Accounting for the Explanations of CEO Compensation: Substance and Symbolism

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While current debates about CEO compensation have generally been dominated by economic and political perspectives on CEO/board relations, we argue in this paper that CEO compensation may be driven by symbolic as well as substantive considerations. We develop an interdisciplinary theoretical framework to (1) explain why alternative explanations rooted in agency and human resource logics may be used to reduce ambiguity surrounding the adoption of new incentive plans for CEOs and (2) identify the possible structural (e.g., institutional, demographic, and economic), and interest-based (e.g., political) factors influencing the use of such explanations. We generate and test hypotheses predicting the alternative explanations for new long-term incentive plans using data taken from proxy statements over a 15-year period. The findings support the notion that explanations for CEO compensation reflect both substance and symbolism.*

In recent years, chief executive officer (CEO) compensation has come under increasingly close and harsh scrutiny, both in the academic literature and the popular press (Jensen and Murphy, 1990; New York Times, 1992). The popular business press has tended to portray executive compensation as excessive (Crystal, 1991; Time, 1993) or out of control (Business Week, 1992) and has generally supported legislative initiatives aimed at reform (Time, 1993). Such attempts include the recent U.S. political decision to question the corporate tax deductibility of executive salaries above $1 million and the efforts of some firms to limit CEO compensation to a multiplier of entry-level-employee compensation. Opponents of these efforts, often economists, decry the visible hand of regulation in the presumably economic decision about the level of CEO compensation (Jarrell, 1993) and, in the case of multiplier limits, suggest that there is efficiency in structuring compensation in large organizations as "tournaments" in which compensation at higher levels is much greater than that at lower levels (Lazear and Rosen, 1981).

This debate has expanded to include long-term incentive compensation, which has become an increasingly significant component of executive pay (Jarrell, 1993). Once viewed by most observers as connoting managerial value and devotion to shareholders' interests (e.g., Crystal, 1984), long-term incentive plans have recently been negatively portrayed as insidious devices that serve only to enrich top management at the expense of shareholders (Crystal, 1991; Business Week, 1992). Such trenchant criticism has helped create widespread skepticism among corporate stakeholders about the motivation for long-term incentives while bolstering legislative efforts to curtail their use (Time, 1993). Jensen and Murphy (1990: 254–255) have suggested that firms are deterred from making full use of long-term incentive plans for CEOs because of the threat of "media criticism and ridicule," which they view as a regrettable form of "implicit regulation." Thus debate surrounding CEO compensation reflects the tension between the economic efficiency of an ideally constructed compensation contract (as agency theorists seek to devise) versus the alleged political reality of

entrenched, overcompensated CEOs and weak boards. In this study, we argue for the need to consider a third perspective: the possibility that CEO compensation debates are also driven by symbolic considerations.

From a symbolic management perspective, the concern about whether CEOs in large U.S. corporations are overpaid or "worth every nickel they get" (Murphy, 1986: 125) is less important than how firms communicate the rationales underlying their CEO compensation decisions. According to this perspective, existing CEO compensation debates typically revolve around the subjective assessment of whether CEO compensation decisions can be considered "justifiable" in the eyes of organizational stakeholders and appeal less to economic logic than to the subjective social perception that some fixed amount (e.g., $1 million) or multiplier (e.g., 12 times that of an entry-level person) is the limit of what constitutes justifiable compensation for a CEO. Compensation beyond that amount could be subject to different interpretations by different stakeholders, some negative and some positive. Very high CEO compensation could be viewed either as an indication of corruption in the upper echelons of management or as a deserved reward for an extraordinary CEO. Thus, given ambiguity about the purpose or implications of high CEO rewards, new incentive arrangements that increase the upper bound of CEO compensation levels represent a justification problem (or opportunity) for corporate leaders. Accordingly, there may be value in studying not only how and how much firms decide to compensate their CEOs but also how firms explain their compensation decisions to shareholders and other interested constituents, including stock analysts, governmental regulators, governance activists, and prospective shareholders.

Our approach has two basic components. First, we examine the extent to which explanations for executive incentives reflect prevailing beliefs about the socially legitimate purpose of incentive compensation. We examine how CEO compensation practices may be embedded in a social and organizational context and how variation in this context (across organizations and/or across time) may result in variation in the socially legitimate explanations provided for new CEO compensation arrangements. As Pfeffer (1981: 4) has argued, "explanations [of corporate activities are] constrained to be legitimate and acceptable in the social context." Second, we examine whether explanations of long-term incentive plans (LTIPs) reflect the interests and concerns of corporate leaders. The LTIPs we studied add long-term performance plans to existing arrangements (e.g., salary and short-term bonus), and the number of firms adopting such plans has increased significantly from the mid-1970s to the late 1980s (Jarrell, 1993).

Using data taken from proxy statements over a 15-year period, we seek to show that (1) when undertaking an action that has ambiguous meaning, such as the adoption of LTIPs, firms generally seek to provide some logic or explanation for that action, (2) alternative explanations for that action may exist, and (3) the construction of a theoretical framework that draws on institutional, demographic, economic, and
sociopolitical factors can predict when one or the other explanation would be used. Thus we consider how the explanations for CEO compensation arrangements can reflect symbolic and substantive purposes.

Alternative Explanations for Long-term Incentive Plans

Given the ambiguity and controversy surrounding CEO incentive compensation, the adoption of new long-term incentive plans can present a significant justification problem for boards and top management. There are two major alternative explanations that may, under certain circumstances, be viewed as appropriate rationales for incentive compensation, in particular for new LTIPs: an agency theory explanation and a human resource explanation. Prior research on impression management suggests that organizations may use media such as annual reports to address stakeholders' concerns about organizational strategies or the outcomes of those strategies (Bettman and Weitz, 1983). We examine how firms use a related media, proxy statements, to provide explanations for the adoption of new LTIPs when announcing them, as in the following extracts from recent proxy statements:

Alcoa’s Board of Directors has decided to place an increasing share of management’s overall compensation at risk rather than in fixed salaries. The new approach to compensation was recommended by the Board’s compensation committee, which is composed solely of outside directors. The board believes that granting stock options, performance shares and [bonuses] will create a more appropriate relationship between compensation and the financial performance of the company in order to increase key employees’ personal financial identification with interests of the Company’s stockholders. (Aluminum Company of America, 1988)

The Board believes that adoption of the Plan will enhance the Company’s ability to attract and retain individuals of exceptional managerial talent upon whom, in large measure, the sustained progress, growth and profitability of the Company depends... (AT&T, 1985)

These announcements reflect two qualitatively different explanations for introducing LTIPs. Alcoa’s explanation uses an agency logic, while AT&T’s explanation uses a human resource (HR) logic. An HR explanation highlights as an important organizational objective the ability of an organization to attract and retain scarce managerial talent (Milkovich and Newman, 1984; Pfeffer, 1994; Wright, McMahan, and McWilliams, 1994). A principal mechanism by which organizations fulfill this objective is providing competitive compensation arrangements that enable the organization to attract and retain talented managers by raising the potential total compensation levels (Gomez-Mejia and Welbourne, 1988). From an HR perspective, in which human resources are critical in enhancing the firm’s competitive position (Pfeffer, 1994), the board adopts CEO incentive plans to compete with other firms for scarce leadership talent, and an HR explanation is commonly invoked in explaining the administration of executive pay (e.g., Lawler, 1990; Foulkes, 1991).

