of directors' remuneration affect banks' performance? A broad empirical analysis in the US banking system. In G. M. Mantovani, A. Kostyuk, & D. Govorun (Eds.), *Corporate governance: Theory and practice* (pp. 34–39). https://doi.org/10.22495/cgtapp5

Copyright © 2022 The Author

Received: 19.04.2022
Accepted: 25.04.2022
Keywords: Bank Performance, Board of Directors, Corporate Governance, COVID-19 Pandemic, Director Remuneration
JEL Classification: G01, G21, G28, G34, M52
DOI: 10.22495/cgtapp5

Abstract

This paper explores the relationship between directors' remuneration and banks' performance using extensive panel data for the period 2002–2021, to be able to make comparisons between the COVID-19 period and the pre-COVID-19 period and also make a comparison with the Great Financial Crisis born in the US in 2007. The scientific analysis methodology adopted is based on panel data analysis and the content analysis approach. The first results of the data analysis allow highlighting the existence of a significant connection between the remuneration policies adopted by the US banks with respect to the results obtained in terms of profitability. These findings can help banks identify best practices for bank management during the financial international crisis, as well as provide useful insights to different categories of stakeholders, including bank regulators and supervisors.

1. INTRODUCTION

One of the most extensive issues in the banking corporate governance literature continues to be the remuneration of members of the board of

directors and managers, especially in times of crisis in the financial and economic system.

In the current period of the COVID-19 pandemic to which the Ukraine international crisis has been added, which will produce economic effects already in the short term, banks are called upon to pay more attention to containing the inevitable negative repercussions on their performance. In this difficult scenario, attention is growing on the remuneration of directors and managers. Banks, more than in the past, are required to review the remuneration structure of their management to make them financially compatible with the general situation of financial and economic crisis.

The theory of managerial remuneration derives mainly from agency theory, within which there is the separation of roles between those who manage the company and the owners/shareholders of the same. Within this theoretical scheme, at least two theoretical approaches can be identified. The dominant approach to studying executive compensation sees manager remuneration arrangements as a remedy for the problematic agency. Based on this approach, clearing systems are designed to provide managers with efficient incentives to maximize shareholder value. Another approach to studying the remuneration of directors (e.g., board of directors, top management) focuses on another link between the agency problems. Specifically, the board of directors' remuneration is seen not only as a potential tool to try to solve the agency problem but also as a structural part of the agency problem. As numerous studies have acknowledged, some features of remuneration contracts seem to reflect the pursuit of managerial characteristics rather than the provision of efficient incentives.

Therefore, it is important to be able to understand the existence of an influence of the remuneration of the boards on the substantial costs for the shareholders, distorting the incentives of the managers and therefore damaging the performance bank.

The board of directors' remuneration is an important mechanism for soliciting effort, rewarding productivity, and ensuring that owners' interests are respected. Hence, information on directors' pay structure is important to understand what effects it may have on the bank's performance.

The purpose of this paper is to contribute to understanding the relationship between board of directors' remuneration and bank performance in the US banking system.

2. WHAT IMPACT DOES THE REMUNERATION OF DIRECTORS AND MANAGERS HAVE ON BANKS' PERFORMANCE?

The business literature is not unanimous in recognizing the existence of a significant relationship between the remuneration of directors and the performance of companies.

The business literature is not unanimous in recognizing the existence of a significant relationship between the remuneration of directors and the performance of companies. This line of research has minimally concerned the banking sector, especially before the 2007 financial crisis.

However, remuneration is an important mechanism for soliciting effort, rewarding productivity and ensuring that owners' interests are respected. Therefore, it is important to understand whether the directors' remuneration structure can be considered an aspect that can stimulate the directors themselves to improve the performance of the bank.

The scientific analysis methodology adopted is based on panel data analysis and the content analysis approach. This methodological choice is consistent with the exploratory nature of the analysis carried out. Through the analysis of the panel data, the existence of a significant relationship between the remuneration of the board and the performance of the bank in terms of profitability was verified. The dataset was built considering two databases: Moody's Analytics BankFocus and BoardEx. Through the content analysis, the historical evolution of the remuneration policies of the board and of the role played by the remuneration committee set up within the board of directors were analyzed.

The relationship between remuneration and CEO performance is also investigated and different dependent banks variables, alternative performance measures and different estimation techniques are used (pooled ordinary least squares (OLS) and fixed effect with lagged variables). The analysis carried out is in-depth as it considers the different roles of the directors (e.g., CFO, deputy chairman, shareholder representative, independent director).

The objective of this work is also to understand the managerial reaction of banks to the management of the COVID-19 crisis, trying to investigate what were the most used variations in the extent and composition of the board's remuneration to contain the effect of crisis.

