Substance and Symbolism in CEOs’ Long-term Incentive Plans

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This study theoretically and empirically addresses the possible separation of substance and symbolism in CEO compensation contracts by examining political and institutional determinants of long-term incentive plan (LTIP) adoption and use among 570 of the largest U.S. corporations over two decades. We find that a substantial number of firms are likely to adopt but not actually use—or only limitedly use—LTIPs, suggesting a potential separation of substance and symbol in CEO compensation contracts. Analyses suggest that this decoupling of LTIP adoption and use is particularly prevalent in firms with powerful CEOs and firms with poor prior performance. Further analyses show that whereas early adopters are more likely to pursue alignment between CEO and shareholder interests substantively, later adopters may pursue legitimacy by symbolically controlling agency costs. More generally, the study highlights how decoupling in organizations can be understood in terms of both micro-political and macro-institutional forces.

INTRODUCTION

The topic of executive compensation has attracted increased attention from researchers taking economic and behavioral perspectives (e.g., O’Reilly, Main, and Crystal, 1988; Finkelstein and Hambrick, 1989; Tosi and Gomez-Mejia, 1989; Jensen and Murphy, 1990; Zajac, 1990; Beatty and Zajac, 1994). The economics-based research, relying primarily on agency theory (Jensen and Meckling, 1976), emphasizes how contingent compensation contracts for managers that link pay to firm performance can align the interests of chief executive officers (CEOs) and shareholders. The board of directors is responsible for fashioning such contingent contracts and functions more generally to monitor executive behavior (Fama and Jensen, 1983). The inability of empirical studies to demonstrate a consistently significant relationship between CEO pay and firm performance (Kerr and Bettis, 1987; Jensen and Murphy, 1990), however, has led some researchers to explore more behaviorally oriented explanations for the board’s apparent failure to fulfill its nominal function. These studies typically focus on the social, political, or psychological aspects of the CEO-board relationship, such as how the CEOs’ relative power over board members may influence cash compensation in the form of salary and bonuses (Finkelstein and Hambrick, 1989; Hill and Phan, 1991). The impact of CEO influence on the specific form or composition of CEO compensation contracts, such as long-term incentives versus cash compensation, has received little attention, however, despite the fact that long-term incentives have become an increasingly large proportion of CEOs’ total compensation (Jarrell, 1993).

This line of behavioral research has also tended to focus on the overtly political aspects of CEO compensation, emphasizing how powerful CEOs are able to pressure boards into giving them higher levels of cash compensation. While this approach has yielded important insights, we believe that current research can be extended to consider...
how more subtle aspects of political behavior might affect CEO compensation, such as how the symbolic, rather than substantive aspects of CEO compensation may be politically managed to the advantage of powerful CEOs.

In addition, prior research has given only limited consideration to the implications of institutional theory for executive compensation issues. From an institutional perspective, actual compensation practices may differ from formal arrangements (Meyer and Rowan, 1977). This perspective also suggests that the predictors of whether firms adopt organizational practices like long-term incentive plans may change over time, with technical considerations predicting early adoption and institutional factors predicting later adoption (Tolbert and Zucker, 1983). In effect, institutional theory can be used to complement political theory in developing a symbolic action perspective on CEO compensation.

This paper seeks to address each of the issues raised above by focusing on how long-term incentive compensation, the aspect of CEO pay that has been least researched in the organizational literature, lends itself best to a study of symbolic action. The study focuses on how long-term incentive plans (LTIPs), which have been widely promoted by compensation consultants and writers on executive compensation (Meyers, 1981) as an effective means of aligning CEO pay with shareholder interests, may be used symbolically, rather than substantively.

**Long-term Incentive Plans**

Corporations adopting LTIPs typically emphasize the role of such plans in aligning the interests of top management with those of the firm’s owners. Several statements taken from company proxy statements reflect how LTIPs are viewed by corporate boards of directors. For example, in proposing a new LTIP, Alcoa proclaimed in its 1988 proxy statement:

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.

Similarly, B. F. Goodrich announced an LTIP in its 1990 proxy statement by declaring, “the purpose of this plan is to promote the interests of the shareholders by furthering the long-term performance of the company, contingent upon the meeting of strategic goals which are determined by a committee of the board of directors."

LTIPs typically comprise one or more of the following vehicles: stock option plans, stock appreciation rights (SARs), restricted stock, and performance plans. Stock options give executives the right to purchase a certain number of shares at a predetermined price—usually the market value at the time they are granted—within a given time period. Stock appreciation rights are typically attached to option grants and permit executives to exchange options
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for a cash payment equal to the stock price less the exercise price.

With restricted stock, an executive is awarded shares of common stock subject to restrictions on sale. These restrictions lapse over a period of years, provided that the executive remains with the firm. Finally, performance plans generally span a three- to six-year performance period and reward executives for meeting specific accounting-based performance goals over that period (Larcker, 1983; Jarrell, 1993). Grants under a performance plan, which confer the right to receive shares of common stock or cash at a particular date in the future to the extent that the specific performance objectives are met, are typically made in either shares of common stock or stock units, referred to as performance shares and performance units, respectively. The final value of each share is the market price at the end of the award period, while each unit is assigned a fixed dollar value—unrelated to share price—at the beginning of the award period.

In this study, the adoption of a long-term incentive plan refers to the introduction, identifiable as an announcement in proxy statements for purposes of gaining shareholder approval, of a relatively comprehensive incentive program that includes a performance plan, as defined above (Larcker, 1983). Introduction of a performance plan is thus a necessary and sufficient condition for LTIP adoption, although other long-term incentive vehicles may also be introduced. The importance of performance plans as a compensation innovation is documented in Larcker (1983), who argued that these plans can lengthen executives’ time horizons and focus their attention on creating shareholder value. Jarrell (1993) also noted that from the mid-1970s to the late 1980s, the number of firms adopting such LTIPS has increased significantly. This increase is at least partly attributable to the fact that LTIPS have been touted by compensation consultants and boards of directors as a compensation innovation that aligns CEO interests more closely with those of the firm. As the following discussion suggests, however, LTIPS may also provide symbolic benefits.

