

# The Impact of Directors with Foreign Experience on Executive Compensation: Listed Evidence from Chinese Listed Companies

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## Abstract

We study the impact of directors with foreign experience on executive Compensation. Using a data set from Chinese listed companies, we find out that executive compensation tends to be higher in companies with directors that have foreign experience. To evaluate this change in executive compensation, we further explore the impact of director with oversea background on pay-performance link in these companies, which is an indicator of corporate governance and compensation management. Result shows that the impact of directors with foreign experience depends on the equity nature of the company.

## Keywords

Directors, Foreign Experience, Executive Compensation

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## 1. Introduction

Instituting appropriate executive compensation policies is an effective way of improving corporate governance and helps reduce a variety of agency costs. Since executive compensations of listed companies are disclosed in 1998, there has been a hot debate on the rationality and effectiveness of executive compensation management. On the one hand, the sky-high annual salaries of executives become the target of public criticism, especially those in state-owned enterprises where CEOs are appointed by SASAC (State-owned Assets Supervision and Administration Commission). On the other hand, however, average CEO earnings are relatively low in China. Because of the socialist characteristics of Chinese society, there is an attempt to moderate the wage differences between workers and executives and hence there is a “cap” on compensation.

In the rest of this chapter, we will take a review on the theories and previous study related to executive compensation and board characteristics.

### **1.1. Executive Compensation**

Executive refers to the senior manager of an organization. Here we include executive directors in the discussion because they often take the position as CEOs in the company and receive regular salaries from the company as compensation for their work.

Previous studies on CEO compensation have focused on a variety of firm characteristics and performance factors. Previous researches have shown how executive compensation practices vary with company size, industry, and country. Initial research on the role of firm's performance yielded disappointing result since the relation between CEO wealth and shareholder wealth is small (Jensen, Murphy, 1990) [1]. Moreover, Hall Jr. and Ko (2017) show that a number of manager and firm characteristics affect total compensation including executive age, revenues and Tobin's Q [2].

Examining corporate performance and CEO compensation in China, Firth, Fung, and Rui (2003) concluded that there is a positive relationship between CEO compensation and performance based on return on assets (ROA). In contrast, the relationship with lagged stock return (RETURN) is not significant. They also found that substantial government ownership and concentrated ownership appear to reduce pay levels. Their results are consistent with other's work on Chinese executive compensation [3].

In this paper we focus on the effect of directors with foreign experience on executive compensation. Therefore, more emphasis should be given to the role of board of directors in setting CEO compensation and the possible effect of attracting directors with foreign experience. These two topics are discussed below:

### **1.2. The Role of Directors**

Directors are appointed by the shareholders of the company, who assists in corporate governance by supervising executive management, makes strategic decisions for the company, provide counsel and act in crisis situation.

Although public firms are managed by executives, not directors, the board of directors can effectively oversee and monitor executives' performance through the design of CEO compensation plan and the decision of CEO turnover. Adams, Hermalin and Weisbach, (2010) inform that more independent and diligent boards are more willing to monitor, which raises the chance of CEO dismissal and lessen their job security [4].

However, board of directors in practice is not perfectly independent of management. On the one hand, evidence suggests that the process of identifying and electing new directors is dominated by the CEOs. In Lorsch (1989)'s study, over 99% of directors agreed that the CEOs have considerable power on a majority of board issues, including selection of new board members [5]. Moreover, CEOs

can also set the agenda for the board and controls the meetings; On the other hand, CEOs may use social influence to influence the board. Norms of reciprocity, authority, and similarity and liking may operate to shape directors' perceptions and decisions. For instance, newly appointed directors may feel a sense of obligation to the CEOs. And empirical study reveals that the compensation of the outside director who serves on the compensation committee has a significant and positive effect on the focal CEOs' own compensation (Brian, Reilly and Wade 1995) [6].

Since a large portion of listed enterprises in China are SOEs, a noteworthy issue related to the board control of executive compensation is the effect of the control exercised by the state.

Government implements control over SOEs through appointment of chief directors and participation in CEO selection. In the past decades, SOEs paid excess salaries and offered considerable perks to the government representative. In order to limit the sky-high salary of appointed directors and ensure their independent position, the central government implemented director compensation reform in 2014, which place a ceiling of 8 times the average salaries of the enterprise on the overall compensation received by company heads appointed. And this practice is followed by many local reforms.

