

The Influence of Strategic Investment on CEO Pay

Research that will appear later this year in the *Strategic Management Journal* shows that when the ratio of the sum of R&E, acquisition, and capital expenditures to total sales is higher, boards seem to tie CEO pay more closely to firm performance than when this ratio is lower. This seems to suggest that while CEO pay and firm performance are inextricably linked, boards assign even more credit to the CEO when the CEO has engaged in bigger strategic investments.

Key Takeaways:

- Boards are more likely to attribute company success to the CEO when the CEO has committed the company to making bigger strategic investments.
- CEO pay is more closely aligned with firm performance when firms make heavier strategic investments.
- The relationship between the CEO's pay and firm performance that is strengthened by strategic investments is even stronger when the CEO is more prestigious.

Using data on S&P 1500 companies between 2000 and 2014, researchers found that the relationship between CEO pay and firm performance was stronger when the CEO had initiated higher strategic investments ((R&E + acquisition + capital expenditures)/ total sales) compared to firms with lower strategic investment ratios. The difference is substantial, such that CEO pay is

about 42% higher, given the same level of shareholder return, when the CEO invested in high levels of strategic investment compared to a firm that invested in a low level of strategic investment.

The research team also found more complex relationships. When the CEO is more prestigious or the board contributes more to conservative candidates and causes, the relationship between strategic investment and CEO pay is even stronger.

Their analysis statistically controlled for aspects of the firm (like size, ROE, and debt ratio), the CEO (like tenure and CEO ownership), the board (like percentage of CEO appointed directors), and the firm's ownership structure. The authors suggest that future research is needed to learn more about the attitudes of individual directors, how underlying biases affect director decisions, and how different strategic decisions affect these relationships.

Source: Shi, W., Connelly, B., & Mackey, J. (2019). Placing their bets: The influence of strategic investment on CEO pay-for-performance. *Strategic Management Journal*, 40: 2047-2077.