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THE ROLE OF CORPORATE GOVERNANCE AND
DIVIDEND POLICY AS AN ALIGNMENT
MECHANISMS TO CEO COMPENSATION AND FIRM’S
PERFORMANCE

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DOCTOR OF PHILOSOPHY
UNIVERSITI UTARA MALAYSIA
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The Role of Corporate Governance and Dividend Policy as an Alignment Mechanisms to CEO Compensation and Firm’s Performance

BY

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(College of Business)  
Universiti Utara Malaysia

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ABSTRACT

Public perception of CEO compensation is evidently unfair as inefficient compensation structures that violate the rights of shareholders result in principal-agent problems. In order to mitigate this issue, theorists argued that executive compensation should be aligned with firm performance. Owing to the prevalence of agency conflicts in Pakistan, this study investigated the effect of firm performance and characteristics on CEO compensation in the capital market of Pakistan. Furthermore, consistent with prior theoretical arguments, this study examined the role of dividend policy and corporate governance as moderators to ensure their effect on pay-performance link. After data cleaning, this study utilized 284 Pakistani-listed companies (PSX) over the period 2010 to 2014. The findings from Multiple Linear regression showed that CEO compensation is positively aligned to operating performance, market performance, firm size and market share, however, no empirical evidence was found regarding the effect of growth opportunities on CEO compensation. The findings also indicated that family owners align their CEO’s compensation with operating performance, institutional owners with market performance and firm size, and foreign investors with market share. Thus, these ownership structures play vital roles in mitigating agency conflicts in an organization. It was also revealed that optimal board size could strengthen the pay-performance link. On the other hand, CEO duality and dividend policy could distort the pay-performance link. Contrary to theoretical arguments, dividend policy cannot act as a substitute control device in the absence of strong corporate governance. The role of independent directors as an alignment mechanism to operating performance and CEO compensation is evident but due to their lower level of representation on the board, they have no influence over other accounting and market-based performance metrics. The study provides various theoretical and practical implications to improve corporate governance and compensation practices especially in the perspective of Pakistan.

Keywords: CEO compensation, firm performance, corporate governance, dividend policy.
ABSTRAK


Kata kunci: pampasan Ketua Pegawai Eksekutif (CEO), prestasi firma, tadbir urus korporat, dasar dividen.
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In the name of Allah, the Most Gracious and the Most Merciful

“Oh Allah, increase me in knowledge, but let this knowledge be with sincerity, not seeking fame, glory, status, material wealth. Let this knowledge serve your cause in a way that you accept, and let it benefit humanity.”

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I am extremely grateful to my parents for their love, prayers, caring and sacrifices for educating and preparing me for my future. My father gave me the greatest gift anyone could give another person, he believed in me. He never forced me to walk in his ways, he lived and let me watch him do it and no matter how old I get, I always want my mother when I do not feel good. I also would like to thank my wife who did not tell me that it is going to be easy, she told me it is going to be worth it.

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1.1 Background of the Study

Over the past few decades, CEO compensation has gained noteworthy attention. Much of the attention is largely due to repugnant increase in compensation of executives in term of cash and stock bonuses and further fuel by debatable ethical practices. Public perception of CEO compensation is evidently unfair, that is why it gains enough attention of academic literature and practitioners (Gray & Benson, 2003; Lin, Kuo, & Wang, 2013, Wilmers, 2014). Researchers have conducted many studies to justify or to condemn the elevation of executive remuneration though most of these studies are related to developed countries and there are basic structural and institutional differences between developed and developing countries such as ownership, control, firm structure, markets, ethical, and business practices (Kashif & Mustafa, 2012).

CEOs are the most persuasive individuals in a firm who can create value or devalue the firm performance (Ueng, 2000). However, compensation of executives falls in the category of immense controversy due to the principal-agent conflicts. Many researchers believe that CEO compensation should be limited as it violated the rights of shareholders (Crumley, 2006). Conversely, according to Tosi, Werner, Katz and Gomez-Mejia (2000), CEOs are highly compensated owing to their eminent skills as they can increase the value of shareholder. Nonetheless, there are different school of thoughts regarding executive compensation and firm performance.
The contents of the thesis is for internal user only
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