3. SOME CONCLUDING REMARKS

The results of this analysis can make it possible to define best practices for the banks' management in times of crisis and provide useful elements for reflection also to the banking supervisory authorities and policymakers.

In times of financial crisis, banking regulators and supervisors expect banks to exercise extreme restraint regarding variable remuneration payments to the extent that such payments may lead to a deterioration in the amount or quality of total capital of the bank.

The first results of the data analysis allow highlighting the existence of a significant connection between the remuneration

policies adopted by the US banks with respect to the results obtained in terms of profitability.

This result shows that remuneration policies can be useful in improving the profitability of banks. However, it needs to be understood whether or not this improvement is associated with an increase in the bank's overall risk.

These findings can help banks identify best practices for bank management during the financial international crisis, as well as provide useful insights to different categories of stakeholders, including bank regulators and supervisors.

REFERENCES

1. Ab Razak, N. H. (2014). Director remuneration, corporate governance and performance: A comparison between government linked companies vs non government linked companies. *Corporate Board: Role, Duties and Composition, 10*(2), 46–63. https://doi.org/10.22495/cbv10i2art4
2. Abdel-Azim, M. H., & Soliman, S. (2020). Board of directors' characteristics and bank performance: Evidence from the Egyptian banking sector. *Journal of Governance and Regulation, 9*(4), 116–125. https://doi.org/10.22495/jgrv9i4art10
3. Alqatan, A., Chbib, I., & Hussainey, K. (2019). How does board structure impact on firm performance in the UK? *Corporate Board: Role, Duties and Composition, 15*(2), 18–27. https://doi.org/10.22495/cbv15i2art2
4. Armstrong, C. S., & Vashishtha, R. (2012). Executive stock options, differential risk-taking incentives, and firm value. *Journal of Financial Economics, 104*(1), 70–88. https://doi.org/10.1016/j.jfineco.2011.11.005
5. Armstrong, C. S., Larcker, D. F., Ormazabal, G., & Taylor, D. J. (2013). The relation between equity incentives and misreporting: The role of risk-taking incentives. *Journal of Financial Economics, 109*(2), 327–350. https://doi.org/10.1016/j.jfineco.2013.02.019
6. Arora, A., & Singh, A. (2021). Board characteristics and financial performance: A comprehensive literature review. *Corporate Ownership & Control, 19*(1), 188–198. https://doi.org/10.22495/cocv19i1art14
7. Bannier, C. E., Feess, E., & Packham, N. (2013). Competition, bonuses, and risk-taking in the banking industry. *Review of Finance, 17*(2), 653–690. https://doi.org/10.1093/rof/rfs002
8. Bebchuk, L. A., & Fried, J. M. (2003). Executive compensation as an agency problem. *Journal of Economic Perspectives, 17*(3), 71–92. https://doi.org/10.1257/089533003769204362
9. Bhagat, S., & Bolton, B. (2014). Financial crisis and bank executive incentive compensation. *Journal of Corporate Finance, 25*, 313–341. https://doi.org/10.1016/j.jcorpfin.2014.01.002
10. Boateng, A., Nguyen, V. H. T., Du, M. & Kwabi, F. O. (2022). The impact of CEO compensation and excess reserves on bank risk-taking: The moderating role of monetary policy. *Empirical Economics, 62*, 1575–1598. https://doi.org/10.1007/s00181-021-02086-4
11. Committee of European Banking Supervisors (CEBS). (2010). *Guidelines on remuneration policies and practices.* Retrieved from https://www.eba.europa.eu/sites/default/documents/files/documents/10180/106961/a3ab77c9-980f-4994-b2cd-397413b77084/Guidelines.pdf