From an agency theory perspective, the primary objective of executive incentive plans is to maximize shareholder wealth by aligning the interests of management (as agent) with the

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1 While current conceptualizations of HR management include a broader array of concerns, such as cost minimization and competency development, we focus here on a specific dimension of this broader literature.
interests of shareholders (as principal) (Jensen and Meckling, 1976; Beatty and Zajac, 1994). This perspective suggests that, by making pay contingent on future firm performance, LTIPs mitigate the shirking behaviors (Alchian and Demsetz, 1972) or excessive perquisite consumption (Jensen and Meckling, 1976) that enhances management’s interests at the expense of shareholders’ welfare (Baysinger and Hoskisson, 1990; Zajac, 1990; Kerr and Kren, 1992). While the HR perspective emphasizes the upside potential of contingent compensation, an agency perspective, with its theoretical focus on reducing managerial shirking and the suboptimal use of firm resources by managers who do not bear the full cost of their actions (Alchian and Demsetz, 1972; Jensen and Meckling, 1976), emphasizes the downside risk of contingent compensation.

The theoretical roots of these alternative logics can be traced historically to alternative academic discussions of the role of top managers. Early statements of the human resource perspective on managers can be traced to Mayo’s (1945) theory on organizations and their employees, which characterizes organizations as arenas for natural cooperation and rejects the assumption that employees in organizations act solely in self-interest and isolation (Perrow, 1986). This literature informed later theories of compensation that stressed the need to satisfy and thus retain valuable employees through incentive compensation (Lawler, 1968). Most recently, HR management researchers have given increased attention to the implications for competitiveness of attracting and retaining those key organizational employees whose skills are not easily replaceable (Pfeffer, 1994; Wright, McMahan, and McWilliams, 1994).

The roots of the agency perspective lie in Berle and Means’ (1932) influential statement about self-interested managers in large U.S. corporations, which highlighted the problems emerging from the growing separation of ownership and control. This theme of concern for aligning managers’ and owners’ interests later blossomed in the academic literature of the 1960s with the so-called managerialist school (e.g., Marris, 1964; Williamson, 1964), which held that top managers pursue personal goals that are incongruent with profit maximization for the firm. In the 1970s, what is now called agency theory began to emerge from more abstract formalized analyses of principal-agent relationships and the basic problem of delegation (e.g., Alchian and Demsetz, 1972; Ross, 1973). Jensen and Meckling’s (1976) statement of the agency problem and their discussion of ways to minimize agency costs in corporations is in many ways a natural extension of Berle and Means (1932).

Thus, whereas from an HR management perspective, top managers are valued, critical resources to be rewarded and retained (Pfeffer, 1994: 37), agency theory emphasizes the need to minimize managerial shirking through monitoring and incentive mechanisms (Jensen and Meckling, 1976). Problems of goal congruence between the CEO and the organization are clearly deemphasized in the former perspective and emphasized in the latter. While the difference between logics is relative—the HR logic is comparatively less sensitive to issues of managerial shirking
and CEO goal incongruence and more sensitive to attraction and retention issues than the agency logic—these contrasting theoretical perspectives nonetheless represent alternative and possibly competing explanations for CEOs’ long-term incentive compensation. We suggest that a number of specific structural and interest-based factors can influence which logic is used to explain LTIPs.

STRUCTURAL AND INTEREST-BASED DETERMINANTS OF ALTERNATIVE EXPLANATIONS

Prevailing Beliefs and the Content of LTIP Explanations

While the two major alternative logics to explain an organization’s decision to adopt a new LTIP for its top managers have both existed for many years, the legitimacy of agency and HR explanations has been changing over the last two decades, and there has been a growing contradiction in discussions about top management in large corporations. On the one hand, the longstanding tendency to celebrate individual CEOs as strong and capable corporate leaders shows no sign of waning. On the other hand, when the discussion of those same CEOs turns to issues of CEO compensation, the “romance of leadership” (Meindl, Ehrlich, and Dukerich, 1985) seems to disappear, replaced by a perspective in which CEO interests are presumed to deviate from those of the organization (Business Week, 1992).

This discussion suggests that any organizational decision to introduce a new CEO compensation plan is likely to be affected by the changing institutional or social context in which CEO compensation decisions take place. It appears that the agency theoretic perspective on executive compensation, with its emphasis on protecting owners’ interests from self-interested managers, has become increasingly prevalent in the business press and the organizational literature. Recent public debate over the size of executive compensation packages and the accounting treatment of long-term incentive compensation increasingly cites shareholder welfare as a primary criterion (e.g., Business Week, 1992; Time, 1993). Moreover, empirical agency theory research on executive compensation has burgeoned in recent years (see Eisenhardt, 1989; Jensen and Murphy, 1990), and organizational behavior and strategic management research routinely acknowledges and frequently incorporates agency theoretic perspectives (e.g., Kerr and Kren, 1992; Beatty and Zajac, 1994). Even political perspectives on CEO compensation increasingly invoke incentive alignment (i.e., the alignment of CEO pay and shareholder wealth) as a normative criterion or benchmark, either implicitly or explicitly, and observe deviations from that ideal (e.g., Hill and Phan, 1991; Kerr and Kren, 1992).

The apparent spread of agency perspectives on executive compensation parallels the rise of financial economic theory in research and public policy on corporate control (Jensen and Ruback, 1983; Davis and Stout, 1992). According to Davis and Thompson (1994), this trend is closely related to the increased activism and political influence of institutional investors. In effect, large investors appear to have coopted normative agency theory to help legitimate their political
agenda, thus contributing to and benefiting from the growth of agency theory as a dominant perspective on corporate control.

Thus, while both HR and agency logics have existed for decades, elements of the institutional context may have led to the dominance of agency thinking about CEO compensation over time. Davis and Thompson (1994) have referred to this as a social movement in corporate control, in which social and institutional factors lead to a changing *zeitgeist* with respect to corporate governance issues. In terms of LTIP explanations, the notion of protecting shareholders’ interests through incentive alignment may have acquired institutional or symbolic value over time as a rationale or explanation for the introduction of long-term incentive compensation (Meyer and Rowan, 1977; Zucker, 1983). According to Meyer and Rowan (1977: 349), the use of language that provides a “legitimate account” of the organization’s activities and practices “increases the commitment of external constituents” to the organization. Thus agency explanations may have gradually eclipsed HR explanations for new LTIPs over time, reflecting boards’ increasing emphasis on incentive alignment rather than retaining valuable executive talent.

While the previous discussion emphasizes how the growing legitimation of an agency perspective may have diminished the use of a human resource perspective, we also allow for the possibility that both explanations may be used. The institutionalization process may include a period of transition from human resource to agency explanations for incentive compensation, during which LTIP explanations have a “dual character” (Zucker, 1983: 25). Just as periods of transition between larger cultural systems are characterized by the integration of old and new practices (Zucker, 1983), so may periods of transition in prevailing LTIP explanations reflect the integration of declining and emerging perspectives. Thus, while the prior discussion suggests that boards are most likely to have used *only* agency explanations in recent years and to have used *only* HR explanations in early years, they may be likely to have used *both* explanations during the middle years of the study period. Taken together, then, this discussion suggests the following hypotheses:

**Hypothesis 1a (H1a):** The later the date of LTIP adoption, the greater the likelihood of agency-based explanations in LTIP announcements.