The involvement of low paid bureaucrats as state representatives can be expected to add downward pressure on CEO compensation. Moreover, previous work do further research on state-owned enterprises and find that they show weaker pay-performance link and factors that enhance the pay performance sensitivity in private companies do not work as well in SOEs. Takao and Cheryl (2006) found that government ownership of China's listed firms is weakening pay-performance link for top managers [7].

These results do not suggest that SOEs are inferior or poor-managed. However, it is partly because they face multiple objective functions. Putting excess emphasis on firm's performance may hinder their fulfilling of other objectives such as improving social wellbeing and reducing unemployment.

### 1.3. Directors with Foreign Experience

The extent to which boards fulfill these duties is widely debated and may depend largely on the characteristics and skills of the directors (Adams, Hermalin, and Weisbach, 2010) [4].

In this report we examine a specific board characteristic: foreign experience, which can be getting an education degree or working abroad. We did not place a limitation on the duration of study or work experience here. Board members with foreign experience could help to improve firm performance in emerging markets through at least three channels.

First, directors with foreign job or study experience have learnt how foreign organization works and facilitate the adoption of best practices, and they may improve firm performance if they bring different perspectives to the decision-

making processes of the company boards. Rodrigues's work (2014) shows that when the firm performance is measured by ROA, nationality diversity does significantly and positively affects it [8]. And the empirical study of Y Wang and D Liu shows that independent directors with foreign experience suppress "tunneling" behaviors of major shareholders and improve the level of corporate governance (2016) [9].

Second, directors with foreign experience can provide professional advice and counsel to the management with regard to foreign business activities such as foreign acquisition or product expansion. Empirical studies of Giannetti, Mariassunta, Liao, and Xiao (2014) also show that the fraction of directors with foreign experience has a positive effect on foreign merger and acquisition and foreign sales activities [10].

Finally, directors with foreign experience may have stronger incentives to pursue profitability and may be more independent in supervising management. On the one hand, they have relatively weaker local ties and less motivation to please politicians or win local support. On the other hand, directors, especially independent directors with foreign experience have higher motivation to protect their social identity and reputation given the high economic cost and large amount of effort they have spent on acquiring foreign study or job experience (Wang, Wang, Hu, Cui 2015) [11].

This paper examines whether attracting exceptionally talented individuals with foreign experience to the board has positive effects on the formulation of CEO compensation plan.

This paper discovered a positive relationship between the introduction of directors with foreign experience and the CEO compensation in listed firms. This result is consistent with previous work. The work of Giannetti, Mariassunta, Liao, and Xiao (2014) reviews that executive compensation appears to be higher in firms with directors with foreign experience and it contributes the change to the substitution of perks for cash, a more transparent form of compensation [10]. Firth, Fung, and Rui (2003) found that the presence of a foreign shareholder is associated with higher CEO pay possibly due to their desire to hire high quality managers [3]. Li, Moshirian, Nguyen, and Tan found a positive influence of foreign investors on CEO compensation. They contribute it to the proximity of the firm with global executive compensation standards given that the average CEO salary is extremely low in China [12].

Previous empirical work on Chinese listed firm has been mostly focused on the impact of independent directors with foreign experience on executive compensation, and we contribute to this topic by including insiders in the analysis. In this paper, we examine the overall effect of a board of directors with foreign experience.

We conduct this analysis in two perspectives. The first is the effect of directors with oversea background on executive compensation, and the second one examines the effect of it on firm's pay-performance link.

The remainder of the paper is structured as follows. The following section introduces backgrounds and establishes hypothesis; Section 3 explains the methodology by developing the model and a series of variables; Section 4 explains sample selection and data collection; Section 5 and Section 6 are descriptive and regression analysis respectively, followed by conclusion in Section 7.

## 2. Backgrounds and Hypothesis

Given the result of previous empirical study and relevant theory, we hypothesize that the introduction of directors with foreign experience has a positive effect on executive compensation. For one thing, the average CEO salary in China is very low relative to US and many other countries, so it is very possible that directors with foreign experience are more generous in setting compensation plans. For another, directors with foreign experience may recognize the governance gaps between domestic and international enterprises and are more willing to offer high salaries which helps attract high quality CEOs—efficiency wage theory. Moreover, some scholars contribute this effect to the transform of perks to cash payment—a more transparent way of compensation.

Hypothesis 1: the introduction of directors with foreign experience raises executive compensation.

Hypothesis 1a: Both the compensation in state-owned enterprises and private enterprises are positively affected.

