BOARD SOCIAL CAPITAL AND CEO PAY

Research appearing in the *Strategic Management Journal* shows that Board Directors ought to be aware and cautious of how potential peer influence affects their role in establishing CEO pay. Researchers examined factors that determine the amount of CEO pay relative to the returns that CEO has generated for shareholders (to be referred to as "equitable pay"). They found that a director's peer influence directly affected the relationship between a CEO's total compensation relative to shareholder return. For example, having independent directors with a longer and stronger history of networking with other board members on the same board is associated with more equitable pay.

Key Takeaways:

- Directors are affected by peer pressure and this can affect the amount of money CEOs receive from the company.
- Independent directors with a stronger history of networking with other members of the board are associated with lower CEO pay relative to shareholder return.
- Powerful CEOs undermine the effects that independent directors have on aligning CEO pay with shareholder return.

Using data on CEO pay and firm performance in S&P 1500 companies between 1999 and 2010, researchers found that the percentage change in total CEO pay relative to changes in shareholder return was lessened when independent directors had strong networking experience with the firm's directors. In contrast, directors with very strong relationships to powerful external directors were more likely to be associated CEOs who were granted pay that was less equitable to shareholders.

The research team also found more complex relationships among the comparisons. When CEOs were more powerful, it diluted the effects that the Director's history of networking had on this relationship. In addition, institutional monitoring plays a role by enhancing the effect that independent director networking can have on this relationship.

Their analysis statistically controlled for aspects of the firm (like size and risk), the CEO (like age and ownership) and the Board (like board independence and size). The authors suggest that future research is needed to understand better the social environment that directors experience, and that it will be important to examine the director's beliefs and motivations and how these are affected by their social networks.

Source: Sauerwald, S., Zhiang, Lin, Peng, M. W., (2016). Boards Social Capital and Excess CEO Returns. *Strategic Management Journal* (37): 498-520.