12. de Andrés, P., Reig, R., & Vallelado, E. (2019). European banks' executive remuneration under the new European Union regulation. *Journal of Economic Policy Reform, 22*(3), 208–225. https://doi.org/10.1080/17487870.2018.1424630
13. DeYoung, R., Peng, E. Y., & Yan, M. (2010). *Executive compensation and business policy choices at U.S. commercial banks* (The Federal Reserve Bank of Kansas City, Research Working Paper No. 10-02). https://doi.org/10.2139/ssrn.1544490
14. Doucouliagos, H., Haman, J., & Askary, S. (2007). Directors' remuneration and performance in Australian banking. *Corporate Governance: An International Review, 15*(6), 1363–1383. https://doi.org/10.1111/j.1467-8683.2007.00651.x
15. Firth, M., Fung, P. M. Y., & Rui, O. M. (2006). Corporate performance and CEO compensation in China. *Journal of Corporate Finance, 12*(4), 693–714. https://doi.org/10.1016/j.jcorpfin.2005.03.002
16. Grove, H., Patelli, L., Victoravich, L. M., & Xu, T. (2011). Corporate governance and performance in the wake of the financial crisis: Evidence from US commercial banks. *Corporate Governance: An International Review, 19*(5), 418–436. https://doi.org/10.1111/j.1467-8683.2011.00882.x
17. Iskandrani, M., Yaseen, H., & Al-Amarneh, A. (2018). Executive compensation and corporate performance: Evidence from Jordanian commercial banks. *Corporate Board: Role, Duties and Composition, 14*(2), 38–44. https://doi.org/10.22495/cbv14i2art4
18. Jarque, A., & Prescott, E. S. (2020). Banker compensation, relative performance, and bank risk. *Journal of the Japanese and International Economies, 56*, 101077. https://doi.org/10.1016/j.jjie.2020.101077
19. Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, *3*(4), 305–360. https://doi.org/10.1016/0304-405X(76)90026-X
20. John, K., Saunders, A., & Senbet, L. W. (2000). A theory of bank regulation and management compensation. *The Review of Financial Studies, 13*(1), 95–125. https://doi.org/10.1093/rfs/13.1.95
21. Joyce, W. B. (2011). Return and reward: Bank performance and CEO compensation. *American Business Review*, *19*(2), 93–99. Retrieved from https://www.proquest.com/openview/502f44dc305ff2eec6fe98a783938305/1?pq-origsite=gscholar&cbl=31895
22. Khumalo, M., & Masenge, A. (2015). Examining the relationship between CEO remuneration and performance of major commercial banks in South Africa. *Corporate Ownership & Control, 13*(1), 115–124. https://doi.org/10.22495/cocv13i1p11
23. Kwon, S. S., Gélinas, P., & Waweru, N. (2022). Earnings management and asymmetric sensitivity of bonus compensation to earnings for high-growth firms. *Corporate Ownership & Control, 19*(3), 25–41. https://doi.org/10.22495/cocv19i3art2
24. Minnick, K., Haluk, U., & Yang, L. (2009). *Pay for performance? CEO compensation and acquirer returns in BHCs* (UCLA Working Paper). https://doi.org/10.2139/ssrn.1982123
25. Ndayisaba, G., & Ahmed, A. D. (2015). CEO remuneration, board composition and firm performance: Empirical evidence from Australian listed companies. *Corporate Ownership & Control, 13*(1–5), 534–552. https://doi.org/10.22495/cocv13i1c5p2

26. Nulla, Y. M. (2015). Pay for performance: An empirical review. *Corporate Ownership & Control, 12*(4), 69–79. https://doi.org/10.22495/cocv12i4p5
27. Ozkan, N. (2011). CEO compensation and firm performance: An empirical investigation of UK panel data. *European Financial Management, 17*(2), 260–285. https://doi.org/10.1111/j.1468-036X.2009.00511.x
28. Proctor, R., & Murtagh, J. (2014). Incentive compensation for bank CEOs and CFOs before and after the financial crisis. *Journal of Legal, Ethical and Regulatory Issues, 17*(2), 61–75. Retrieved from https://www.proquest.com/openview/bcb70ca0b973d8fba0fd2c10e2dfea11/1?pq-origsite=gscholar&cbl=38868
29. Shah, A. Z. A., Akbar, S., Liu, J., & Cao, S. (2017). CEO compensation and banks' risk-taking during pre and post financial crisis periods. *Research in International Business and Finance, 42*, 1489–1503. https://doi.org/10.1016/j.ribaf.2017.07.089
30. Shiwakoti, R. K. (2012). Comparative analysis of determinants of executive remuneration in the UK financial services sector. *Accounting and Finance, 52*(1), 213–235. https://doi.org/10.1111/j.1467-629X.2010.00391.x
31. Sigler, K. J., & Porterfield, R. (2001). CEO compensation: Its link to bank performance. *American Business Review*, *19*(2), 110–114.
32. Soni, T. K., & Singh, A. (2020). Directors' remuneration, corporate governance and firm performance linkages: Evidence from the emerging country [Special issue]. *Corporate Ownership & Control, 18*(1), 382–392. https://doi.org/10.22495/cocv18i1siart12
33. Sylos Labini, S., & Donofrio, F. (2021). Banks' compensation policies under the global pandemic: Evidence from the European banking sector. *Journal of Governance & Regulation, 10*(1), 74–82. https://doi.org/10.22495/jgrv10i1art8
34. Zalewska, A. (2016). A new look at regulating bankers' remuneration. *Corporate Governance: An International Review, 24*(3), 322–333. https://doi.org/10.1111/corg.12149