As stated earlier in the paper, directors with foreign experience can help facilitate adoption of best practices, provide counsel to business activities and have more incentives to pursue profitability. The increased desire for more competent executives and increased transparency of compensation indicates improved corporate governance. Therefore, the improvement of executives' compensation can be viewed as the result of the improvement in corporate governance.

However, the improvement of pay level of executives is not always a good. Since some of the board members (especially those major shareholders) also take management positions in the company, they may have the incentive to manipulate their salary as a CEO. Therefore, it is possible that higher executive compensation indicates excessive compensation, which might result from managerial power.

To evaluate the impact of directors with foreign experience on pay level, we further test the pay-performance link of the same set of companies. Agency theorists have traditionally considered compensation to be the most effective form of incentive to align the interests of top executives and shareholders. If compensation is sufficiently linked to the performance of the company's performance, then executives will be encouraged to improve performance in order to enjoy higher levels of executive compensation. On the contrary, low level of pay performance sensitivity, or pay without performance is the result of "managerial power" (Bebchuk and Fried, 2003), which indicates that CEOs have exerted significant influence over the board of directors who are expected to determine

executive pay independently [13]. Therefore, in this paper, we are going to test whether the introduction of directors with foreign experience enhance corporate governance by measuring the pay performance sensitivity using the same data set.

We believe that pay for performance methodology is an efficient approach to align the interests of executives and shareholders, and to ensure corporate performance. If the introduction of directors with foreign experience increases the independence of board of directors and helps structure a more efficient executive compensation scheme, the pay-performance link should be tightened; otherwise, if the introduction of directors with foreign experience is intended to justify a higher compensation scheme, it is very likely that the pay-performance link is weaker as a result of significant managerial power.

Here we expect a difference between state-owned enterprises and private enterprises. Firstly, the pay-performance sensitivity of SOEs is always lower because they face many objectives other than profit-maximizing. And since the largest shareholder is absent in SOEs, insider control, if any, will further lower pay-performance sensitivity.

Hypothesis 2a: the introduction of directors with foreign experience increases the pay-performance sensitivity of the executive compensation in private enterprises.

Hypothesis 2b: the introduction of directors with foreign experience decreases the pay-performance sensitivity of the executive compensation in state-owned enterprises.

### 3. Model and Variable Description

#### 3.1. Model Description

We establish two models for the two objectives described above, one for the executive compensation and the other for pay for performance sensitivities.

Model 1: The effect of directors with foreign experience on executive compensation:

$$\text{LnCEOpay} = \beta_0 + \beta_1\text{FE} + \beta_2\text{Lnperformane} + \Sigma\text{Controls} + \varepsilon$$

Model 2: The effect of directors with foreign experience on pay-performance sensitivity:

$$\text{LnCEOpay} = \beta_0 + \beta_1\text{FE} + \beta_2\text{Lnperformane} + \beta_3\text{FE}*\text{Lnperformance} + \Sigma\text{Controls} + \varepsilon$$

#### 3.2. Variable Description

Executive compensation (LnCEOpay): Since executives in Chinese listed enterprises hold very little or no amount of stocks of their companies and it is difficult to distinguish whether the stocks they hold are self-purchased or rewarded, the compensation measure we chosen is total compensation of the top three executives, which is taken from the annual reports and does not include any stock incentives. To find out the impact of directors with foreign experience on pay

performance elasticity, I use log of CEO compensation as proxy for compensation and thus, zero pay cases are ruled out in this analysis.

**Performance (LnPerformance):** Two proxies for firm performance used as dependent variables are net income and operating profit since listed companies often use them as performance indicators in stock option incentive schemes (Fung, 2009) [14]. I used both type of measures in empirical analysis to check the robustness of the results to alternative measure of performance. To find out the impact of directors with foreign experience on pay performance elasticity, I use log of net income and log of operating income as proxy for performance. Therefore, companies that incurred a loss at a time are ruled out in the sample.

**Foreign Experience (FE):** Foreign experience (FE) is a dummy variable that takes the value of one if there is at least one director with foreign experience in the board and zero otherwise. We do not distinguish foreign study or job experience here.

**Control Variables:** In this model, we control factors including corporate size, leverage, board characteristics, region, and industry:

**Size (Lnsiz):** CEO pay is positively and significantly associated with compensation levels in most of the researches conducted around the world (Canyon, 1997) [15]. In this paper, we use log of operating income as a size indicators.