**Hypothesis 1b (H1b):** The earlier the date of LTIP adoption, the greater the likelihood of HR-based explanations in LTIP announcements.

**Hypothesis 1c (H1c):** The closer the date of LTIP adoption to the middle of the study period, the greater the likelihood of both agency-based and HR-based explanations in LTIP announcements.

**Demographic Context and the Content of LTIP Explanations**

While macro-institutional factors such as those discussed above may provide an overarching set of social constraints on the use of alternative explanations, there may also be organization-specific constraints. This study examines one such set of constraints that may be relevant in the choice of
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explanations used to justify LTIPs but is rarely considered as part of an organizational context, namely, the demographic context. The relevance of the demographic context can be seen in social-psychological research on performance appraisal, which has consistently documented bias in evaluation decisions in which raters and ratees are demographically similar (e.g., Tsui and O'Reilly, 1989). Both laboratory and field research have demonstrated a positive relationship between demographic similarity along one or more attributes (e.g., age, sex, race, education, or tenure) and the perceived ability, effort, and/or potential of subordinates (Latham, Wexley, and Pursell, 1975; Mobley, 1982). More generally, abundant evidence suggests that actual or perceived similarity enhances interpersonal attraction and liking (Homans, 1950; Byrne, 1971; Judge and Ferris, 1993).

These findings are consistent with social-psychological research on intergroup relations, which has documented a robust tendency to favor in-group members in making evaluation or allocation decisions (Messick and Mackie, 1989). To the extent that demographic similarity provides a salient basis for psychological group membership (Tsui, Egan, and O'Reilly, 1992), in-group bias should produce inflated evaluations of subordinates’ abilities and potential when both parties are demographically similar.

Thus research in the areas of performance appraisal and intergroup relations suggests that when a large portion of board members are demographically similar to the CEO, they should be more likely to view the CEO as a valuable human resource to be retained. As a result, increased demographic similarity between CEOs and board members may be positively associated with the use of HR-management explanations in LTIP announcements. Under such circumstances, the use of an HR explanation can generate benefits for directors on a psychological level, as well as on a social or professional level. As suggested by social identity theory (Tajfel and Turner, 1986), directors should enjoy psychological benefits from vicarious validation of their personal attributes. Affirmation of a demographically similar CEO’s worth to the organization is also indirect affirmation of the director’s own human capital, both to the director and to shareholders. Social affirmation of directors’ attributes to shareholders may help justify their own compensation and, ultimately, their position on the board.

CEO-board similarity may also decrease the likelihood of agency motivations for new LTIPs. Given that a high level of demographic similarity generally enhances interpersonal trust (Kanter, 1977; Useem and Karabel, 1986), the perceived need to direct CEO behavior and reduce shirking through greater incentive alignment is reduced. Moreover, given that demographic dissimilarity hinders communication and social integration (Ouchi, 1980; O'Reilly, Caldwell, and Barnett, 1989), thus interfering with interpersonal monitoring of CEO decision making, high CEO-board dissimilarity may increase the perceived need to use LTIP adoption as an incentive alignment mechanism. Finally, the ambiguous situation of an intermediate level of CEO-board similarity—in which the CEO and board are demographically neither very similar nor
very different—may result in dual explanations. Thus, just as a firm’s institutional context can influence the content of LTIP logics, so too can a firm’s demographic context, by influencing the beliefs of corporate actors about the purpose of new LTIPs.

The basis for perceived similarity or psychological group membership can be a characteristic itself or the underlying skills, philosophy, or behavioral style that the characteristic indicates. Thus, for instance, directors may recognize CEOs as fellow finance-types, or alternatively, perceived similarity may derive from recognition of the CEO’s common philosophies about strategic goals and objectives, as indexed by similarity in functional backgrounds (Hambrick and Mason, 1984; Bantel and Jackson, 1989; Tsui, Egan, and O’Reilly, 1992). Similarity in educational background may also indicate common socioeconomic status, as well as similar leadership and communication styles (Collins, 1979; Hambrick and Mason, 1984; Useem and Karabel, 1986). Considerable theory and evidence also suggest that age provides a salient basis for group identification (e.g., Stangor et al., 1992) and that variation in age predicts a variety of attitudinal and behavioral differences, including risk orientation and approaches to strategic decision making (Hitt and Tyler, 1991). Finally, there is growing evidence that people perceive similarity on the basis of multiple social features, so that in-group bias is more likely when people share multiple group memberships (Stangor et al., 1992); accordingly, we also examine the independent effect of similarity across multiple demographic attributes. This discussion suggests the following specific hypotheses:

**Hypothesis 2a (H2a):** The less demographic similarity there is between the CEO and the board (measured in terms of functional background, education, and age), the greater the likelihood of agency-based explanations in LTIP announcements.

**Hypothesis 2b (H2b):** The greater the demographic similarity between the CEO and the board, the greater the likelihood of HR-based explanations in LTIP announcements.

**Hypothesis 2c (H2c):** When the CEO and the board are demographically neither very similar nor very different, both agency-based and HR-based explanations are likely to be used in LTIP announcements.

**Performance Context and the Content of LTIP Explanations**

We also consider another set of organization-specific constraints, namely, how an organization’s performance context may influence the selection of an agency or HR explanation when introducing new LTIPs. Organizations need to select explanations that are plausible (Morrill, 1991) in light of current firm performance. Thus, for example, by using an agency explanation when performance is poor, boards implicitly acknowledge a lack of convergence between stockholders’ and CEOs’ interests, while also implying that the board has rectified this problem through LTIP adoption. This logic emphasizes that CEOs will now be in the same situation as shareholders: If firm performance does not improve, and shareholders continue to suffer as a result, the CEO will also suffer.
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Under conditions of relatively high firm performance, by contrast, boards may use HR-based explanations, given apparent evidence of the value of their executive’s talent and the importance of retaining it. In effect, good firm performance provides an opportunity to invoke the romance of leadership (Meindl, Ehrlich, and Dukerich, 1985) as a credible justification for long-term incentive compensation, implicitly associating LTIPs with an optimistic perspective on corporate leadership. When performance is neither high nor low, both explanations are credible, given that performance is ambiguous. Thus, the firm’s performance context may represent an important constraint on the content of LTIP justifications. We thus hypothesize:

Hypothesis 3a (H3a): The poorer a firm’s performance, the greater the likelihood of agency-based explanations in LTIP announcements.

Hypothesis 3b (H3b): The higher a firm’s performance, the greater the likelihood of HR-based explanations in LTIP announcements.

Hypothesis 3c (H3c): The closer a firm’s performance is to an average level, the greater the likelihood of both agency-based and HR-based explanations in LTIP announcements.

CEO vs. Board Power and the Content of LTIP Explanations

From an interest-based perspective, influential organizational leaders may seek to manipulate actively external constituents’ perceptions of CEO compensation. This is reflected in how the relative power of the CEO vis-à-vis the board of directors may affect the use of alternative explanations for the introduction of LTIPs. From a power perspective, explanations for LTIPs may be contested, reflecting and perhaps reinforcing the relative power of corporate actors (Friedland and Alford, 1991). While CEOs may favor explanations that reflect romanticized conceptions of corporate leaders, thus accentuating their perceived value to the firm, powerful boards may favor accounts that proclaim their control over management. In effect, HR explanations of LTIPs afford reputational benefits to CEOs, while agency explanations provide reputational benefits to board members. We examine the impact of four potential sources of board power on the content of LTIP justifications: separation of the CEO and board chair positions, the portion of the board composed of outsiders appointed before the CEO, low CEO tenure, and the relative stock ownership of the board and CEO.

