The Theory of Executive Compensation and Empirical Compensation Research Before and after in Pandemic Situation

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Abstract

This paper aims to provide an easy-to-use executive compensation model and explained challenges and problems with empirical research. This study examines the theoretical and empirical literature on executive compensation. The research methodology was carried out using descriptive analysis related to data and literature review without conducting data testing. The explanation that can be put forward from the findings of this study is that first, there is an impression that institutional owners as the majority shareholder ask for Executive Compensation placed in the management ranks or even those who become managers to minimize earnings engineering, because if the institutional owner as the majority shareholder asks the manager to do engineering profits that benefit him, the minority shareholders and the stock market will discount the company's stock price which will actually harm the majority shareholders themselves. So Executive Compensation is synonymous with low earnings management. Second, the dominance of institutional owners causes managers to be unable to act opportunistically which tends to benefit themselves but may harm the owners. So that managers cannot freely manipulate the profit figures generated by the company. Third, institutional investors are far more forward-looking than individual investors who only focus on current profits.

Keywords: Executive compensation theory, empirical compensation, earnings management.

1. Introduction

In carrying out its activities, the company will issue financial statements. Bakar et al., (2021) state that users of financial statements will be more likely to be interested in first seeing profits on the financial statements of a company. According to PSAK number 1, earnings information. Earnings management practice can be viewed from two different perspectives, namely as a wrong action (negative) and an action that should be taken by management (positive). Suh (1990) and Healy and Wahlen (1998) regard earnings management as misleading and deceiving shareholders. This is because management has asymmetric information about the condition of the company. Another view assumes that earnings management is an attempt to satisfy shareholders. Earnings management is carried out to maximize firm value when there is information asymmetry between managers and owners (Chaney and Lewis, 1994). This can reduce the perceived risk of investors because of the uncertainty of future returns so that it is expected to improve shareholder value. Earnings management causes a lot of information to be disclosed to resulting in increased costs incurred by the public (cost of equity capital). Earnings management in line with the increasing cost of equity capital issued by the company (Utami, 2005).

According to Scott (2003) agency contract between a company to align the interests of the owner and manager by basing the manager's compensation on one to operate the company. Jensen and Meckling (1976) state that the compensation is a service provided by the owner of the company to its management which consists of components of basic salary, variable salary and benefits, the most distinguishing thing is the existence of special types of compensation that are not received by employees. namely compensation in the form of stock options (Widamunti 2010). Stock option program is a program that aims to provide opportunities for executives and employees to own company shares through the provision of stock options. Employee stock option program (POSK) is a form of compensation provided to employees, especially executive employees (Asyik 2006).

Wardani (2012) conducted negative influence on earnings management practices. Ratmono (2010) found empirical evidence that public companies in Indonesia carry out earnings management through manipulation of real activities with the aim of avoiding reporting annual losses. Hassen (2014) examines the effect of executive compensation on earnings management. In this study, executive compensation is proxied as total compensation and stock option compensation. The results of this study indicate that executive compensation greatly determines earnings management. Sosiawan's research (2012) concluded that the magnitude of the ratio and the company's influence on the occurrence of earnings management acts, while compensation and firm size did not affect the occurrence of fraudulent acts profit management.

2. Literatur Riview

Theory of Executive Compensation

The principal may try to limit the difference in preferences by establishing an appropriate or adequate compensation contract. The greater the reward of the agent depending on the size or level of performance, the more compensation can be given to the agent concerned to improve the measure. Therefore, principals should define performance measures so that they can advance their interests (Radu, 2021). The ability to achieve this can be done with the alignment of goals. When the contract given motivates the agent to work for the benefit of the company, then the contract is considered to be in line with the objectives.

Anthony and Govindarajan (2005) suggest that the total compensation package of a manager consists of 3 (three) components, namely salary, allowances (pension benefits, health, etc.), and compensation. These components have dependencies between one another. Regulations within the company and the capital market require that the compensation plan and revisions to existing plans be approved by the shareholders.

A company that provides bonuses to the CEO in the form of stock options is an example of agency costs involved in compensation. One of the costs is the difference in risk preferences between owners and CEOs. The agent in question is ready to avoid risk, facing additional risk if his salary is determined based on the performance of the stock price (Radu, 2018). To compensate the CEO for taking the pertinent risk, the contract must increase the estimated salary amount. In addition, in order to minimize the potential downside that may occur, the agent may not take on projects that are high risk or high rate of return, which may be desired by the principal (Sheikh, 2018).