The Adoption Versus Use of Long-term Incentive Plans

Although the antecedents and consequences of LTIPS have not received much attention in behavioral research on executive compensation, a number of studies in the financial economics literature have investigated the consequences of LTIP adoption. In particular, research has consistently shown a favorable stock market reaction to the announced adoption of executive incentive plans (Larcker, 1983; Brickley, Bhagat, and Lease, 1985; Tehranian, Travlos and Waegelein, 1987). While an implicit assumption in this literature is that LTIPS will mitigate substantively the agency problem between top managers and owners, an interesting feature of LTIPS is that they typically do not specify any targeted amount of incentive compensation. In fact, the adoption of an LTIP does not guarantee that it will be used at all: A board may announce a new LTIP and then make trivially small grants under the plan or no grants at all.
The adoption of LTIPs may thus constitute an action that is partly or even largely symbolic, representing a possible decoupling of actual compensation practices from formal arrangements (Meyer and Rowan, 1977). From this perspective, organizations adopt institutionalized policies and programs but decouple these policies from the actual functioning of the organizations. Interestingly, while empirical tests of institutional theory have found indirect support for the decoupling of institutionalized policies and programs among late adopters (e.g., Edelman, 1990, 1992), the financial economics event studies cited above (Larcker, 1983; Brickley, Bhagat, and Lease, 1985; Tehranian, Travlos, and Waegelein, 1987) never discuss the possibility of decoupling, and their empirical analyses implicitly equate LTIP adoption with use.

In the sample of 570 firms we studied, however, 21 to 45 percent of the firms that adopted LTIPs did not use them, which indicates that such decoupling does exist. We draw on power, impression management, and institutional perspectives to explain why and under what conditions the decoupling of LTIP adoption and use exists. In particular, we discuss the separation of LTIP substance and symbolism as deriving from three possible sources: (1) the ability of powerful CEOs to enhance their legitimacy while minimizing risk in their compensation contracts; (2) the need to manage stakeholders’ impressions in the face of poor performance; and (3) the increasing legitimation or institutionalization of LTIPs as a component of CEOs’ formal compensation contracts.

**CEO influence.** A theoretical analysis of how CEO influence may play a role in the decoupling of substance and symbolism in LTIPs should start with a discussion of why CEOs would prefer boards to adopt, but not necessarily use LTIPs. Adopting LTIPs may serve a symbolic role in demonstrating commitment to incentive alignment and to pay for performance more generally, as LTIP announcements typically emphasize shareholder welfare and stress the firm’s overall commitment to pay for performance. Thus, to the extent that CEOs benefit from association with normatively sanctioned values and legitimate practices (Schlenker, 1980; March, 1984; Elsbach and Sutton, 1992), influential CEOs may actively encourage the adoption of LTIPs. In aligning themselves with practices that display concern for shareholders’ interests, CEOs are better able to manage their reputation among stockholders and other stakeholders. As Meyer and Rowan (1977: 50) argued, “by designing a formal structure that adheres to the prescriptions of myths in the institutional environment, an organization demonstrates that it is acting on collectively valued purposes in a proper and adequate manner.” By encouraging LTIP adoption, CEOs align their formal compensation contracts with collectively valued normative prescriptions, such as incentive alignment and pay for performance, and thus enhance their legitimacy with external stakeholders. The formal adoption of alignment mechanisms may also serve the CEO’s interests by signalling to stakeholders that the board of directors controls the compensation-setting process and that the CEO has little influence over the board. This is
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the kind of message conveyed by Alcoa’s announcement:
“Alcoa’s Board of Directors has decided to place an
increasing share of management’s overall compensation at
risk rather than in fixed salaries.”

Considerable evidence suggests that CEOs can benefit from
such symbolic management of stakeholders’ perceptions. An
established finding in the impression management literature
is that people can enhance their reputation among interested
constituents by verbally aligning themselves and their
actions with normatively sanctioned values and practices
(Schlenker, 1980; Tedeschi and Reiss, 1981; Schlenker and
Weigold, 1992). At the organization level of analysis,
research has shown that specific impression management
tactics, such as linking potentially controversial actions with
important constituent or societal goals, can generate
significant reputational benefits for organizations (Marcus
and Goodman, 1991; Staw and Sutton, 1992). When
organizational policies are associated with CEOs as
individuals, as is the case with incentive compensation,
CEOs’ reputations are affected directly by firm-level
impression management (Sutton and Callahan, 1987).

While CEOs may therefore encourage LTIP adoption, several
theoretical perspectives suggest that they will also seek to
avoid or minimize subsequent use of newly adopted plans.
We assume, as does much current compensation research,
that incentive compensation is not a gift to the CEO (Tosi
and Gomez-Mejia, 1989) but, rather, that firms using LTIPs
substitute contingent for noncontingent compensation when
making long-term incentive grants. This assumption is
consistent with recent empirical research demonstrating that
the use of long-term incentive compensation increases
overall compensation risk (Beatty and Zajac, 1994). Both the
economic and behavioral literatures on executive
compensation suggest that, other things being equal, CEOs
prefer less of their compensation to be contingent on future
firm performance. From a normative agency theory
perspective, CEOs, as risk-averse agents, prefer less risk in
their compensation contracts (Harris and Raviv, 1979). By
making compensation contingent on future firm
performance, long-term incentives add uncertainty to a
CEO’s compensation. Moreover, stock-based compensation
effectively increases the CEO’s nontradeable investment in
the firm and reduces the diversification of his or her
investment portfolio (Beatty and Zajac, 1994).

Managerialist theory suggests another reason why CEOs
avoid long-term incentive compensation (Marris, 1964). To
the extent that CEOs prefer growth-maximizing or
self-aggrandizing strategies (Marris, 1964; Williamson, 1964)
and such strategies sacrifice profits, CEOs should avoid
LTIPs that tie compensation to firm profitability (Tosi
and Gomez-Mejia, 1989; Hill and Phan, 1991). Finally, a related
behavioral perspective suggests simply that powerful CEOs
will resist compensation contracts that reduce their
discretion and autonomy. CEOs with the ability to influence
the board to adopt but not use LTIPs, however, can
simultaneously enhance the legitimacy of their formal
compensation contract and satisfy their personal preferences.
to avoid having their compensation at risk. The above discussion suggests the following two related hypotheses:

**Hypothesis 1 (H1):** The greater the CEO’s influence over the board, the higher the likelihood that the firm will adopt an LTIP.

**Hypothesis 2a (H2a):** The greater the CEO’s influence over the board, the lower the likelihood that the firm will actually use (i.e., make any grants under) an adopted LTIP.

While influential CEOs may be able to reduce compensation uncertainty by avoiding LTIPs altogether, a more subtle exercise of influence would involve limiting the magnitude of such compensation. By permitting token incentive grants, for example, CEOs display a willingness to accommodate pay-for-performance constraints while still minimizing the proportion of their compensation that is at risk. This suggests an additional hypothesis, related to H2a, that examines the magnitude of LTIP use among firms that have adopted and used LTIPs:

**Hypothesis 2b (H2b):** The greater the CEO’s influence over the board, the smaller the magnitude of LTIP use (i.e., the smaller the size of LTIP grants as a proportion of total compensation).