Separation of the CEO and board chair positions.
Managerial power theorists, agency theorists, and advocates of board reform have all argued that creating separate CEO and board chair positions enhances the board’s independent monitoring capacity and curtails managerial entrenchment (Rechner and Dalton, 1991; Finkelstein and D’Aveni, 1994; Beatty and Zajac, 1994). In contrast, CEOs holding both positions simultaneously are thought to possess greater formal authority over board members and heightened informal stature (Patton and Baker, 1987; Harrison, Torres, and Kukalis, 1988). Thus when these positions are separated, boards are better able to frame explanations for new LTIPs in terms of controlling CEO behavior. Conversely,
when CEOs are also board chairs, they are better able to signal that they, as uniquely talented leaders, deserve minimal board interference in managing corporate affairs (Finkelstein and D'Aveni, 1994); thus they are more likely to frame new LTIPs as a means of retaining scarce leadership talent.

**Appointment of outsiders.** Several authors have argued that, through control of the director-nominating process, CEOs are able to select outsiders with whom they have a personal relationship or who are otherwise sympathetic to them (Mace, 1971; Fredrickson, Hambrick, and Baumrin, 1988; Wade, O'Reilly, and Chandratat, 1990). Like insiders, these directors may feel beholden to CEOs for their position. Thus when CEOs have appointed a relatively large portion of outside directors to the board, HR explanations are likely to be used for new LTIPs; in contrast, when a relatively large portion of the board is composed of outsiders appointed before the CEO was appointed, agency explanations are more likely to be used in LTIP announcements.

**CEO tenure.** Several studies have hypothesized that board control over management diminishes as CEO tenure increases (Finkelstein and Hambrick, 1989; Singh and Harianto, 1989). As CEO tenure increases, CEOs develop a “personal mystique or patriarchy” (Finkelstein and Hambrick, 1989: 124), resulting in sanctions against questioning the CEO’s authority. CEOs are also thought to coopt boards over time by appointing sympathetic outsiders (Wade, O'Reilly, and Chandratat, 1990). Thus when CEO tenure is low, boards should have greater influence over the symbolic content of LTIP explanations, and agency-based explanations are likely, while high CEO tenure should increase the likelihood of HR explanations.

**Relative director and CEO stock ownership.** From an agency perspective, board members’ stock ownership more closely aligns the interests of board members with the interests of shareholders, creating an incentive for the board to exercise greater control over the CEO compensation-setting process. Moreover, voting rights afford additional power to owner-directors, and this power increases with the portion of total shares held (Zald, 1969). Thus higher stock ownership may give directors greater relative power vis-à-vis the CEO and therefore lead to greater use of agency explanations and less use of HR explanations when announcing new LTIPs. Because stock ownership is also an important source of power for the CEO, we examine the effect of relative stock ownership (i.e., director stock ownership divided by CEO ownership) on the use of each logic (Finkelstein, 1992).

For each of these measures of power, we also consider the situation in which power is relatively balanced between the CEO and the board. Under such circumstances, both parties may be sufficiently powerful to influence the content of LTIP explanations. The presence of both explanations in LTIP announcements thus may represent a compromise or truce between CEOs and boards. This discussion suggests the following hypotheses:

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Hypothesis 4a (H4a): The greater the power of the board (measured in terms of separate CEO and chair positions, the proportion of the board composed of outsiders appointed before the CEO, a CEO with relatively low tenure, and high director stock ownership), the greater the likelihood of agency-based explanations in LTIP announcements.

Hypothesis 4b (H4b): The greater the power of the CEO, the greater the likelihood of HR-based explanations in LTIP announcements.

Hypothesis 4c (H4c): The more balanced the distribution of power between the board and the CEO, the greater the likelihood that both agency-based and HR-based explanations will be used in LTIP announcements.

METHOD

Data

The initial sample for this study consisted of all LTIP adoptions between 1976 and 1990 among firms listed in the 1976 Forbes 500 or Fortune 500 indexes. The Forbes 500 uses multiple lists whose overlap depends on the specific size measure used. This study used those firms that appeared on at least two lists. We chose the year 1976 to approximate the onset of LTIP adoption, defined here as the addition of a new performance plan that is aimed at providing multiyear performance incentives, such as performance shares or performance units, to a CEO’s compensation contract (Westphal and Zajac, 1994). We excluded amendments or updates to existing plans and adoptions for which sufficient proxy statements were unavailable to identify the specific year of adoption. We included cases only if complete demographic data were available for at least three-quarters of the outside directors in each year. This procedure yielded a final sample of 352 firms. Two-sample t-tests revealed no significant differences in size (measured as sales and number of employees) or performance (measured as return on assets and total stock returns) between the initial and final samples.

We collected data on performance and CEO influence (tenure, separate CEO and board chair, and the appointment of outsiders) for the years 1976 to 1990, inclusive. Two indicators of CEO influence (CEO tenure and separate CEO and board chair) were collected for each year, while data on outsiders were gathered at three-year intervals beginning in 1976. Stock ownership data were collected for the year of adoption. Information to measure CEO influence was obtained from both proxies and Standard and Poor’s Register of Corporations, Directors, and Executives. Demographic information was obtained from the Dun & Bradstreet Reference Book of Corporate Managements and from Who’s Who in Finance and Industry. Data from Standard and Poor’s COMPUSTAT service and the Center for Research in Security Prices (CRSP) were used to calculate performance and size measures.

Dependent Variables

To determine the presence or absence of various explanations for new LTIPs, we conducted a content analysis of proxy statements in the year of adoption (Holsti, 1968; Weber, 1985). Boards commonly announce the
adoption of new LTIPs in a separate section of the proxy statement (Westphal and Zajac, 1994). This announcement typically includes a detailed description of the plan's features (e.g., administration, eligibility, award types), which may be preceded by an introductory section outlining the reasons for adopting the plan. When explanations are provided, they are typically included in this introductory portion of the announcement. Nonetheless, we carefully read each proxy statement from the beginning of the compensation section forward.

Since we anticipated little ambiguity in the coding process, we decided not to develop an exhaustive rule book specifying the appropriate categorization of every possible phrase or combination of phrases, a strategy that can jeopardize the content validity of the coding scheme (Holsti, 1968). Instead, we simply provided coders with summary descriptions of agency and HR perspectives, together with a shorter list of key concepts characterizing each theory, and specific coding instructions. The summary descriptions were very similar to the paragraphs above describing each perspective shown earlier. While some of these concepts may appear abstract and theoretical, boards typically used terminology from the theories in explaining the plan (e.g., "align" pay with shareholder returns, or "attract and retain" executive talent).

