

RELATIONSHIP BETWEEN FIRM CHARACTERISTICS AND EMPLOYEE COMPENSATION: EVIDENCE FROM THE NON- FINANCIAL QUOTED FIRM IN NIGERIA

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ABSTRACT

The rising compensations are the result of inefficiencies in the market for executives and other employees which form the knowledge gap in this study. The objective of this study is to examine the significant relationship between firm size, firm leverage, firm profitability and employee compensation. This study employs a cross-sectional research design in which secondary data were collected from the quoted companies in the Nigeria Stock Exchange for year, 2016. Employee compensation is measured by the amount of money paid to the employee, firm size is measure by log of total assets, firm leverage is measure by ratio of debt to total assets and firm profitability is measure by Returns on Assets (ROA). The study adopts White Heteroscedasticity least square regression, Variance Inflation Factor (VIF) test and ARCH Heteroskedasticity for the data analysis. The empirical findings show that firm size has a significant positive relationship with employee compensation at 1% level of significance while firm leverage and firm profitability has an insignificant negative relationship with employee compensation. The study recommends that management should make strategic decision against higher compensation for employee due to increase in the size of the firm.

Keywords: Employee compensation, firm size, firm leverage, firm and firm profitability

INTRODUCTION

Employee compensation is a key indicator in human resource management practices (Mittar, Saini, & Agarwal, 2014). Organizations are sometimes worried when their highly rated employees underperform while others resign and leave the organizations. They fail to understand why some employees are not committed to their organizations even when the best practices of human resources are applied pro-actively to get them motivated through fair compensation policies (Alon & Yoram, 2010). Magdi and Nadereh (2002) argue that that corporate governance is about ensuring that the business is run well and investors receive a fair return and shareholders are happy. Shleifer and Vishny (1997:737) posited that corporate governance deals the confidence of suppliers of finance to corporations in getting returns on their investments. Alon and Yoram (2010) argued for more research regarding how executives' pay contributed to firms' financial performance, how to fix compensation structure, and what role the government should play in the structure and amount of compensation.

Profitability can best be achieved if both short-term and long-term strategies of the business are carefully planned and executed (Kyle, 2004). Mouna and Maha (2018), claims that profitability in organizations has been the shortcomings experienced in order to strengthen the financial positions and meet the risks associated with competition and globalization. The optimal contracting school of thought maintains that employee compensation is the result of market

performance for executive and worker's ability and capability (Edmans & Gabaix, 2016). It is rational for shareholders to rely on management incentive programmes. The weaker the corporate governance system of the company, the more important the management incentive programme becomes. However, the managerial power school, on the other hand, argued that rising compensations are the result of inefficiencies in the market for executives and other employees (Morse, Nanda & Seru, 2011). Based on the above premise, the study critically examined the relationship between firm characteristics and employee compensation in the context of Nigeria data. This is where the study bridged the gap in research.

Theoretical Review/Framework

Based on theoretical reviews, the study was anchored on the stakeholder theory which focused on the employee compensation attributes of any given quoted companies.

Managerial Power

The theory focused on the employees and its union with selfish ability to give detailed explanations about discoveries in different compensation plans and the enormous level or volume of directors' and employee compensation (Finkelstein, 1992). The theory believed that the position of directors in a company is desirable, profitable and responsible, and gives them an opportunity to have access to the economic profit of the organisation (Finkelstein & Hambrick, 1990). It was observed that the level of compensation received by an employee was not commensurate with the amount of time and energy involved. Most times, management cares more for the compensation plans of the directors than for any other issues affecting the employee's work.

Stakeholder Theory

The managerial aspect of the organizations' close ties with the potential stakeholder is significantly related to the success of the organization (Deegan, Rankin, & Tobin, 2002). Deegan et al., (2002) argued the ethical aspect of the stakeholder theory that the organisation needed to be fair to all the stakeholders. This implied that powers given to the stakeholders are not relevant. Stakeholder theory contends that the pressure exercised on organizations by different stakeholders' conditions firms' behaviour. Chenhall (2003) indicated that organisations that faced intense pressure needed to develop a structure for effective control mechanism and hence adopt organic system. Moneva and Liena (2012) asserted that there was an improvement in the behavioural pattern by stakeholders on social and environmental information as an acknowledgement of the pressure by stakeholders.

Empirical reviews

Bloom, Lemos, Sadun, Scur, and Van Reenen (2014) documented from their work on new empirical economics of management that ownership and control structures are factors influencing managerial ability and firm productivity across some countries. They also revealed that firms owned by founding family have a significant negative impact on the performance of the firm. This means that founding family members serving as the CEO has the tendency of worsening management ability than firms under other ownership and control structures.