3. Metodology

This research method uses qualitative methods. The sources of this research use indexed journals that have been published, proceedings, magazine working papers and online and offline news, then re-examined and withdrawn to be used as the basis for events or cases to be investigated by the author related to the Eceutive Compensation theme. Another source, the author obtained the results of data analysis from various sources of magazines and blogs. The data analysis technique uses literature study by collecting data in the form of documentation or using a literature review. Researchers obtain problems that are drawn as the basis of analysis to answer the research formulation.

4. Result and Discussion

4.1. Result

The Executive Commpensation CEO show in Figure 1 as a follows :

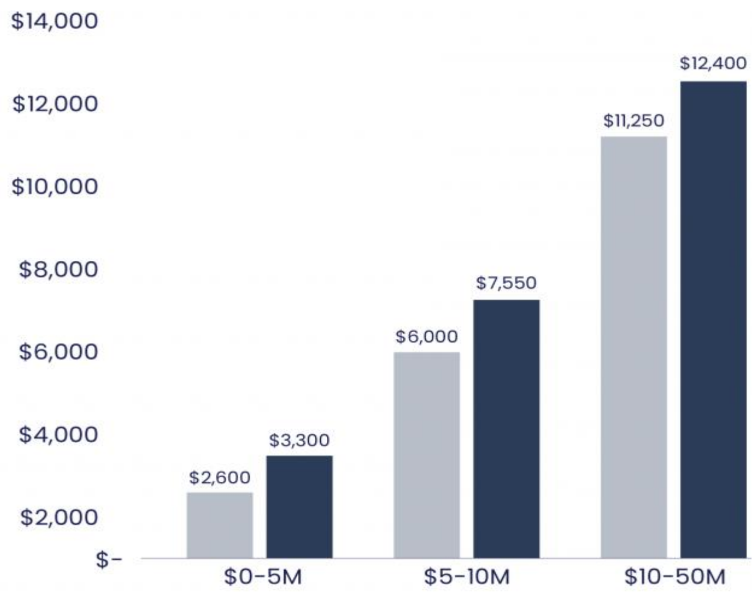

Figure 1: Executive Commpensation CEO

Sources: Median.com

From the diagram above it can be seen that the average compensation increased 1.3x for CEOs and CTOs in the US$5-10 million funding stage. This reflects a strong relationship between the amount of funding raised and the compensation earned by C-levels. In addition, CEO compensation increases from US$2,600 to US$6,000 a month at startups with US$0-10 million funding stages. While the CTO gets compensation of around US$3, 300 to US$7, 550 a month in the funding stage of US$0-10 million.

Typically, in executive compensation there are two schools of thought: exponential discounting, which uses time rationality as a standard, and time discounting is based on time consistency, or in other words, the discount rate does not change over time; and hyperbolic discounting, which assumes no time rationality, and in which the discount rate between two points in the near future is not equal to the discount rate between two points the same distance but in the more distant future, with the discount rate for the nearer future get bigger.

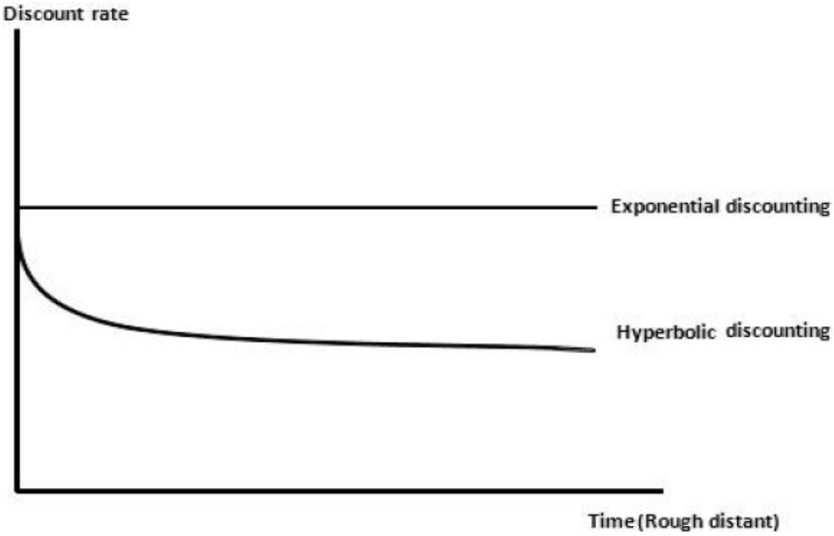

Figure 2; Illustration for Executive Compensation Beore Pandemic

Let's examine human neglect and these two management problems. From a temporal perspective, it has long been known that humans have a tendency to ignore values to be achieved in the future or, in the case of interpersonal relationships, they tend to ignore values from those who are distant. However in recent studies, it has been empirically confirmed that trend discounting is not exponential discounting, but hyperbolic discounting where the more recent future values are discounted the most. In other words, as shown in Figure 2 where compensation executives who are prone to hyperbolic discounts rather than exponential discounts have a pattern of behavior where they will apply a large discount rate in the short run and a small rate in the long run.