Three people independently coded the relevant sections of all proxy statements that included some explanation for the new plans. Two of the coders were doctoral students in business, and the third was a demographically different undergraduate. The coding itself consisted of two sequential and dichotomous choices (Holsti, 1968): (1) Was an agency theory explanation used? (2) Was a human resource management explanation used? Coders were instructed to answer the first question before proceeding to the second. Based on these classifications, we created three dichotomous dependent variables (agency explanation, HR explanation, and agency and HR explanations), coded 1 if the relevant explanation(s) were used in the proxy statement, and 0 otherwise. Thus the unit of analysis is the entire proxy statement. Coders also noted whether some other explanation was used. Analysis of prenegotiation intercoder reliability yielded Pearson correlation coefficients ranging from .903 to .972, and the rate of intercoder agreement was 95 percent for both explanations, suggesting minimal ambiguity in the coding scheme.

Independent Variables

Board/CEO influence. Separate CEO and board chair is a binary variable, coded 1 if a CEO is not also chairman of the board, and 0 otherwise. Appointment of outsiders indicates the portion of the board composed of outside directors appointed after the CEO. CEO tenure was measured in years. Finally, relative directors' stock ownership was measured as the percentage of common stock owned by non-CEO directors divided by the percentage held by all directors, including the CEO.

Firm performance. The impact of performance on the content of LTIP explanations was measured by two
variables. Total stock returns was used as a market-based measure of firm performance, calculated as capital gains plus dividends accrued/paid during the year, divided by share price at the beginning of the year. Return on assets was used as an operating measure of performance. We measured performance in the year of adoption. Results were not sensitive to alternative operationalizations of performance, such as average stock returns or return on assets over the past three or five years.

Demographic similarity. In measuring functional background similarity, educational degree similarity, and educational affiliation similarity between the CEO and the board, we applied a variant of Blau’s (1977) index of heterogeneity, defined as \((P_i)^2\), where \(P_i\) is the proportion of CEO-board-member dyads sharing the \(i\)th category. Thus, for functional background, this measure indicates the squared proportion of CEO-board-member dyads in which both individuals have primary experience in the same functional area. Following Hambrick and Mason (1984) and Miles and Snow (1978), we consolidated the various functional backgrounds into three core areas: output functions, which include marketing and sales; throughput functions, which include operations, research and development, and engineering; and peripheral (or staff) functions, comprising law, finance, and accounting. In a separate model, we used a more fine-grained classification scheme consisting of nine different categories (Bantel and Jackson, 1989) and found that the results were substantively unchanged. We opted to use Hambrick and Mason’s (1984) classification scheme in the final models, however, given empirical evidence that this particular measure of functional background explains variation in generic strategy (Chaganti and Sambharya, 1987).

For educational degree, this measure represents the portion of such dyads in which both individuals have the same type of degree. Degree type was measured as the highest obtained university degree and was divided into five categories: arts, sciences, engineering, management or economics, and law (Wiersema and Bantel, 1992). When specialities were not listed, B.S. and M.S. degrees were classified as science degrees. Educational affiliation similarity simply indicates the portion of CEO-board-member dyads in which both individuals attended the same educational institution, at the undergraduate or graduate level.

Age similarity was measured with an analog of the euclidean distance measure (i.e., the coefficient of variation) commonly used in research on organizational demography (O’Reilly, Caldwell, and Barnett, 1989):

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\left[ \frac{1}{n} \sum_{j=1}^{n} (S_i - S_j)^2 \right]^{1/2},
\]

where \(S_i\) is the CEO’s age, \(S_j\) indicates the age of director \(j\) (excluding the CEO), and \(n\) represents the number of directors. This measure was converted to an indicator of similarity by subtracting each firm’s coefficient from the highest value in the sample. Finally, we measured similarity
on multiple dimensions as the portion of CEO–board-
member dyads sharing the same demographic category for
at least three of the four dimensions. To create this variable,
we first created a dichotomous measure of age similarity,
coded as 1 for a given dyad if the individuals differed in age
by less than one standard deviation, and 0 otherwise.

Other independent variables. To test H1, we created a
variable indicating time of adoption, with values ranging from
1 (adoption in 1976) to 15 (adoption in 1990). In addition,
given that larger firms may be relatively visible to external
stakeholders (Jensen and Murphy, 1990), and external
visibility may be differentially related to the use of agency
and HR explanations, log of sales was included as a control
variable. Finally, to test hypotheses relating intermediate
levels of the variables measuring time, firm performance,
relative CEO-board power, and demographic similarity to the
use of both explanations, we converted each independent
variable into raw deviation form (i.e., $|X - \bar{X}|$). While our
theoretical predictions refer to all large U.S. corporations
adopting LTIPs, to ensure that our findings are not materially
affected by industry-specific differences, we also controlled
for industry by including dummy variables for all two-digit
Standard Industry Classification codes represented in the
sample and found that the results were substantively
unchanged.

Data Analysis
We used logistic regression models to analyze the likelihood
of firms’ using agency, HR management, or both
explanations. Ordinary least squares (OLS) analysis is
inappropriate when the dependent variable is binary,
because OLS assumes a linear additive model with normally
distributed error terms, while the true probability model is
nonlinear with binomially distributed errors (Aldrich and
Nelson, 1984). The logistic function we used takes the
following form:

\[
\log\left(\frac{P}{1 - P}\right) = b_0X_{ik}
\]

where $P_i$ is the probability of observing the relevant
explanation, $X_{ik}$s are independent variables, and $b_0$s are the
estimated coefficients. $P_i$ is defined as:

\[
\exp(b_0X_{ik})/(1 + \exp(b_0X_{ik})),
\]

such that $P_i$ increases monotonically with $b_0X_{ik}$ and can
assume any value between zero and one.

We analyzed the likelihood of using agency explanations, HR
explanations, or both explanations in three separate logit
models, corresponding with the a-b-c ordering of the
hypotheses. Thus, for instance, the agency explanation
model assesses the likelihood that an agency explanation
will be used rather than a different explanation or no
explanation at all. The coefficients from this model indicate
the increase in log odds (i.e., the logit) that the firm will use
an agency explanation for each one-unit increase in the
independent variable (Allison, 1984). Because the use of two
explanations (i.e., agency and HR) was coded 1 in all three
analyses, the descriptive statistics showing the percentage
of agency, HR, and dual explanations exceed 100 percent.
This modeling approach represents a very conservative test of the hypotheses predicting the use of only agency or only HR explanations. In separate unreported logistic analyses, we also modeled the probability of using only an agency explanation and the probability of using only an HR explanation by coding dual explanations as 0 in these two analyses. Predictably, the results were stronger than those reported here in Tables 2 and 3, below. Also, to increase our confidence in the results, we conducted a multinomial logistic regression analysis (Aldrich and Nelson, 1984; Greene, 1993) in which LTIP explanations were divided into three categories: (1) agency only, (2) HR only, and (3) agency and HR. This model estimates separate coefficients for each explanation type, given a base category of no justification. The findings were consistent with the results reported here.

RESULTS

Table 1 provides the means, standard deviations, and bivariate correlations for all variables in the study. As Table 1 shows, nearly half (47 percent) of all firms in the sample used an agency explanation in announcing new LTIPs, and a slight majority (51 percent) used HR-management explanations. Moreover, 19 percent of these firms used both explanations.