**Performance.** If LTIP adoption signals commitment to shareholders’ interests, then the impetus for adoption should be greatest when shareholders’ interests are viewed as having been neglected. From an impression management perspective (Schlenker, 1980; Pfeffer, 1981; Tedeschi and Reiss, 1981; Schlenker and Weigold, 1992), poor performance threatens the credibility of board members as guardians of shareholder interests (Fama and Jensen, 1983); in order to alleviate this “predicament,” boards must at least “give the appearance of efficacy” (Salancik and Meindl, 1984: 238) by symbolically affirming and tightening their control over management (Pfeffer, 1981). A new incentive plan may signal the board’s willingness to reshape executive compensation policy in a way that benefits shareholders. DiMaggio and Powell (1983: 151) offered a similar rationale for the proliferation of quality circles among U.S. firms: “companies adopt these ‘innovations’ to enhance their legitimacy, to demonstrate that they are at least trying to improve working conditions.”

Although a variety of innovations could be used to symbolize organizational change or adaptation in response to poor performance, LTIPs offer several advantages over other innovations. They are highly visible, relatively inexpensive, attend specifically to shareholders’ interests, and are generally viewed by external constituents as beneficial, as evidenced by the positive stock market reactions found in the event studies discussed above. These advantages can be realized by the LTIP adoption announcement alone, however, independent of actual use. This suggests the following hypothesis:

**Hypothesis 3 (H3):** The lower a firm’s performance, the greater the likelihood a firm will adopt (but not necessarily use) LTIPs.

**Institutionalization.** Some institutional theorists (Meyer, Scott, and Deal, 1981; Zucker, 1983) have argued that organizational phenomena only acquire legitimate status with time and that while early adoption of an organizational form
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may be motivated by economic or technical needs, later adoption provides legitimacy rather than improved technical performance (Zucker, 1983). This general hypothesis has been supported in empirical studies of the adoption of civil service reforms by city governments (Tolbert and Zucker, 1983), the proliferation of city finance agencies (Meyer, Stevenson, and Webster, 1985), and the adoption of personnel administration programs (Baron, Dobbin, and Jennings, 1986). More recently, Burns and Wholey (1993) found that organizational characteristics predicted adoption of a new organizational form during early periods of the diffusion process, while institutional factors influenced adoption during later phases. In addition, Edelman (1990, 1992) documented the institutionalization of Equal Employment Opportunity and Affirmative Action structures, finding that different forms of compliance gradually acquired symbolic value. Once these plans became institutionalized, organizations signalled their compliance with institutional demands through adoption alone. Implementation became unnecessary, since the institutional benefits for late adopters are derived from adoption alone.

Similarly, the normative status of LTIPs as a response to the perceived need for greater incentive alignment may have developed over time. In this scenario, technical or economic exigencies motivate the early adoption and actual use of LTIPs as an efficient means of aligning CEO and firm interests. Over time, however, this technically rational, agency-based rationale gives way to a more normatively rational, institutional-based rationale, in which later adopters seek to signal improvement through adoption alone, exploiting the LTIPs' symbolic value. In effect, symbolic or ceremonial incentive alignment increasingly substitutes for actual incentive alignment as LTIPs become institutionalized. This logic suggests the following hypothesis:

Hypothesis 4a (H4a): The later the date of LTIP adoption, the lower the likelihood of its subsequent use.

While H4a captures the most obvious categorical distinction between a technical and symbolic response to shareholders' concerns, a similar logic suggests that early and late adopters may also differ in the magnitude of LTIP grants provided—measured as a proportion of total compensation—rather than simply in the use and nonuse of LTIPs:

Hypothesis 4b (H4b): The later the date of LTIP adoption, the smaller the magnitude of subsequent grants under the plan.

While hypotheses 4a and 4b describe institutional processes in terms of a growing decoupling of actual incentive compensation from formally adopted incentive plans, a more traditional test of institutionalization, focusing on early versus late adoption, is also possible. From an institutional theory perspective, as LTIPs acquire normative or taken-for-granted status as a component of formal compensation contracts, technical motives for adoption, such as poor prior performance, may decline in importance (Tolbert and Zucker, 1983; Zucker, 1983). To the extent that late adoption is a normative act, all deliberate motives should become less significant in predicting adoption over time, including the desire by influential CEOs to enhance their reputation.
through formal incentive alignment (Zucker, 1977). This logic suggests the following hypotheses:

**Hypothesis 5a (H5a):** The strength of the relationship between prior performance and LTIP adoption will decrease over time.

**Hypothesis 5b (H5b):** The strength of the relationship between CEO influence and LTIP adoption will decrease over time.

**METHOD**

**Data**

The population for this study included the largest U.S. industrial and service companies. The initial sample consisted of 669 firms listed in the 1972 Forbes 500 and Fortune 500 listings. The year 1972 was chosen to approximate the onset of LTIP adoption (Larcker, 1983; Jarrell, 1993), as explained in more detail below. Firms were excluded from the final sample if proxy statements were unavailable or compensation information was incomplete or if firms experienced CEO succession during the year of adoption or the following year. The final sample included 570 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 population and the final sample.

Data on LTIPs and CEO influence were collected for the years 1972 through 1990. Two indicators of CEO influence, CEO tenure and combined CEO and chair positions, were collected for each year, while two additional indicators, insider ratio and number of board appointments since CEO hire, were gathered at three-year intervals beginning in 1971. Information on LTIP adoption and use were obtained from proxy statements, and indicators of CEO influence were obtained from both proxies and Standard and Poor’s Register of Corporations, Directors, and Executives. Data from Standard and Poor’s COMPSTAT service and the Center for Research in Security Prices (CRSP) were used to calculate performance and size measures.

**Dependent Variables**

**LTIP adoption.** A necessary and sufficient condition for coding a firm as having adopted an LTIP is the adoption of a new performance plan that is aimed at adding multiyear performance incentives, such as performance shares or performance units, to a CEO’s compensation contract. If a firm adopted a performance plan along with other long-term incentive vehicles, we also considered it as having adopted an LTIP. In a separate analysis, we examined whether the empirical findings would be substantively changed if one defined LTIP adoption as the introduction of only performance plans, which represented 66 percent of all adoptions in our sample. This reduced sample excluded so-called “omnibus plans,” representing 11 percent of all adoptions, which give boards the right to grant any long-term incentive vehicle; it also excluded LTIPs comprising performance plans and one or more additional vehicles, such as restricted stock, which represented 23 percent of all
adoptions. We found that the empirical results were substantively unchanged.

We analyzed proxies before and after the LTIP adoption date to confirm the newness and uniqueness of coded LTIP adoptions. To ensure that the LTIPs we documented were in fact new, we checked proxies from the date of adoption backward to 1972 for any earlier references to performance plans. We also examined each coded LTIP adoption and observed that in 81 percent of the cases (339 of 419), there was explicit mention of the LTIP’s newness and/or direct evidence that LTIPs (i.e., performance plans) had not been previously adopted. Excluding the remaining 19 percent had no substantive effect on the results reported in this study, as most of the excluded cases were stand-alone performance-unit plans, which were also the only type of LTIP in our study not requiring a shareholder vote.