An empirical investigation carried out by Ismail, Yabai, and Hahn (2014) on the relationship between CEO pay and firm performance measured by return on asset, return on equity and profit margin in Malaysia listed for the periods of 2006 to 2010 showed a relationship between CEO pay and firm performance. A study conducted by Nulla (2014) on the effect of CEO compensation on performance in the New York Stock Exchange (NYSE) companies for the

periods of 2005 to 2010. This study selected one hundred and twenty companies through stratified sampling method. It would be documented that a significant relationship was found between CEO salary, CEO bonus, CEO total commendation, chairman pay and firm performance.

Xue and Munir (2015) carried out research on relationship important management employee remuneration performance of ADIs (Authorised Deposit Institutions) in Australia. The study sampled 91 ADIs managed by Australian Prudential Regulation Authority. The study revealed that compensation is significant to performance of ADIs. The study further explained that board size and existence of compensation board committee is significant with the performance of ADIs in Australia while composition of the board is partially related to performance of ADIs in Australia.

Kalay and Lyan (2015) did an empirical study on Turkey manufacturing companies to establish whether there is relationship between strategic innovation management practices and organisational performance. The study sampled 132 managers from selected 66 publicly quoted companies in Turkey using survey research design. The method of data analyses is least squares structural models to the extent to which the stated hypotheses justified the intended research objectives. The findings from the study indicated that organisational structure and innovative culture and strategy have significant relationship with innovative performance of the sampled companies.

Similarly, Lone, Hassan, and Afzal (2015) investigated the factors affecting CEO compensation in Pakistan's banking sector. They employed cross-sectional design for periods of 2006 to 2013 for the data analysis. The results revealed that firm performance, firm size, founding CEO, independence directors, board shareholding, percentage ownership and CEO compensation were not significantly related.

Liu and Liu (2015) carried out an extensive study on equity compensation and research and development (R & D) investments among Chinese public quoted companies for the period of 2007 to 2012. The study adopted ordinary least square using the multivariate regression method. The study revealed that management shareholding ratio in most owned companies has impact on research and development (R&D) investment intensity. The study also revealed that management shareholding ratio in "non-state owned" companies has range effect research and development (R&D) investment intensity. The study aligned with relevant theories on corporate governance and research and development (R & D) investment which assists organisation to take appropriate decisions to optimise directors' decisions to achieve effect research and development (R & D) investment intensity.

Mehul and Komera (2016) did an empirical study on directors' compensation and firms' performance in Indian. The study adopted generalized methods of moments (GMM) to examine the absence of compensation performance among small businesses and its subsidiaries in Indian. The performance of the companies is measured by market and accounting based indicators. The study revealed that organisational performance has significant relationship with executive compensation. But the study has failed to align with other studies on performance based directors' compensational plans among Indian companies.

The study of Idemobi, Onyeizugbe and Akpunonu (2011) on compensation management and organisational performance in Anambra State Civil Service revealed that compensation has no significant effect on performance of the civil service. Aduda (2011) studies the effect of executive compensation on firm performance in the Kenyan banking sector and found a significant relationship between executive compensation and bank performance. This implies that increase in executive compensation would lead to an increase in bank performance. Scholt and Smith (2012) conducted a study on executive remuneration and company performance

among South African companies listed. It would be revealed from the empirical analysis that a strong positive relationship between executive remuneration and company performance.

The review of related previous studies concerning the relationship between firm characteristics and employee compensation uncovered several vacuums which prompted the need for this study. The identified vacuums in literature were that among the extant studies in Nigeria mainly focus on dimensions of firm characteristics and performance (e.g., Ibojo & Asabi, 2014; Idemobi, Onyeizugbe, & Akpunonu, 2011; Oladejo & Yinus, 2014; Olawale, Ilo, & Lawal, 2017). Likewise, to the best of the researcher's knowledge, none of extant literature considered the possibility that the relationship between firm characteristics and employee compensation. In essence, among other objectives, this study was intend to ascertain whether or not there is a significant relationship between firm characteristics and employee compensation, even as it was expected that their relationship would vary within the sample period of 2016.