**Leverage:** Leverage is a control mechanism which affects management's flexibility in allocating resources. John and John (1993) [16] argue that pay policy can be used as a pre-commitment device to reduce the agency cost of debt. Therefore, we also control for this factor in our analysis. Leverage is defined as the ratio of long-term debt to total asset.

**Board Characteristics:** We control three factors for board characteristics: ownership concentration degree (LShare), duality, and board independence (Indd). The diffuse ownership structure may diminish shareholder incentives to monitor managers and to limit managerial perquisite-consumption (Berle and Means, 1932) [17]. So the ownership concentration degree is expected to have negative relationship with CEO pay. We define ownership concentration degree as the portion of shares hold by the largest shareholder; Duality exists when a firm's CEO also serves as chairman of board of directors and it gives CEO wider managerial power. The measure of duality is a dummy variable that take the value of 1 if duality exists and zero otherwise; Board independence is measured by the percentage of board members who are outsiders. It is considered a mechanism to strengthen board control and thus, expected to be negatively related to executive compensation.

**Region:** Living expenses and average wage costs in coastal regions are much higher than the interior. CEO salaries are, therefore, likely to depend on the location of the business. To capture the differences in the economic development and the pay differences in different regions in China, we use two dummy variables: West takes the value of 1 if the company is registered in the western China and Central takes the value of 1 if the company registered in the western China.

Industry (Ind): We also use industry dummy variables to capture the different industries of the corporations. The industries are industrial and manufacturing, commercial, public utility, property, and conglomerate (composites) sectors. Financial sector is eliminated the sample.

Year: Our study was based on the data over a seven-year period from 2008 to 2014. Year is a dummy variable.

**Table 1** lists the variables and definitions used in our study. The table also shows the predicted effect of each variable on CEO compensation in our study.

#### 4. Sample Selection and Data Collection

The sample and data are obtained from the China Stock Market & Accounting Research Database. We have excluded foreign enterprises in the database. In line with the other studies, we have also excluded companies in the financial sector. As a result, data were collected from 2480 companies listed on the stock exchanges of Shanghai and Shenzhen across five industry groups over a seven-year period from 2008 to 2014.

#### 5. Descriptive Analysis

**Table 2** presents the descriptive statistics on CEO compensation, performance indicators, size, and board characteristics.

As shown in the table, average CEO compensation in this seven-year period keep increasing from 1.04 million RMB in 2008 to 1.82 million RMB in 2014. Although zero pay existed from 2008 to 2011, it was really rare and disappeared

**Table 1.** Variable Definition.

Variable		Definition
Executive Compensation	LnCEOpay	Natural log of total compensation of the top three executives
Performance	LnNI	Natural log of net income
	LnOP	Natural log of operating profit
Foreign Experience	FE	Equal to 1 if there is at least one director with foreign experience in the board
Size	LnSize	Natural log of operating income
Leverage	Leverage	The ratio of long-term debt to total asset.
Ownership Concentration	Lshare	The portion of shares hold by the largest shareholder
Duality	Duality	Equal to 1 if a firm's CEO also serves as chairman of board
Board independence	Indd	The percentage of board members who are outsiders
Region	Central	Equal to 1 for companies registered in the central China
	West	Equal to 1 for companies registered in the western China
Industry	Ind	Industry dummy variables
Year	Year	Year dummy variables