The results of logistic regression analyses predicting the likelihood of agency, HR-management, or dual explanations are provided in Tables 2, 3, and 4, respectively. H1a predicted that later adopters would be more likely to use agency explanations. The findings in Table 2 support this hypothesis: Time of adoption is positively and significantly related to the likelihood of agency explanations. The results provided in Table 3 also support H1b: The later the year of adoption, the lower the likelihood of HR explanations. Finally, the results shown in Table 4 strongly support H1c, which predicted that adoption nearer the middle of the study period is likely to lead to the use of dual explanations. The closer the time of adoption to the mean value, the greater the likelihood of the use of both agency and HR explanations. Because the independent variables were converted to raw deviation scores, statistically significant, negative coefficients provide support for the hypotheses.

H2a and H2b related measures of demographic similarity between the CEO and the board to the use of agency and HR explanations in LTIP announcements. The results in Tables 2 and 3 generally support these hypotheses. In particular, four of the five measures of demographic similarity (similarity in functional background, educational degree, educational affiliation, and across multiple dimensions) are positively and significantly related to the use of HR explanations and negatively related to the use of agency explanations in LTIP announcements. H2c is not supported by the results in Table 4: The use of dual explanations is not more likely at intermediate levels of CEO-board demographic similarity for four of the five similarity measures.

The findings in Tables 2 and 3 strongly support H3a and H3b, respectively. Both measures of firm performance are
negatively related to the likelihood of agency explanations but positively related to the likelihood of HR-management explanations in LTIP announcements. High-performing firms tend to use HR explanations, while poorly performing firms rely on agency explanations to justify new LTIPs. Moreover, as shown in Table 4, deviations from average performance levels are negatively associated with the use of dual explanations. Thus, consistent with H3c, firms are more likely to use both explanations at intermediate levels of firm performance.

H4a and H4b predicted that greater board power increases the likelihood of agency explanations and decreases the likelihood of HR explanations. In general, these hypotheses are strongly supported in Tables 2 and 3. Consistent with H4a, all four measures of board power over the CEO (separate CEO and board chair, relative director and CEO stock ownership, low CEO tenure, and few outside directors appointed by the CEO) are positively associated with the use of agency explanations. A similar pattern of findings emerges in Table 3, supporting H4b: Three of the four measures of CEO power over the board (combined CEO and board chair positions, low relative director and CEO stock ownership, and outsiders appointed after the CEO) are positively associated with the use of HR explanations, suggesting that relatively high CEO power over the board increases the use of HR explanations in LTIP announcements. The results in Table 4 also afford strong support for H4c: The use of dual explanations is more likely at intermediate levels of board power, as indicated by the appointment of outside directors (significant at $p \leq .10$), CEO tenure, and relative director and CEO stock ownership (separate CEO and board chair, a categorical variable, was excluded from this specific analysis). The implications of these results are discussed below.

We also examined whether firms may be using agency and HR logics for LTIPs in a more straightforward, nonsymbolic way to report differences in how the plans are actually used. HR explanations may reflect the use of LTIPs to increase

---

**Table 1**

Descriptive Statistics and Pearson Correlation Coefficients ($N = 352$)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<td></td>
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<tr>
<td>2. Total stock returns</td>
<td>7.34</td>
<td>16.55</td>
<td>.04</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Return on assets</td>
<td>5.03</td>
<td>5.78</td>
<td>.05</td>
<td>.28</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Separate CEO and board chair</td>
<td>.16</td>
<td>.37</td>
<td>.08</td>
<td>.07</td>
<td>.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. CEO tenure</td>
<td>7.99</td>
<td>5.01</td>
<td>-.17</td>
<td>-.06</td>
<td>-.08</td>
<td>-.20</td>
<td></td>
</tr>
<tr>
<td>6. Appointment of outsiders</td>
<td>.29</td>
<td>.22</td>
<td>-.05</td>
<td>-.06</td>
<td>-.04</td>
<td>-.23</td>
<td>-.41</td>
</tr>
<tr>
<td>7. Relative director and CEO ownership</td>
<td>.41</td>
<td>.34</td>
<td>.07</td>
<td>.17</td>
<td>.04</td>
<td>.18</td>
<td>-.18</td>
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<td>8. Functional background similarity</td>
<td>52</td>
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<td>-.10</td>
<td>-.11</td>
<td>.15</td>
<td>-.05</td>
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<td>9. Educational degree similarity</td>
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<td>.33</td>
<td>.03</td>
<td>.02</td>
<td>.24</td>
<td>-.08</td>
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<tr>
<td>10. Educational affiliation similarity</td>
<td>.12</td>
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<td>.14</td>
<td>.02</td>
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<td>-.05</td>
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<td>11. Age similarity</td>
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<td>3.19</td>
<td>.20</td>
<td>-.11</td>
<td>-.16</td>
<td>.07</td>
<td>-.02</td>
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<td>-.08</td>
<td>-.10</td>
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<td>-.04</td>
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<td>.32</td>
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<tr>
<td>14. Human resource explanation</td>
<td>.51</td>
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<td>-.22</td>
<td>.33</td>
<td>.26</td>
<td>-.15</td>
<td>.16</td>
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<tr>
<td>15. Agency and HR explanations</td>
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<td>.04</td>
<td>.02</td>
<td>-.06</td>
<td>.01</td>
<td>-.06</td>
</tr>
<tr>
<td>16. Log of sales</td>
<td>6.86</td>
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<td>.05</td>
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<td>.03</td>
<td>.05</td>
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CEO Compensation

Table 1 (continued)

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<th>15</th>
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<td>.08</td>
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<td>.53</td>
<td>.41</td>
<td>.55</td>
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<td>-.01</td>
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<td>.03</td>
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<tr>
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<td>.03</td>
<td>.02</td>
<td>-.01</td>
<td>.03</td>
</tr>
</tbody>
</table>

pay level, while agency explanations may reflect the use of LTIPs to increase pay contingency. Similarly, high-performing firms may simply use LTIPs as a way to provide additional compensation, while low-performing firms may use them to increase compensation contingency, measured as the value of long-term incentives granted to the CEO in a particular year divided by total compensation (i.e., salary plus annual bonus plus the value of long-term incentives). We found no evidence supporting these alternative assumptions.

Regression analyses of change in compensation level and contingency following adoption revealed that firms using agency explanations did not increase compensation contingency after LTIP adoption any more than those firms not using agency explanations and that firms using HR explanations did not increase the total compensation level after LTIP adoption any more than those firms not using such explanations. In addition, we found that low-performing firms

Table 2

Logistic Regression Analysis Predicting the Use of Agency Explanations (N = 352)*

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Unstandardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Time of adoption</td>
<td>.096 (.047)*</td>
</tr>
<tr>
<td>2. Total stock returns</td>
<td>-.021 (.010)*</td>
</tr>
<tr>
<td>3. Return on assets</td>
<td>-9.997 (3.369)**</td>
</tr>
<tr>
<td>4. Separate CEO and board chair</td>
<td>1.150 (.446)**</td>
</tr>
<tr>
<td>5. CEO tenure</td>
<td>-.090 (.049)*</td>
</tr>
<tr>
<td>6. Appointment of outsiders</td>
<td>-2.663 (1.218)*</td>
</tr>
<tr>
<td>7. Relative director and CEO ownership</td>
<td>2.891 (1.148)**</td>
</tr>
<tr>
<td>8. Functional background similarity</td>
<td>-1.637 (.536)**</td>
</tr>
<tr>
<td>9. Educational degree similarity</td>
<td>-1.784 (6.78)**</td>
</tr>
<tr>
<td>10. Age similarity</td>
<td>-.059 (0.50)</td>
</tr>
<tr>
<td>11. Educational affiliation similarity</td>
<td>-2.619 (1.364)*</td>
</tr>
<tr>
<td>13. Log of sales</td>
<td>-.183 (1.68)</td>
</tr>
<tr>
<td>Constant</td>
<td>2.773 (3.416)</td>
</tr>
<tr>
<td>Chi-square</td>
<td>136.76**</td>
</tr>
</tbody>
</table>

*p ≤ .05; **p ≤ .01; ***p ≤ .001; t-tests are one-tailed for hypothesized effects, two-tailed for control variables.