Hypotheses Development

Employee Compensation

Employees receive compensation packages in the form of wages, salaries and pay (Aslam, Ghaffar, Talha, & Mushtaq, 2015). However, good compensation motivates the employee to perform better. Azeez (2017) believed that employee compensation is a reward system that encourages long stay in the firm. Employee compensation means the actual money employees receive from their employers for jobs done or services rendered (Naukrihub, 2009). Ojo (2008) stated there are three components of staff's compensation in an organization: the basic pays; the fringe benefits; and performance incentives or bonus. The basic pay is the basic wage in the form of salary; fringe benefits are supplementary compensation awarded to employers over and above the basic wage or salary. A compensation structure that is good will benefit the performance and effectiveness of a firm (Aslam et al., 2015). Employee compensation systems based on employee performance are seen as a way to correct some of the imperfections in labour, product and capital markets that affect the employment relationship (Pendleton, Whitfield, & Bryson, 2009). They emphasize that money as a compensation criterium tends to create money motivation rather than good-work motivation in the sense that when people struggle for monetary compensation, they may sacrifice quality to take the shortest and fastest way to maximize their monetary gain (Pendleton et al., 2009).

Firm Characteristics

Firm characteristics were employed as the explanatory variables in this study. The variables include firm size, firm leverage and firm profitability.

Firm Size and Employee Compensation

According to Watts and Zimmerman (1986), firms with greatest size would incur more political costs because such firms were more politically oriented and attracted more resentment due to their power in the market. Empirical research by Barton and Simko (2002) revealed that firms with a large firm size had the tendency to effectively manage returns on their investments than smaller firms due to pressure from those who had invested in the business to meet the intended goal of the analysts. Firm with larger a size has the capacity to more financial resources to encourage the utilisation of best practices and technology and employ best hands to handle the affairs to provide timely information to stakeholders (Barkar & Ahmad, 2010). Overall, firms with a small size effectively manage their return than firms with a large size because such firms

consider cost, integrity and their reputation. Based on the relevant literature, we therefore formulate hypothesis that: *firm size has a significant relationship on employee compensation.*

Firm leverage and Employee Compensation

Firms in developing countries may have less long-term debt than firms in developed countries simply because they have different characteristics, rather than necessarily implying a deficiency in the credit market. Jensen and Meckling (1976) have used agency theory to assert that political transfers of wealth, from bondholders to shareholders can take place in highly leveraged firms. Agency theory predicts that restrictive covenant may be written into debt contracts to protect firm's economic interests. According to Diamond and Verrecchia (1991), firm leverage is a useful tool for mitigating the agency problem in a given organization especially in the reporting of intangible assets. Leftwich, Watts and Zimmerman (1981) suggested that the proportion of outside capital tends to be higher for larger firms as the potential benefits of voluntary disclosure increase with shareholder debt holder-manager conflicts. Olawale, Ilo, and Lawal (2017) investigated the effect of firm size on the performance of firms in Nigeria. The study used 12 non-financial quoted firms in Nigeria Stock Exchange (NSE) within the timeframe of 2005 to 2013. The panel data are analysed using a pooled regression model, fixed effects model and random effects model to identify the relationship between firm size, performance of firms listed. The study documented that firm size in terms of total assets had a negative effect on performance as well as employee compensation, while in terms of total sales, firm size has a positive effect on the performance Nigerian non-financial companies. Prior studies were based on the relationship between firm leverage and performance. In order to bridge the gap in knowledge, we therefore formulate hypothesis that: *firm leverage has a significant relationship on employee compensation.*

Firm profitability and Employee Compensation

Profitability is the degree of efficiency and effectiveness with which organizational objectives and goals are achieved. However, "profitability in a given business operations is a good measure of the performance of a firm and it is the basis of financial reporting quality void of earnings management (Margaretha & Supartika, 2016). Odusanya, Yinusa and Ilo (2018), are of the opinion that the maximization of profitability which deals with the optimum goal for a company to remain in business and to withstand competition from firms operating in similar industry. Based on the issue of profitability in business organizations, managers are solely to maximize the firms' wealth (Abdullahi, 2015). Extant literatures have shown that competitive business environment, marketing organisations implement business strategies to retain customers in terms of improved satisfaction and to enhance profitability level of the firm (Abu-Hassan, Wan Jusoh, & Hamid, 2013). Ibojo and Asabi (2014) examined the effect of compensation management on employee's profitability in Nigerian manufacturing sector. The study revealed that there is a significant relationship between firm profitability and employee compensation. This means that increase in the profitability of firm would significantly lead to increase employee compensation. Oladejo and Yinus (2014) examined the relationship between employee compensation and firm profitability in the Nigerian food and beverage manufacturing companies. The study adopted a survey research design by distributing structured questionnaires to the staff of the selected food and beverages companies in Lagos state. Descriptive statistics and non-parametric statistical test Chi-square for the data analysis with the help of STATA 10.0 economic software. Results show that employee compensation has a significant positive relationship with firm profitability in the Nigerian foods and beverages industry. Prior studies reviewed above were based on the relationship between firm profitability

and employee compensation looking at the manufacturing sector without sampling the entire quoted companies in Nigeria. But in this study, all quoted companies were sampled in order to bridge the gap in Knowledge. We therefore formulate hypothesis that: *firm profitability has a significant relationship on employee compensation.*