We followed prior research (Larcker, 1983; Jarrell, 1983) in treating LTIP adoption as a unique event and LTIPs as a discrete compensation innovation whose origin can be traced to the early 1970s and whose diffusion continued through the 1980s. Given the definition of LTIP adoption, specified above as the introduction of a performance plan, the only type of “repeated events” observed in this sample were either requests for additional shares (i.e., for issuance under the plan) and/or enlargement of the current plan to encompass additional vehicles, such as adding restricted stock to an existing performance plan based on shares. Neither of these events really constitute the adoption of a new LTIP and therefore do not represent repeated adoptions.

LTIP use. To test hypotheses predicting the likelihood of LTIP use, we created a dichotomous measure, coded as 1 if any units or shares were granted during the year of adoption or the year thereafter, and 0 otherwise. An observation period of two years rather than just one year was used because some companies make long-term incentive grants biannually. A longer observation period seems unnecessary, given that firms intending to use LTIPs have no obvious incentive to delay implementation. Nonetheless, we also examined in a separate analysis whether our results were somehow sensitive to the two-year observation period chosen. Results showed that extending the time period for observing grants to three or four years had no substantive effect on the multivariate results.

The vast majority (94 percent) of the 419 LTIP-adopting firms in our study reported the use or non-use of the LTIP. In only 6 percent of the cases did we infer from the lack of any reference to grants made that the LTIP was not implemented. Firms coded as non-users or non-implementers in our sample typically reported the absence of grants by reporting a value of 0 in a tabular display or by verbally stating that no grants were made under the plan. Some verbal references to use or non-use were less clear. For instance, firms sometimes stated in the second year that no grants had been made under the plan, but they did not say whether grants were made in the first year. Although this statement implies non-use in both years, some
ambiguity remains. Similarly, firms were sometimes ambiguous about precisely which long-term incentive plan(s) were not used in a given year (e.g., option plan only or option plan and performance plan). To ensure that our results were not contingent on the inclusion or exclusion of these relatively ambiguous cases, we conducted separate analyses with these cases excluded (18 percent), while also excluding the 6 percent that made reference to grants. The multivariate findings were substantively unchanged.

To test hypotheses about the magnitude of LTIP use, the average annual grant value, as a proportion of total compensation, was calculated for the two-year period. While vesting in restricted stock is not contingent on firm performance (Crystal, 1991), the value of these shares still depends on stock price. Thus, restricted stock introduces greater uncertainty into a CEO’s contract than does cash compensation. The value of restricted stock grants was therefore included in calculating the size of LTIP grants. The specific formulas used for valuation purposes are shown in the Appendix. Finally, we used the Consumer Price Index to adjust all compensation values for inflation to represent 1990 constant dollars.

Independent Variables

A number of indicators of CEO influence have been used in the growing literature on CEO/board relations. To ensure that this study’s findings are not dependent on a single measure of CEO influence, we used the following multiple measures: (1) CEO tenure, (2) the ratio of inside to outside directors on the board, (3) the number of outside directors appointed after the CEO, and (4) combined CEO and chair positions.

CEO tenure. A number of studies have hypothesized a link between tenure and CEO influence over the board (Finkelstein and Hambrick, 1989; Ocasio, 1994; Singh and Harianto, 1989; Hill and Phan, 1991). It is typically argued that as tenure increases, CEOs acquire personal power by populating boards with supporters (Fredrickson, Hambrick, and Baumrin, 1988) while gaining expert power through an increased familiarity with the firm’s resources (Zald, 1969; Singh and Harianto, 1989).

Insider ratio. Agency theorists and advocates of board reform typically assume that outside directors will be less conciliatory than insiders toward CEOs (Beatty and Zajac, 1994; Schellenger, Wood, and Tashakori, 1989). Since insiders are “beholden to CEOs for their jobs” (Fredrickson, Hambrick, and Baumrin, 1988: 262), they may be more willing to accommodate CEOs’ preferences about compensation arrangements. Although the evidence remains limited and inconclusive (Singh and Harianto, 1989), several studies have observed a positive link between the ratio of outsiders and organizational performance (Schellenger, Wood, and Tashakori, 1989).

Appointment of outside directors. A related measure of influence has been proposed by Wade, O’Reilly, and Chandratat (1990), who found that the percentage of the board composed of outside directors appointed after the
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CEO is positively associated with the likelihood of golden parachute adoption. Mace (1971) argued that CEOs typically control the nominating process and are able to select board members sympathetic to their preferences. Moreover, like insiders, these directors may feel beholden to CEOs for their position. In effect, this measure represents a modification of the insider ratio discussed above.

Combined CEO and chair positions. In serving simultaneously as CEO and chairman of the board, a CEO should have greater stature and influence among board members (Harrison, Torres, and Kukalis, 1988), hampering the board’s independent monitoring capacity (Beatty and Zajac, 1994). If these positions are separate, compensation arrangements should be determined more objectively.

Other independent variables. The impact of prior performance on the likelihood of adoption (H3) was measured by one market-based and one accounting-based variable, each lagged by one year. Total returns were calculated as capital gains plus dividends accrued during the year, divided by share price at the beginning of the year (Davis, 1991). The second performance measure is return on assets (ROA). Finally to test H4a and H4b, we created a continuous measure of time of adoption, with values ranging from 1, when adoption was in 1972, to 19, when adoption was in 1990. Given the well-established empirical relationship between firm size and compensation (Hill and Phan, 1991), the log of sales was also included as a control variable in all analyses.

Analysis

LTIP adoption and use were analyzed separately, as recommended by Allison (1984: 43) for the analysis of multiple events when the causal determinants of each event are distinct and logically sequential, as adoption and use are. We used event history analysis to model the occurrence of LTIP adoption, the first event, and for the reduced set of adopting firms, we modelled the causal process that determined LTIP use, the second event. The hypotheses on LTIP adoption were tested using continuous-time event history analysis with time-varying covariates (Allison, 1984; Yamaguchi, 1991). Event history analysis is appropriate when the data is longitudinal and the phenomenon of interest is a discrete event, as is LTIP adoption. Since specific dates of adoption were available and adoption was observed over a relatively long time interval, minimizing the number of tied events, a continuous-time, proportional hazards model was used (Cox, 1972; Yamaguchi, 1991). The Cox model takes the following form:

$$h(t) = q(t) \exp(b'X(t)),$$

where $h(t)$ is the hazard rate of adoption at time $t$, $q(t)$ is the unspecified function of time dependence, $X(t)$ is a vector of covariates, and $b$ is the corresponding vector of coefficients. Because the model is log-linear, a one-unit change in $X$ increases the hazard rate by $\exp(b)$.