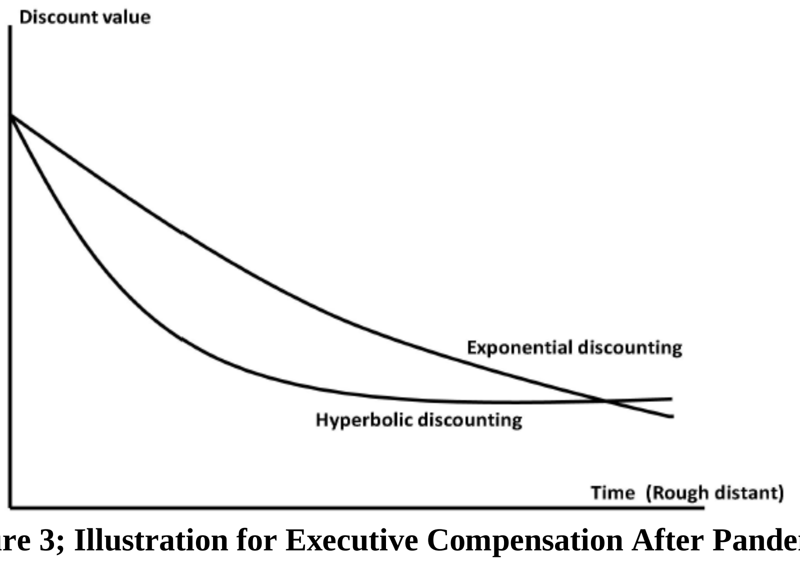

Figure 3; Illustration for Executive Compensation After Pandemic

However, even if we assume that hyperbolic discounting is an inherent discounting trend in the post-pandemic period, what is unique about recent management problems is that managers' discount rates have become more radical, outpacing the general trend, and focusing on short-term performance and The attention that the relative increase in executive compensation has drawn is the main issues that characterize modern management. From the data presented and analyzed qualitatively based on previous research reviews, we make the following broader points (Lozano, 2020):

4.2. Discussion

Zhang (2018) states that shareholders will supervise management, but if the cost of supervision is high, shareholders will use third parties (debtholders or bondholders) to help carry out supervision. In accordance with the statement, shareholders who have the ability to carry out reliable supervision are majority shareholders (concentrated), institutional or concentrated on institutional owners. The reason is that institutional owners as the majority shareholder have advantages over individual investors. In terms of funding, institutional owners are stronger than individual owners (Jin, 2022). In general, the majority shareholder compensation (Executive Compensation) submits the management of their investment to a special division by appointing professionals who have expertise in analysts and finance, so that the majority owner can monitor the progress of their investment properly. So if the ownership percentage is large enough (the majority), then they have an incentive to effectively supervise management (agents), and have the ability to influence or change management's actions and decisions. If the analyst can analyze well, of course, the results of the analysis can be used to assess whether the manager can advance the company or not. If the manager is not able to advance the company which is not liked by the owner, it can result in the manager being replaced and this is one form of effective supervision.

Executive Compensation allows owners to act in their own interests. The majority owner can be part of the management line or even put the person into the manager itself. Executive compensation that includes its people into the company's management can carry out profit engineering that benefits the majority shareholders and management but harms minority shareholders (Elsayed, 2018). However, the institutional owner as the majority shareholder will not ask his people who are placed in the management ranks or even those who become managers to do profit engineering or at least will only minimize profit engineering, because if the institutional owner as the majority shareholder asks the manager to make profitable profit engineering itself, then the minority shareholders and the stock market will discount the company's share price which will actually harm the majority shareholders themselves. So, Executive Compensation is synonymous with low earnings management.

5. Conclusion

The explanation that can be put forward from the findings of this study is that first, there is an impression that institutional owners as the majority shareholder ask for Executive Compensation placed in the management ranks or even those who become managers to minimize earnings engineering, because if the institutional owner as the majority shareholder asks the manager to do engineering profits that benefit him, the minority shareholders and the stock market will discount the company's stock price which will actually harm the majority shareholders themselves. So Executive Compensation is synonymous with low earnings management. Second, the dominance of institutional owners causes managers to be unable to act opportunistically which tends to benefit themselves but may harm the owners. So that managers cannot freely manipulate the profit figures generated by the company. Third, institutional investors are far more forward-looking than individual investors who only focus on current profits. So that institutional investors put pressure on managers not to manipulate earnings. Institutional investors prefer how stock prices in the stock market increase rather than manipulate profits that are misleading for those interested in the company if profit engineering is considered a disadvantage.

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