*Standard errors are in parentheses.

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## Table 3

**Logistic Regression Analysis Predicting the Use of Human Resource Explanations \(N = 352\)**

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Unstandardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Time of adoption</td>
<td>-0.092 (0.043)*</td>
</tr>
<tr>
<td>2. Total stock returns</td>
<td>0.017 (0.008)*</td>
</tr>
<tr>
<td>3. Return on assets</td>
<td>5.979 (3.152)*</td>
</tr>
<tr>
<td>4. Separate CEO and board chair</td>
<td>-0.981 (0.385)**</td>
</tr>
<tr>
<td>5. CEO tenure</td>
<td>0.049 (0.040)</td>
</tr>
<tr>
<td>6. Appointment of outsiders</td>
<td>5.549 (1.565)***</td>
</tr>
<tr>
<td>7. Relative director and CEO ownership</td>
<td>-2.813 (1.286)*</td>
</tr>
<tr>
<td>8. Functional background similarity</td>
<td>1.023 (0.489)*</td>
</tr>
<tr>
<td>9. Educational degree similarity</td>
<td>1.236 (0.601)</td>
</tr>
<tr>
<td>10. Age similarity</td>
<td>-0.044 (0.045)</td>
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<tr>
<td>11. Educational affiliation similarity</td>
<td>3.582 (1.374)**</td>
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<tr>
<td>12. Similarity on multiple dimensions</td>
<td>7.393 (3.227)*</td>
</tr>
<tr>
<td>13. Log of sales</td>
<td>0.372 (1.152)*</td>
</tr>
<tr>
<td>Constant</td>
<td>-2.079 (2.147)</td>
</tr>
<tr>
<td>Chi-square</td>
<td>113.58***</td>
</tr>
</tbody>
</table>

* \( p \leq .05; \quad ** p \leq .01; \quad *** p \leq .001; \quad t\)-tests are one-tailed for hypothesized effects, two-tailed for control variables.  
* Standard errors are in parentheses.

## Table 4

**Logistic Regression Analysis Predicting the Use of Both Agency and Human Resource Explanations \(N = 352\)**

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Unstandardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Time of adoption</td>
<td>-0.247 (0.091)**</td>
</tr>
<tr>
<td>2. Total stock returns</td>
<td>-0.008 (0.004)*</td>
</tr>
<tr>
<td>3. Return on assets</td>
<td>-10.002 (4.464)*</td>
</tr>
<tr>
<td>4. CEO tenure</td>
<td>-0.211 (0.095)*</td>
</tr>
<tr>
<td>5. Appointment of outsiders</td>
<td>-1.681 (1.262)</td>
</tr>
<tr>
<td>6. Relative director and CEO ownership</td>
<td>-3.062 (1.540)*</td>
</tr>
<tr>
<td>7. Functional background similarity</td>
<td>1.296 (1.265)</td>
</tr>
<tr>
<td>8. Educational degree similarity</td>
<td>-1.101 (1.395)</td>
</tr>
<tr>
<td>9. Age similarity</td>
<td>0.092 (0.088)</td>
</tr>
<tr>
<td>10. Educational affiliation similarity</td>
<td>-3.868 (1.690)*</td>
</tr>
<tr>
<td>11. Similarity on multiple dimensions</td>
<td>-2.516 (2.014)</td>
</tr>
<tr>
<td>12. Log of sales</td>
<td>-0.175 (1.194)</td>
</tr>
<tr>
<td>Constant</td>
<td>5.809 (1.836)***</td>
</tr>
<tr>
<td>Chi-square</td>
<td>76.84***</td>
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</table>

* \( p \leq .05; \quad ** p \leq .01; \quad *** p \leq .001; \quad t\)-tests are one-tailed for hypothesized effects, two-tailed for control variables.  
* Standard errors are in parentheses. Each of the independent variables except log of sales was transformed to equal the absolute value of the raw deviation.

Firms did not increase compensation contingency after LTIP adoption any more than high-performing firms and that high-performing firms do not increase the total compensation level after LTIP adoption any more than low-performing firms. These findings suggest that LTIPs are not used differently by firms providing different explanations and that the choice of explanations provided may be driven more by symbolic considerations.

**DISCUSSION**

The present study is distinctive in at least three ways. First, it highlights how a symbolic management perspective

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provides a relevant new perspective in discussing CEO compensation contracts. Second, it explains why alternative explanations may exist to justify the adoption of new incentive plans for CEOs. Third, it uses an interdisciplinary approach that shows how multiple dimensions of an organization’s macro and micro context, along with managerial self-interest, can predict the use of particular explanations. The findings suggest that (1) organizations use alternative explanations to justify the adoption of CEOs’ long-term incentive plans, and (2) these alternative explanations are not chosen randomly but can be predicted by variables capturing the structural (e.g., institutional, demographic, and economic) and interest-based (e.g., political) factors facing these organizations.

The descriptive findings confirm that boards frequently explain new LTIPs in terms of rewarding and retaining scarce leadership talent, and/or controlling executive behavior by aligning executive pay more closely with shareholders’ interests. Thus, in explaining the purpose of new LTIPs to shareholders, boards appear to draw consciously or unconsciously on HR-management and/or agency theory logics as potentially legitimate institutional logics (Friedland and Alford, 1991) for incentive compensation. These findings also indicate that there is no uniform boilerplate language used in introducing LTIPs; rather, different logics are used, with similar phrasing within logics. Although one could argue that if consultants or other third parties sometimes write these documents, directors and top managers have little influence over their content, even when corporate leaders exercise little direct influence over the writing process itself they can exercise indirect influence (Mizruchi, 1983) by dictating the climate within which communications are formulated (Arendt, 1986) or by selecting third parties with similar orientations toward incentive compensation.

The multivariate results address the institutional, demographic, economic, and sociopolitical factors leading organizations to use one explanation and/or the other in justifying new LTIPs. For example, we found that agency theoretic perspectives have become more prevalent in LTIP explanations over time, while HR-management perspectives have become less common. This result suggests that agency theoretic concepts such as incentive alignment and control may have acquired institutional or symbolic value over time as explanations for incentive compensation (Meyer and Rowan, 1977; Zucker, 1983). The analyses also show that firms are most likely to use both agency and HR explanations near the middle of the study period, suggesting that institutional logics have a “dual character” during periods of transition between dominant logics (Zucker, 1983: 25).