A limitation of the Cox model is that it uses information only about the relative order of event times, rather than information about the specific timing of events, thus
lowering the efficiency of parameter estimates. The loss of efficiency, however, is generally small for large samples (Yamaguchi, 1991). A more serious potential problem would be the presence of left-censored observations, when the event occurs before the study period. If a very large portion of the sample adopts prior to the observation period, serious bias in parameter estimates can occur. Fortunately, our sample begins with the year 1972, which approximates the onset of LTIP adoption (Larcker, 1983; Jarrell, 1993); thus, bias in parameter estimates should be minimal.

The data were arranged by firm-year, beginning on January 1, 1972, and updated annually. Since adoption was treated here as an absorbing state, firms were removed from the risk set upon adoption. Also, 81 cases were right-truncated due to mergers, acquisitions, or takeovers during the risk period. The time of adoption was recorded as the date of the annual meeting. All independent variables were lagged by one year; thus, the risk of adoption during each year depended on the firm, CEO, and board characteristics in the prior year (Davis, 1991).

To test hypotheses about the likelihood of LTIP use following adoption, for those firms adopting LTIPs, we used logistic regression analysis. Ordinary least squares (OLS) analysis is inappropriate when the dependent variable is categorical, because OLS assumes a linear additive model with normally distributed error terms, while the true probability model is nonlinear with binomially distributed errors (Hosmer and Lemeshow, 1989). Finally, we used OLS regression analysis to test predictions about the magnitude of LTIP grants, for those firms making such grants.

RESULTS

Table 1 displays the means, standard deviations, and correlations between the variables for all 19 years of data.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
<th>3</th>
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<th>6</th>
<th>7</th>
<th>8</th>
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<th>10</th>
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<tbody>
<tr>
<td>1. Year of adoption*</td>
<td>9.87</td>
<td>4.58</td>
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<td>2. Appointment of outsiders</td>
<td>.46</td>
<td>.27</td>
<td>.05</td>
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<td>3. CEO tenure</td>
<td>7.33</td>
<td>2.64</td>
<td>.01</td>
<td>.34</td>
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<td>4. Inside director ratio</td>
<td>.26</td>
<td>.16</td>
<td>.04</td>
<td>-.08</td>
<td>-.06</td>
<td></td>
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<td>5. Combined CEO/chair (yes/no)</td>
<td>.79</td>
<td>.41</td>
<td>.00</td>
<td>.30</td>
<td>.23</td>
<td>-.06</td>
<td></td>
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<tr>
<td>6. Return on assets</td>
<td>6.10</td>
<td>7.41</td>
<td>.06</td>
<td>-.10</td>
<td>-.08</td>
<td>.19</td>
<td>-.35</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Total stock returns</td>
<td>8.14</td>
<td>18.76</td>
<td>.03</td>
<td>-.12</td>
<td>-.04</td>
<td>.07</td>
<td>-.01</td>
<td>.27</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Log of sales</td>
<td>6.38</td>
<td>.87</td>
<td>.01</td>
<td>.02</td>
<td>.13</td>
<td>.18</td>
<td>.05</td>
<td>-.01</td>
<td>.13</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. LTIP (yes/no)</td>
<td>.76</td>
<td>.43</td>
<td></td>
<td>.21</td>
<td>-.03</td>
<td>.20</td>
<td>-.18</td>
<td>-.28</td>
<td>.09</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Average LTI value†</td>
<td>.30</td>
<td>.59</td>
<td>-.19</td>
<td>-.17</td>
<td>-.23</td>
<td>.07</td>
<td>-.28</td>
<td>.00</td>
<td>.06</td>
<td>.10</td>
<td>.00</td>
<td>.01</td>
</tr>
<tr>
<td>11. LTI grant (yes/no)*</td>
<td>.55</td>
<td>.50</td>
<td>-.14</td>
<td>-.26</td>
<td>-.24</td>
<td>-.18</td>
<td>-.23</td>
<td>-.02</td>
<td>-.13</td>
<td>.07</td>
<td>-.21</td>
<td></td>
</tr>
</tbody>
</table>

* These variables apply only for firms who have adopted LTIPs (N = 419).
† This variable applies only for firms who have adopted LTIPs and made LTI grants (N = 230).

Table 2 shows the results of the event history analysis modelling the rate of LTIP adoption. Model 1 includes all main effects and control variables. In general, the results provide strong, statistically significant support for hypothesis 1: The greater the CEO's influence, as indicated by three of the four measures of influence (CEO tenure, combined CEO
Table 2

Event History Analysis Predicting Rate of LTIP Adoption: Unstandardized Coefficients (N = 6314)*

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appointment of outside directors</td>
<td>.11***</td>
<td>.10***</td>
<td>.10***</td>
</tr>
<tr>
<td>(0.03)</td>
<td>(0.03)</td>
<td>(0.03)</td>
<td></td>
</tr>
<tr>
<td>CEO tenure</td>
<td>.02*</td>
<td>.02*</td>
<td>.02*</td>
</tr>
<tr>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
<td></td>
</tr>
<tr>
<td>Inside director ratio</td>
<td>.30</td>
<td>.32</td>
<td>.35</td>
</tr>
<tr>
<td>(0.55)</td>
<td>(0.68)</td>
<td>(0.66)</td>
<td></td>
</tr>
<tr>
<td>Combined CEO/chair</td>
<td>.57***</td>
<td>.66***</td>
<td>.68***</td>
</tr>
<tr>
<td>(0.21)</td>
<td>(0.24)</td>
<td>(0.23)</td>
<td></td>
</tr>
<tr>
<td>Return on assets</td>
<td>-1.67**</td>
<td>-1.79*</td>
<td>-1.75*</td>
</tr>
<tr>
<td>(0.78)</td>
<td>(0.87)</td>
<td>(0.82)</td>
<td></td>
</tr>
<tr>
<td>Total stock returns</td>
<td>-0.03***</td>
<td>-0.03***</td>
<td>-0.03***</td>
</tr>
<tr>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
<td></td>
</tr>
<tr>
<td>Log of sales</td>
<td>.10</td>
<td>.10</td>
<td>.08</td>
</tr>
<tr>
<td>(0.07)</td>
<td>(0.08)</td>
<td>(0.08)</td>
<td></td>
</tr>
<tr>
<td>Return on assets × year</td>
<td>.11***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.04)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total stock returns × year</td>
<td>.06***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.02)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appointment of outside directors × year</td>
<td></td>
<td>-0.04*</td>
<td></td>
</tr>
<tr>
<td>(0.02)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO tenure × year</td>
<td></td>
<td>-0.03***</td>
<td></td>
</tr>
<tr>
<td>(0.01)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inside director ratio × year</td>
<td></td>
<td>-0.08</td>
<td></td>
</tr>
<tr>
<td>(0.11)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Combined CEO/chair × year</td>
<td></td>
<td>-0.02*</td>
<td></td>
</tr>
<tr>
<td>(0.01)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chi-square</td>
<td>56.95***</td>
<td>82.72***</td>
<td>89.37***</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.

and chair positions, and the portion of the board composed of outsiders appointed after the CEO), the higher the rate of LTIP adoption. Hypothesis 3 is also strongly supported: Prior performance (market returns and ROA) is significantly and negatively related to firms’ propensity to adopt an LTIP.

