Abstract

To explore the impacts of ownership and firm performance on the contracting of CEO compensation, this paper extends Fu and Chang (1998) by incorporating managerial ownership in the model specifying a linear relationship between compensation and multiple indicators of efforts. The model shows that the optimum weights placed on market, financial and nonfinancial measures of performance are all positive when the CEO has very low equity stake in the firm. With the increases in managerial ownership, the optimum weight placed on market measure of performance is decreasing and even becomes negative. The finding reveals that managerial ownership affects executive compensation through its influence on the optimum weight placed on the market measure of performance instead of being a direct explanatory variable of executive compensation. Empirical evidence with executive compensation data in 1995-1999 is generally consistent with the predictions of the model.

Keywords: Executive Compensation, Managerial Ownership, and Firm Performance