**Table 2.** Descriptive Statistics.

		2008	2009	2010	2011	2012	2013	2014
Ceopay /million	mean	1.04	1.14	1.33	1.50	1.59	1.71	1.82
	sd	1.07	1.03	1.22	1.37	1.53	1.67	1.74
	min	0.00	0.00	0.00	0.00	0.08	0.07	0.11
	max	15.20	12.00	15.20	16.90	30.70	28.50	27.10
Net income /billion	mean	0.31	0.37	0.49	0.48	0.41	0.47	0.46
	sd	3.65	3.30	4.10	3.94	3.57	3.82	3.25
	min	(14.00)	(6.74)	(2.74)	(8.84)	(10.30)	(5.92)	(17.00)
	max	126.00	106.00	151.00	146.00	131.00	142.00	119.00
Operating Profit /billion	mean	0.30	0.44	0.57	0.57	0.48	0.55	0.53
	sd	4.21	4.36	5.25	4.99	4.49	4.42	4.12
	min	(26.10)	(6.38)	(2.53)	(6.81)	(9.89)	(5.85)	(16.80)
	max	149.00	145.00	193.00	185.00	165.00	152.00	154.00
Foreign Experience	mean	0.23	0.27	0.31	0.34	0.35	0.36	0.39
	sd	0.42	0.44	0.46	0.47	0.48	0.48	0.49
	min	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	max	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Operating Income /billion	mean	6.27	6.28	7.44	8.63	8.94	9.66	9.70
	sd	49.00	45.60	59.40	73.70	79.30	82.30	81.00
	min	0.00	0.00	0.00	0.00	0.00	0.00	0.01
	max	1450.00	1350.00	1910.00	2510.00	2790.00	2880.00	2830.00
Asset /billion	mean	7.49	8.79	9.23	10.30	11.30	12.50	13.60
	sd	41.50	48.40	51.20	57.20	63.10	69.10	71.70
	min	0.00	0.00	0.00	0.01	0.01	0.01	0.03
	max	1190.00	1450.00	1660.00	1920.00	2170.00	2340.00	2410.00
Indd	mean	0.36	0.37	0.37	0.37	0.37	0.37	0.37
	sd	0.05	0.05	0.05	0.06	0.06	0.06	0.05
	min	0.14	0.09	0.13	0.20	0.25	0.18	0.23
	max	0.67	0.71	0.80	0.75	0.71	0.71	0.71
Lshare	mean	36.56	36.42	36.39	36.15	36.41	36.05	35.40
	sd	15.40	15.59	15.62	15.51	15.54	15.53	15.20
	min	3.74	4.44	3.51	2.20	2.20	2.20	2.20
	max	86.42	86.20	86.49	86.49	86.35	86.35	86.35
Duality	mean	0.15	0.19	0.23	0.25	0.26	0.25	0.26
	sd	0.36	0.39	0.42	0.43	0.44	0.43	0.44
	min	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	max	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Source: Stata generated from China Stock Market &amp; Accounting Research Database.

from 2012. However, the average CEO compensation in China is significantly lower than that in Western economies such as the US and Britain. This is consistent with findings in Conyon and He (2011) [18].

Although both average net income and operating profit dropped significantly in 2012 and 2014 possibly due to financial crisis, they had no influence on executive compensation, which continued to show an increasing trend. This might suggest changes in pay performance sensitivity.

Thanks to the introduction of policies to attract talented emigrants and increase the supply of individuals with foreign experience in different provinces, the percentage of companies that have at least one directors with foreign experience keep increasing during the period, from 23% in 2008 to 39% in 2014. This trend can also be contributed to the economic globalization and the increase in numbers of talents with foreign study or job experience.

Both operating income and asset indicates significant growth in size of local Chinese listed firms. Average operating income increased by 54.7% from 2008 to 2014, and average total asset in 2014 nearly doubled that of 2008. The growth in size of the firms is expected to have positive relationship with executive compensation.

For board characteristics, the ratio of independent directors is pretty stable with a slight increase for about 1% during the period. Ownership concentration is also very stable during the period. Duality shows a rapid increase from 2008 to 2011. This is largely due to the rapid increase of private listed companies in which chairman of the board is more likely to take the position as a CEO. In most SOEs, however, chairman of the board is appointed by the government and CEO is recruited from the talent market.

**Table 3** shows the comparison of executive compensation in SOEs and private companies and also presents the difference of pay level between companies that have directors with foreign experience and those that do not.

SOEs have higher pay level than private companies mainly because of their size effect. And companies that have directors with foreign experience shows higher executive pay level regardless of their equity nature. Interestingly, the effect of directors with foreign experience seems to have larger influence on executive compensation in SOEs, as shown from the difference of about 53% as compared to 28% of private companies. This may possibly due to other factors such as size and performance because we expect that firms with larger size and better performance may be more willing to hire directors with foreign experience. Therefore, we can only interpret the result after control for those factors.

**Table 3.** Average CEO pay.

	Full Sample	FE = 1	FE = 0	Difference
State	1,613,563	2,174,015	1,424,060	52.66%
Private	1,375,226	1,585,211	1,234,902	28.37%

Source: Stata generated from China Stock Market & Accounting Research Database.

## 6. Result

**Table 4** shows the correlation among variables. As sometimes reported in previous studies, executive compensation is positively and significantly related to firm size and performance. As shown in the table, the existence of directors with foreign experience is likely to have positive relationship with executive compensation.