METHODS

The methods are the scientific principles and procedures that served as a guide to achieving the core objectives of this study. This study employed a quantitative and a cross-sectional research design in which secondary data were collected from some selected quoted firms in the Nigeria Stock Exchange for the year 2016. The population of this study consists of one hundred and seventy (170) companies (both financial and non-financial) listed on the first-tier of the Nigerian Stock Exchange (NSE) as at 31st December, 2016. However, for the purpose of determining the sample size, the sampling technique was derived from Burley’s formula that was propounded and popularized by Yamane (1967). The 14% error margin is applied on the population using the formula stated below:

$$n = \frac{N}{1 + N(e)^2} \dots\dots\dots (1)$$

Where: n = sample size; N = population size (i.e. 170); e = desired level of significance, (in this case is 14%).

$$n = \frac{170}{1 + 170(0.14)^2}$$

$$n = 39.26$$

Therefore, the value was approximated round-off to thirty-nine (39) listed companies. In order to avoid bias, random sampling techniques was used to select 39 companies among the sampled population.

Methods of Statistical Analysis

The model specification of this study is based on least square (OLS) regression econometric model. Least square (OLS) regression econometric is one that seeks to explain variation in the value of employee compensation on the basis of changes in firm characteristics employing a cross-sectional data. This assumption is that, the dependent variable is a linear function of the independent variables. The least square (OLS) regressions with an error term (e_t) is expressed in the equation below:

$$ECOMP = \alpha_0 + \alpha_1FSZ + \alpha_2FLEV + \alpha_3PRFT + e_t \dots\dots\dots (i)$$

Measures Construct

ECOMP = Employee compensation was measured by the amount of money paid to the employee disclosed at the footnotes of the audited annual report;

Where: FSZ = Firm size was measured by log of total assets;

FLEV = Firm leverage was measured by ratio of debt to total assets;

PRFT = Firm profitability was measured by Returns on Assets (ROA);

α_0 =Constant Coefficient; $\alpha_1 - \alpha_4$ = Explained coefficient of the independent variables

e_t = Error term or disturbance term. The presumptive signs of the parameters in the

Specifications were: $\beta_1, \beta_2, \beta_3 > 0$

This study used White Heteroskedasticity least square (OLS) regression techniques in examining the significant relationship between the firm characteristics and employee compensation. We also conducted diagnostic tests such the ARCH Heteroskedasticity test and Variance Inflation Factor (VIF). The analyses were conducted using Eviews 8.0 econometric software.

RESULTS

The study employed White Heteroskedasticity regression technique to examine the relationship between firm characteristics and employee compensation.

Table 1: White Heteroskedasticity Regression Technique

PARAMETERS	COEFFICIENT	t-STATISTIC	P-VALUE
Constant	-7998720	-1.90	0.6550
FSZ	7902063	3.41	0.0016
FLEV	-5114.35	-0.08	0.9366
PRFT	-149647.7	-1.33	0.1893

$R^2 = 0.417277$, $ADJ. R^2 = 0.367329$, $WALD F-STAT.= 3.919676$ (0.016347).

FSZ = Firm Size, FLEV = Firm Leverage, PRFT = Firm Profitability

The results from Table 1 showed that a systematic variation was found between employee compensation and firm characteristics with Adjusted R-Square value of 0.367329 accounted for about 37% exactly explained by firm characteristics. This means that the model overall was good for statistical conclusion and prediction while value of Wald statistic (3.91, p-value = 0.01) further revealed that there was a significant linear relationship between firm characteristics and employee compensation. To test for the presence of heteroskedasticity in the regression result, the ARCH Heteroskedasticity results revealed that the value of F-statistic (0.59, 1, 36; $p = 0.4439$) and Observed R^2 (0.62, 1; $p = 0.4302$) showed the absence of heteroskedasticity in the regression result because the parameters were not significant. Also, to test for the presence of multicollinearity in the regression result, the Variance Inflation Factor aggregate value of (1.182 < 10) revealed the absence of multicollinearity in the regression results (see appendix).