Hypotheses 5a and 5b predicted decreasing effects for prior performance and CEO influence on the rate of LTIP adoption over time. Results in the second column of Table 2 provide strong support for hypothesis 5a: The effect of prior performance, as measured by total stock returns and return on assets, on the rate of LTIP adoption significantly decreases over time. Results in the third column of Table 2 support hypothesis 5b: Prior performance interacts with time in predicting the rate of adoption for three of the four influence measures. While we tested the interaction terms in two separate models for presentational purposes and to avoid multicollinearity problems, we also found that t-statistics remained significant in the full model. Overall, then, it appears that deliberate motives for adoption have decreased in importance as LTIPs have become a taken-for-granted component of formal compensation contracts.

Results of the logistic regression analysis, which models the likelihood of LTIP use for those firms adopting LTIPs, are...
shown in Table 3. The findings strongly support hypothesis 2a, which proposed that CEO influence would be negatively related to the actual use of LTIPs that had been adopted. Three of the four indicators of CEO influence (CEO tenure, combined CEO and chair positions, and appointment of outsiders) are significantly and negatively associated with the likelihood of LTIP use during the first two years after adoption. While CEO influence is thus positively related to the formal adoption of LTIPs (Table 2), it is negatively related to the actual use of LTIPs (Table 3).

Table 3

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Unstandardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time of adoption</td>
<td>-.11*** (.03)</td>
</tr>
<tr>
<td>Appointment of outside directors</td>
<td>-.11** (.04)</td>
</tr>
<tr>
<td>CEO tenure</td>
<td>-.06*** (.02)</td>
</tr>
<tr>
<td>Insider ratio</td>
<td>-.60 (.77)</td>
</tr>
<tr>
<td>Combined CEO/chair</td>
<td>-.92** (.31)</td>
</tr>
<tr>
<td>Return on assets</td>
<td>-3.19 (1.74)</td>
</tr>
<tr>
<td>Total stock returns</td>
<td>-.02 (.03)</td>
</tr>
<tr>
<td>Log of sales</td>
<td>.11 (.12)</td>
</tr>
<tr>
<td>Constant</td>
<td>1.84* (.91)</td>
</tr>
</tbody>
</table>

Chi-square = 66.02***
Cases correctly classified: 78%

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

Results in Table 3 also support hypothesis 4a, which addressed the institutionalization of LTIPs over time, as indicated by a growing decoupling of LTIP adoption and use. Results show that the later the year of LTIP adoption, the lower the likelihood of any LTIP grants during the two-year period following adoption. This relationship can also be graphed, as shown in Figure 1. The figure, which captures the cumulative adoption and use of LTIPs over the two decades studied, shows vividly the increasing decoupling of LTIP adoption and use over time.

Analysis of the magnitude, rather than likelihood of LTIP use yields similar evidence in support of hypotheses 2b and 4b. The findings, based on the multiple regression analysis shown in Table 4, provide statistically significant support for H2b: For two of the four measures (combined CEO and chair positions and CEO tenure), the greater the CEO’s influence, the smaller the average size of LTIP grants following adoption. Only one of the four CEO influence variables used, the commonly used ratio of inside to outside
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Figure 1. The adoption and use of LTIPs, 1972–1990.

directors, was unrelated to both LTIP adoption and use. Overall, the set of significant findings with respect to H1, H2a, and H2b is quite consistent with the argument that powerful CEOs are able to influence boards of directors to adopt, but not to use long-term incentive plans.

Consistent with H4b, for those firms that did make grants, the grants were smaller among late adopters than among early adopters. The tests of H4a and H4b, when taken together, thus suggest that the separation between formal adoption and actual use of LTIPs was greater for later adopters than for earlier adopters. To control for the possibility that particular macro-economic factors, such as the stock market crash of 1987, might be affecting these findings, we eliminated 1987 adopters, reestimated the models, and found that the results were essentially unchanged.

A more complete understanding of the effect of performance on LTIP adoption and use (H3) emerges from a comparison of Table 2 with Tables 3 and 4. The findings show that prior performance, while significantly related to the rate of LTIP adoption (Table 2), is not significantly related to the use of LTIPs (Table 3). Tables 3 and 4 show that this holds true for both measures of LTIP use, i.e., the likelihood and relative size of LTI grants. Taken together, these results are consistent with H3, which proposed that performance deficiencies may be met with more symbolic than substantive organizational actions.

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Table 4

Multiple Regression Analysis: Predicting Size of Long-term Incentive Grants: Unstandardized Coefficients (N = 230)*

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Unstandardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time of adoption</td>
<td>-.05**</td>
</tr>
<tr>
<td></td>
<td>(.02)</td>
</tr>
<tr>
<td>Appointment of outside directors</td>
<td>-.05</td>
</tr>
<tr>
<td></td>
<td>(.04)</td>
</tr>
<tr>
<td>CEO tenure</td>
<td>-.04*</td>
</tr>
<tr>
<td></td>
<td>(.02)</td>
</tr>
<tr>
<td>Insider ratio</td>
<td>-.56</td>
</tr>
<tr>
<td></td>
<td>(.70)</td>
</tr>
<tr>
<td>Combined CEO/chair</td>
<td>-.53***</td>
</tr>
<tr>
<td></td>
<td>(.19)</td>
</tr>
<tr>
<td>Return on assets</td>
<td>-1.99</td>
</tr>
<tr>
<td></td>
<td>(1.95)</td>
</tr>
<tr>
<td>Total stock returns</td>
<td>-.04</td>
</tr>
<tr>
<td></td>
<td>(.04)</td>
</tr>
<tr>
<td>Log of sales</td>
<td>.11</td>
</tr>
<tr>
<td></td>
<td>(.09)</td>
</tr>
<tr>
<td>Constant</td>
<td>.47</td>
</tr>
<tr>
<td></td>
<td>(.93)</td>
</tr>
</tbody>
</table>

\( F = 3.72^{***} \)

Adjusted \( R^2 = .22 \)

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

* Standard errors are in parentheses.

Finally, although analyzing adoption and use separately appears to represent the most appropriate modeling approach, for the reasons cited earlier (Allison, 1984), we also considered an alternative form of modelling the effects of CEO influence and firm performance on LTIP adoption and use. We created a dependent variable called "adoption and non-use of LTIPs" and conducted a discrete-time event history analysis on the 6314 firm-years of data. The results of this analysis were consistent with those reported here: CEO influence was positively related to the likelihood of adopting and not using LTIPs for the same three influence measures (t-statistics ranged from 2.18 to 3.54). Also, both measures of prior performance were significantly and negatively related to the likelihood of adopting but not using LTIPs (t-statistics ranged from 2.07 to 3.28).