The second set of findings shows that demographic similarity between the CEO and the board increases the likelihood of HR explanations while decreasing the likelihood of agency explanations in LTIP announcements. It appears that board members perceive demographically similar CEOs as valuable human resources to be rewarded and retained and that LTIPs are explained in this way. In contrast, board
members apparently view out-group CEOs as agency problems rather than valued human resources. Drawing from social psychological research on intergroup perceptions, Kramer (1991: 210) argued that “ingroup members tend to perceive outgroup members as less trustworthy, less honest, and less cooperative than members of their own group.” Thus CEOs with different functional specializations or educational backgrounds may be perceived as less trustworthy than CEOs with similar philosophies, skills, or social backgrounds (Kanter, 1977; Useem and Karabel, 1986). In addition, the findings indicate that demographic similarity across multiple dimensions has an independent effect on the use of different explanations, after controlling for the effect of similarity on individual dimensions. This finding is consistent with recent evidence that individuals use multiple social features to assess similarity, increasing the likelihood of in-group bias when individuals share multiple group memberships (Stangor et al., 1992). More generally, the findings suggest that the demographic context of organizations—by introducing cognitive biases—can exert a constraining effect on the content of impression management directed toward shareholders.

The third set of findings suggests that the content of LTIP explanations is also influenced or constrained by the performance context in which LTIPs are introduced. When performance is poor, the observed tendency of firms to use an agency explanation implicitly suggests both the problem and solution: lack of incentive alignment to be remedied by the adoption of a new LTIP. This explanation also emphasizes that CEOs will suffer along with shareholders if performance does not improve. Similarly, DeAngelo and DeAngelo (1991: 6) found, controlling for firm performance, that companies were less likely to pay bonuses to top management during union negotiation years. They concluded that “top management’s financial sacrifices appear to be symbolic actions which indicate that they too will bear personally significant costs during the firm’s financial difficulties.” When performance is high, boards implicitly attribute this success to the CEO by affirming the value of executive talent and the importance of retaining it (Staw, McKechnie, and Puffer, 1983; Salancik and Meindl, 1984). Finally, the analyses suggest that both explanations are plausible when performance is average or ambiguous.

The fourth and final set of findings deals with interest-based determinants of LTIP explanations, namely, the relative power of CEOs and boards. The results show that board influence over the CEO increases the likelihood of agency explanations, while decreasing the likelihood of HR explanations. Thus, consistent with a political perspective on impression management (Pettigrew, 1985), it appears that the content of LTIP explanations may be “contested” among organizational actors, reflecting and perhaps reinforcing the existing distribution of power within the firm (Friedland and Alford, 1991). While powerful CEOs advertise their value to the firm and rationalize their power over the board by favoring LTIP explanations that reflect romanticized conceptions of corporate leaders, powerful boards favor accounts that emphasize board control over management.

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Consistent with this perspective, the results also suggest that, when board control over management is neither particularly high nor low, firms are most likely to use both agency and HR explanations. It appears that under such circumstances both parties are sufficiently powerful to influence the content of LTIP explanations. In effect, the presence of both explanations in LTIP announcements may represent a compromise between management’s and shareholders’ interests.

This study extends prior research on the role of substance and symbolism in executive compensation (Westphal and Zajac, 1994). First, we examined how CEO compensation practices may be significantly influenced by the social and organizational context and how variation in this context across organizations and/or across time resulted in variation in the explanations provided for new CEO compensation arrangements. This aspect of our approach is consistent with Pfeffer (1981: 4), who noted that explanations of corporate activities “are constrained to be legitimate and acceptable in the social context.” By choosing explanations within these constraints, organizations, as Meyer and Rowan (1977: 50) suggested, “provide an account of activities that protects the organization from having its conduct questioned.” In the present study, institutional logics or accounts were provided to enhance the legitimacy of new formal structures or activities (i.e., LTIPs). The study also extends this literature by specifying how multiple sources of constraint, both institutional and organization-specific factors, may affect which explanations are provided.

Second, the study’s findings also support the more interest-based perspective on organizational communication, wherein powerful corporate leaders seek to encourage favorable interpretations of organizational actions and thus enhance their professional reputations (Elsbach and Sutton, 1992). It appears that organizational participants exercise power not only “on the level of substantive action” (e.g., to determine the form of executive compensation contracts), but also “on the expressive or symbolic level” to ensure the commitment and support of organizational stakeholders (Pfeffer, 1981: 1). Future research might extend the present study by examining whether political conflict and debate over compensation issues relevant to employees at lower levels of the organization, such as the minimum wage debate, are also carried out on both symbolic and substantive levels.

Moreover, this research makes several contributions to the growing literature on organizational impression management. First, while most research in this area has analyzed press statements or letters to shareholders (e.g., Staw, McKechnie, and Puffer, 1983; Salancik and Meindl, 1984; Marcus and Goodman, 1991; Elsbach, 1994), the present study describes a unique vehicle for symbolic management: LTIP explanations. Relative to press statements, which must appeal to multiple stakeholders and can be altered or colored by media interpretation, LTIP explanations in proxy
statements speak primarily to shareholders and are not vulnerable to media intervention.

Second, we have identified two specific institutional goals or legitimate purposes that may be used to explain a variety of governance arrangements and other organizational policies to stakeholders that are not easily classified according to extant typologies of organizational accounts (cf., Elsbach, 1994). Whereas the existing literature has focused almost exclusively on reactive forms of impression management, such as denying responsibility for some outcome or accepting responsibility while attempting to change stakeholders’ perceptions about it (e.g., Sutton and Callahan, 1987; Dutton and Dukerich, 1991; Marcus and Goodman, 1991; Elsbach and Sutton, 1992), LTIP explanations represent a proactive kind of symbolic management. Both HR explanations and agency explanations serve to preempt or stave off potential criticism of CEO compensation, rather than counteract existing criticism. Typologies of organizational impression management might be enriched by distinguishing between reactive and proactive explanations.

Finally, we examine explicitly the role of power in governance communication. While prior research in this area has typically assumed that corporate officers and directors communicate with stakeholders as a unified group with common interests (e.g., Staw, McKeevie, and Puffer, 1983; Salancik and Meindl, 1984), in this study we acknowledge the potential for parochial interests among corporate leaders and empirically examine how those divergent interests can influence the content of explanations for controversial organizational action.

It is also noteworthy that we found no support for the notion that variation in the choice of explanations for new LTIPs may simply reflect differences in how the plans are actually used. Firms using agency explanations did not increase compensation contingency after LTIP adoption any more than did those firms not using agency explanations, and firms using HR explanations did not increase the total compensation level after LTIP adoption any more than did those firms not using such logics. This finding suggests that LTIPs are not actually used differently by firms using different explanations and, consequently, that the choice of explanations may be driven by symbolic considerations. Since prior symbolic management studies have typically not explored whether different explanations or justifications fit the facts of the situation (e.g., Sutton and Callahan, 1987; Marcus and Goodman, 1991), these supplementary findings may also contribute to the symbolic management literature.

This study highlights how a symbolic management perspective can enhance our knowledge about CEO compensation issues beyond the traditional focus on economic and political perspectives. It is noteworthy that even within existing CEO compensation debates, the arguments are often couched in symbolic terms, emphasizing whether CEO compensation is justifiable in the
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eyes of an organization’s constituents. We treat CEO compensation as a justification problem that is socially defined, inherently subjective, and also potentially subject to manipulation. The supportive findings of this study suggest that our interdisciplinary framework can lead to a greater understanding of the social definition and possible manipulation of the phenomenon of CEO compensation. We hope this framework can also be used to shed light on the many other organizational phenomena that are driven by the interests of powerful organizational elites but are also embedded in an organizational, social, and historical context.

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