DISCUSSION

Results in Table 1 showed that firm size (FSZ) had a coefficient value of 7902063 which revealed a positive linear relationship and t-statistic value of 3.41 with a probability value of 0.0016 ($p < 0.05$) which further revealed a significant positive relationship with employee compensation at 1% level of significance. This therefore means that we were 99% confidence level that the larger the firm size, the higher employee compensation. This implies that increase in firm size would significantly bring about increase in employee compensation. The result was consistent with the findings of Olawale, Ilo, and Lawal (2017) firm size had a significant relationship with employee compensation. Firm leverage (FLEV) had a coefficient value of -5114.35 which revealed a negative linear relationship and t-statistic value of -0.08 with a probability value of 0.9366 ($p > 0.05$) which further revealed an insignificant negative relationship with employee compensation. This implies that increase in firm leverage would

result to a decrease in employee compensation but it was statistically not significant. Firm profitability (PRFT) had a coefficient value of -149647.3 which revealed a negative linear relationship and t-statistic value of -1.33 with a probability value of 0.1893 ($p > 0.05$) which further revealed an insignificant negative relationship with employee compensation. This implies that increase in firm profitability would lead to a decrease in employee compensation but it was statistically not significant. The result was inconsistent with the findings of Ibojo and Asabi (2014) and Oladejo and Yinus (2014) that employee compensation has a significant positive relationship with firm profitability.

CONCLUSION AND RECOMMENDATIONS

The study examined firm characteristics and employee compensation. Profitability is the degree of efficiency and effectiveness with which organizational objectives and goals are achieved. Human resource management has been described in its basic form as the discipline that focuses on finding and keeping the best employees and focuses on employees as the foremost resource in any enterprise (Armstrong, 2006). The empirical findings showed that firm size had a significant positive relationship with employee compensation at 1% level of significance, firm leverage had an insignificant negative relationship with employee compensation and firm profitability had an insignificant negative relationship with employee compensation. The study recommended that management should make strategic decision against higher compensation for employee due to increase in the size of the firm.

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APPENDIX: RESULTS

Dependent Variable: ECOMP

Method: Least Squares

Date: 05/19/19 Time: 00:54

Sample: 1 39

Included observations: 39

White heteroskedasticity-consistent standard errors & covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-7998720.	4199202.	-1.904819	0.0650
FSZ	7902063.	2312662.	3.416869	0.0016
FLEV	-5114.353	63819.07	-0.080138	0.9366
PRFT	-149647.3	111787.3	-1.338679	0.1893

R-squared	0.417277	Mean dependent var	4600904.
Adjusted R-squared	0.367329	S.D. dependent var	9032964.
S.E. of regression	7184875.	Akaike info criterion	34.50977
Sum squared resid	1.81E+15	Schwarz criterion	34.68039
Log likelihood	-668.9405	Hannan-Quinn criter.	34.57099
F-statistic	8.354275	Durbin-Watson stat	1.485075
Prob(F-statistic)	0.000254	Wald F-statistic	3.919676
Prob(Wald F-statistic)	0.016347		

Heteroskedasticity Test: ARCH

F-statistic	0.599225	Prob. F(1,36)	0.4439
Obs*R-squared	0.622159	Prob. Chi-Square(1)	0.4302

Test Equation:

Dependent Variable: RESID^2

Method: Least Squares

Date: 05/19/19 Time: 00:59

Sample (adjusted): 2 39

Included observations: 38 after adjustments

White heteroskedasticity-consistent standard errors & covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.15E+13	2.35E+13	1.768683	0.0854
RESID^2(-1)	0.127904	0.075230	1.700170	0.0977
R-squared	0.016373	Mean dependent var		4.75E+13
Adjusted R-squared	-0.010950	S.D. dependent var		1.30E+14
S.E. of regression	1.31E+14	Akaike info criterion		67.90058
Sum squared resid	6.17E+29	Schwarz criterion		67.98677
Log likelihood	-1288.111	Hannan-Quinn criter.		67.93124
F-statistic	0.599225	Durbin-Watson stat		1.969579
Prob(F-statistic)	0.443928			

Variance Inflation Factors

Date: 05/19/19 Time: 00:57

Sample: 1 39

Included observations: 39

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	1.76E+13	43.21639	NA
FSZ	5.35E+12	23.38623	1.257337
FLEV	4.07E+09	27.63583	1.029621
PRFT	1.25E+10	1.522455	1.259116