**DISCUSSION**

The results of this study suggest that there is a separation of symbol and substance in the composition of CEO compensation contracts, and that behavioral theories addressing the political and/or institutional use of organizational symbols can predict the likelihood and extent of that separation (Pfeffer, 1981; DiMaggio, 1988; Edelman, 1990; Friedland and Alford, 1991). While institutional and symbolic action theorists commonly invoke the separation of substance and symbol in organizational activity, large-scale empirical observation of this phenomenon is relatively rare. Moreover, in raising the possibility of symbolic action in the context of executive compensation, we use a theoretical framework not yet considered in the existing behavioral and economics-based literature on executive compensation.
The first set of results addresses the effect of relative power in the CEO-board relationship on the likelihood of LTIP adoption and subsequent implementation. In general, the findings provide strong and consistent evidence that firms with relatively influential CEOs are more likely to decouple LTIP adoption and use. While agency theory contributes to a partial understanding of this phenomenon by specifying the personal preferences that could motivate non-use of formally adopted LTIPs, such as CEO risk-aversion (Beatty and Zajac, 1994), it cannot explain why firms announce but do not use LTIPs or why the separation is more likely to be found in firms having more influential CEOs. Instead, this finding is more consistent with a political perspective, in which CEOs exercise influence subtly by encouraging the adoption of LTIPs while discouraging or limiting their actual use. By personally associating themselves with practices that display concern for shareholders’ interests, CEOs enhance their legitimacy with stockholders and other stakeholders, signalling board control and the absence of any agency problem (Schlenker, 1980; Tedeschi and Reiss, 1981; DiMaggio and Powell, 1983). Thus, CEOs with the ability to influence the board to adopt but not use—or only limitedly use—LTIPs can simultaneously enhance the legitimacy of their formal compensation contract, while satisfying their personal preferences for noncontingent compensation.

It is possible to attempt to construct an efficiency explanation for the observed decoupling of LTIP adoption and use. One such argument might involve transaction-cost economizing, whereby firms are seen as adopting but not fully using LTIPs as a way to economize on the transaction costs of seeking shareholder approval for subsequent plans. But such an argument could only explain why some elements of an LTIP were not used, not all. Since our analysis of the decoupling of substance and symbolism in LTIPs examines only those cases in which none of the elements are used, a transaction-cost economizing explanation does not apply.

Another rational or efficiency explanation might be that simply adopting LTIPs—without actually using them—is a sufficient threat to ensure appropriate managerial behavior. Such an argument takes a game theoretic perspective, in which the board can credibly threaten the CEO. This argument is logically problematic, however, in at least one important respect: The alleged implied threat of adopting but not using LTIPs is either credible or it is not. If it is not, then it is irrelevant and would have no effect on a CEO’s behavior. If it is credible, however, and assuming the targeted party is rational, game theory suggests that the targeted party will act appropriately without the other party even having to make the threat. Because rational CEOs would know their board could credibly threaten them simply by adopting LTIPs, it would be rational for the CEO to behave appropriately whether or not the board adopted LTIPs. Even in this simple model, the rational board will not need to adopt LTIPs, since the threat to adopt is as effective as the actual adoption, which is as effective as actual implementation. If adoption of LTIPs is a credible threat,
then we should not observe rational boards adopting LTIPs at all. Since there is no rational game theoretic logic for LTIP adoption, there will be no rational logic to expect any decoupling of adoption and implementation. Thus, a credible threat story cannot explain the decoupling observed in this study.

In terms of the behavioral literature on top executive compensation, the results discussed thus far are distinctive in going beyond the overtly political questions surrounding CEO compensation, such as whether powerful CEOs pressure boards into raising the level of CEO cash compensation, to show that powerful CEOs may also exercise influence more subtly by politically managing the form of CEO compensation, as in the decoupling of LTIP adoption and use.

Attention to the subtle aspects of influence attempts may be increasingly relevant in future CEO compensation research, given increasing stakeholder vigilance of executive compensation and related corporate governance issues (Jensen and Murphy, 1990; Useem, 1992; Fortune, 1993). To the extent that stakeholders focus on more obvious aspects of compensation policy, such as the level of pay, intraorganizational political activity may be redirected toward the nuances of compensation contracts, such as the form of pay. In effect, just as companies seek little-known loopholes in government regulations, corporate elites may capitalize on analogous loopholes in stakeholders’ demands about compensation practices. Finally, such a political interpretation of the decoupling described here is consistent with DiMaggio’s (1988) recent call for institutional theorists to address more directly the role of individual political interests in shaping institutional practices.

Other results suggest that boards use impression management in response to poor performance. Independent of CEO influence over the board, declining prior performance is positively related to the likelihood of LTIP adoption but not to the likelihood or magnitude of subsequent grants in actual compensation packages. Thus it appears that LTIP adoption frequently represents a symbolic rather than a purely substantive adaptation to poor performance. In effect, boards facing the pressures associated with a firm’s poor performance may seek to restore their credibility with stakeholders by ceremonially increasing control over management (Salancik and Meindl, 1984; Elsbach and Sutton, 1992). LTIP adoption can provide an opportunity for the firm to manage stakeholders’ impressions about CEO compensation and the role of compensation in organizational affairs (Schlenker, 1980; Tedeschi and Reiss, 1981). Pondy (1983) has argued that organizational symbols or metaphors simultaneously facilitate change and reinforce traditional values. Thus, regardless of whether or not organizations actually use their LTIPs, adoption may signal that shareholders’ interests play a role in determining managerial action, while reaffirming the value of executive leadership (Meindl, Ehrlich, and Dukerich, 1985).

In portraying compensation as incentive alignment rather than reward, firms “attenuate the negative meaning and
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accentuate the positive meaning” associated with CEO compensation (Elsbach and Sutton, 1992: 717). Similarly, while salary and short-term bonuses are backward-looking forms of compensation, rewarding executives for performance in the prior year, LTIPs are forward-looking and consequently portray executive compensation as an opportunity for shareholders to increase their wealth, and not as a cost to be incurred (Dutton, 1993).

The final set of results provides two sources of evidence for institutionalization in the diffusion of LTIPs. First, the study documents a growing separation of LTIP adoption and use over time. Consistent with prior studies of institutionalization (Tolbert and Zucker, 1983; Meyer, Stevenson, and Webster, 1985; Baron, Dobbin, and Jennings, 1986), it appears that LTIPs are increasingly adopted in response to institutional demands rather than technical exigencies. Whereas early adopters may seek to reduce agency costs and improve firm performance by aligning CEOs’ and shareholders’ interests, later adopters incorporate LTIPs into their formal compensation arrangements as a taken-for-granted component of compensation contracts. Second, and consistent with traditional tests of institutionalization (cf., Zucker, 1983), additional results show that specific motives for adoption, such as poor performance and the reputational concerns of influential CEOs, have declined in importance over time. Both of these results imply that LTIPs have gradually acquired normative or “rule-like” status over time (Meyer and Rowan, 1977: 341) as a feature of CEO compensation arrangements.

We believe that the observed growing separation of LTIP adoption and use over time provides a powerful and original test of institutionalization. Prior tests of the institutionalization hypothesis have tended to rely on whether particular independent variables capturing technical indicators are differentially strong for a set of early adopters versus another set of late adopters (e.g., Tolbert and Zucker, 1983). While such studies are valuable, the modelling approach used can be subject to the criticism that (1) the particular technical factors specified have simply been replaced by other increasingly important technical factors that were not measured, and (2) no institutional factors are ever measured. This study examines more directly whether the institutional decoupling of substance and symbol is greater for late than for early adopters, as captured in the equation predicting LTIP use versus non-use for those organizations that have adopted. By specifying and measuring dependent variables that are derived from institutional theory, as we do in examining adoption and use separately, and observing the increase in this decoupling over time, this approach offers a distinct test of institutional predictions and allows for stronger inference. Finally, the findings of our more traditional test of early versus late adopters are consistent with prior institutional research but are distinctive in showing not only that the predictive strength of prior performance variables are weaker for late adopters but also that the CEO-power variables exhibit a similar pattern.
The theoretical perspective and empirical findings of the present study suggest other avenues for future research on corporate governance issues. One would involve examining whether other apparently substantive changes in corporate governance features may also be largely symbolic. For example, increasing the number and/or proportion of outsiders on the board of directors, as recommended by some activists interested in governance reform (Fortune, 1993), could be a more symbolic than substantive action, given that CEOs may simply recruit sympathetic outsiders to the board (Wade, O’Reilly, and Chandratat, 1990). While such changes may enhance the formal structural bases of board power, they may nevertheless decrease the board’s informal power over management if CEOs effectively control the selection process. At the same time, while changes in board structure are highly visible to stakeholders, the reality of those changes and their consequences for the board’s relationship with the CEO are less apparent to outside observers; stakeholders may be “unable to discern what outcomes they are obtaining or the value of such outcomes,” thus making it easier for boards to take symbolic action (Pfeffer, 1981: 28).

There may be limits, however, to how much substance and symbol can be decoupled in corporate governance issues, since alterations in CEO compensation and board structure can carry substantial risk for the CEO. An important question for future research would be under what circumstances informal bases of control, such as norms of reciprocity and friendship ties, are less reliable than formal bases of control. In comparison with LTIPs, alterations in board structure may produce a more fundamental change in the bases of board power and thus represent a relatively risky means of symbolic action. Thus future research might examine whether the use of such risky symbolic actions in the area of corporate governance are used only after less risky actions have been taken.

It may be that LTIPs belong to a class of organizational innovations that are both symbolic and substantive and whose formal features can be decoupled at relatively low cost from actual practices. Similar innovations might include quality circles and affirmative action rules. Future research should examine whether organizational practices or policies whose adoption entails extensive political, cognitive, or financial resource commitments are as well-suited to potential decoupling. Devoting greater attention to the study of how, or under what circumstances, internal political processes affect the adoption and subsequent implementation of innovations would help us learn more about both institutionalization and diffusion. It would also teach us to be more skeptical. As this study shows, assuming from the fact of its adoption that an innovation has been implemented may be mistaking a symbolic action for a substantive change. When the purpose of innovations is controversial or ambiguous, as it is in CEO compensation practices, substance and symbolism may be particularly likely to diverge. The payoffs for recognizing this divergence could be great.
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Fortune 1993 "The king is dead: Why more boards are waking up and pushing out the CEO." January 11: 34–50.


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APPENDIX: Formulas Used in Calculating Magnitude of LTIP Use

Stock options were valued using the following, simplified version of the Black-Scholes (1973) model (Noreen and Wolfson, 1981; Kerr and Kren, 1992):

\[
\text{option value} = \text{price} \times \text{shares} \times \left[ \exp(-d\tau N(Z) - \exp(-\tau t)) N(Z - s\tau) \right].
\]

where

- \( \text{price} \) = the exercise price of an option,
- \( \text{shares} \) = the number of shares granted,
- \( d \) = the average dividend yield over the previous five years,
- \( \tau \) = the time to the expiration of the option, either five or ten years,
- \( N \) = the standard normal probability distribution function,
- \( r \) = the risk-free interest rate, based on five- and ten-year average yields on U.S. government securities,
- \( s \) = the stock return variance for the previous five years, and
- \( Z \) = \( (r - d + s^2/2) \times (t/s \tau) \).

When the expiration date was not specified, we assumed 10 years. The Black-Scholes model has been criticized for using several unrealistic or inaccurate assumptions. For instance, although options are nontransferable, the model assumes that options are marketable and sold on the date of grant. In addition, it is implicitly assumed that executives value options in the same way as shareholders, even though each party holds different risk preferences (Lambert, Larcker, and Verrecchia, 1991). Nevertheless, despite these theoretical shortcomings, the model has performed well at predicting the prices of marketable warrants, which resemble stock options (Noreen and Wolfson, 1981). Moreover, a widely accepted alternative is not currently available.

Performance units/cash were valued using the following formula, used by several large consulting firms in conducting surveys of executive compensation (cf., Towers Perrin 1991 Compensation Data Bank):
Value = \text{price} \times \text{shares} \times \text{target} \times \{1/(r + p + f)\},

where

\begin{align*}
\text{price} & = \text{the price at which shares/units were granted}, \\
\text{shares} & = \text{the number of shares/units granted}, \\
\text{target} & = \text{the target payout, expressed as portion of shares granted}, \\
r & = \text{the risk-free interest rate, based on five- and ten-year average yields on U.S. government securities}, \\
p & = \text{long-term average equity premium (6 percent)}, \\
f & = \text{forfeiture risk (3 percent)}, \\
z & = \text{length of performance period}.
\end{align*}

When adequate information was not provided in the proxy statement, we used a progressive series of assumptions. For instance, if the date of grant was specified but the grant price was not, we used the market price at date of grant; if neither the grant price nor the grant date was provided, we used the average annual market price. When the target payout was not specified, we assumed it was 100 percent. We used analogous assumptions in valuing other incentive vehicles. For instance, when the share value was not specified, book units were valued according to the book value per share on the date of grant. The forfeiture risk was based on empirical analysis of forfeiture among Fortune 500 CEOs conducted by a large compensation consulting firm.

In valuing performance shares and restricted stock, we used a simplified adjustment factor: $1/(fz)$. This approach implicitly sets the discount rate equal to expected stock returns (cf., Towers Perrin 1991 Compensation Data Bank).