### 6.1. Test of Hypothesis 1

**Table 5** shows the results of the regression with model 1. Columns 1 to 3 use net income as performance indicator and columns 4 to 6 use operating profit instead to check robustness. Columns 1 and 4 test the effect on the full sample, columns 2 and 4 present the result on merely SOEs, and columns 3 and 6 present result on merely private enterprises.

Consistent with other research, executive compensation is positively and significantly related to the existence of directors with foreign experience, duality, firm size and performance. Ownership concentration and board independence have a negative impact on executive compensation as expected. And companies that locate in southern and western China are likely to offer lower compensation package. Note that although pay performance sensitivity in private enterprises are slightly higher in line up with other research, the difference is very small. This convergence can be contributed to a serious of SOEs reform carried out during the period. In the shareholding system reform, the highly centralized investment administration under the planned economy had been progressively transformed into a new pattern of diversification of investors and investment modalities. The goal of increasing vitality and competitiveness has been stressed over time, so it is not surprising to see an increase in executive pay performance sensitivity.

**Table 4.** Correlation Among Variables.

	Inceopay	FE	Central	West	Lshare	Duality	Indd	Leverage	Lnsiz	LnNI
Inceopay	1	0.158***	-0.135***	-0.151***	0.0798***	-0.00681	0.0172*	0.115***	0.450***	0.511***
FE	0.161***	1	-0.0561***	-0.0880***	-0.00234	0.0818***	0.0187*	-0.0530***	0.0232**	0.0787***
Central	-0.133***	-0.0561***	1	-0.210***	-0.0306***	-0.0372***	-0.00675	0.0600***	0.0288***	-0.0198*
West	-0.145***	-0.0880***	-0.210***	1	-0.0282***	-0.0772***	-0.00484	0.0947***	-0.0525***	-0.0538***
Lshare	0.0817***	-0.00228	-0.0260**	-0.0242**	1	-0.0536***	0.0385***	0.0756***	0.262***	0.241***
Duality	-0.00337	0.0818***	-0.0372***	-0.0772***	-0.0614***	1	0.0800***	-0.165***	-0.199***	-0.115***
Indd	0.0168*	0.0227**	-0.0163	-0.00344	0.0567***	0.0862***	1	-0.0023	-0.0192*	0.00542
Leverage	0.0774***	-0.0629***	0.0524***	0.0972***	0.0851***	-0.141***	0.00115	1	0.351***	0.237***
Lnsiz	0.464***	0.0504***	0.0118	-0.0612***	0.301***	-0.178***	0.0117	0.198***	1	0.664***
LnNI	0.511***	0.0971***	-0.0337***	-0.0597***	0.274***	-0.110***	0.0279**	0.178***	0.688***	1
*	P < 0.05,	**	P < 0.01,	***	P < 0.01					

Source: Stata generated from China Stock Market & Accounting Research Database.

**Table 5.** Test of Hypothesis 1.

2-46-8	Net Income			Operating Profit		
	(1)	(2)	(3)	(4)	(5)	(6)
2-8	Full Sample	State	Private	Full Sample	State	Private
FE	0.124*** (11.11)	0.169*** (10.07)	0.116*** (7.90)	0.125*** (10.91)	0.175*** (10.11)	0.117*** (7.76)
Central	-0.245*** (-17.45)	-0.269*** (-14.06)	-0.252*** (-11.71)	-0.248*** (-17.03)	-0.275*** (-13.87)	-0.260*** (-11.79)
West	-0.212*** (-14.39)	-0.278*** (-14.25)	-0.158*** (-6.70)	-0.200*** (-13.06)	-0.280*** (-13.68)	-0.140*** (-5.79)
Lshare	-0.00492*** (-13.83)	-0.00669*** (-13.48)	-0.00360*** (-7.02)	-0.00504*** (-13.70)	-0.00677*** (-13.09)	-0.00382*** (-7.24)
Duality	0.0706*** (5.62)	0.0688*** (2.59)	0.104*** (6.94)	0.0739*** (5.72)	0.0941*** (3.45)	0.105*** (6.83)
Indd	-0.175* (-1.84)	-0.259** (-2.00)	0.161 (1.19)	-0.243** (-2.50)	-0.317** (-2.38)	0.0934 (0.68)
Leverage	0.0645 (1.05)	-0.0802 (-1.20)	0.254* (1.80)	0.00911 (0.14)	-0.182** (-2.57)	0.281* (1.91)
LnSize	0.109*** (18.92)	0.0744*** (9.08)	0.120*** (13.08)	0.107*** (17.86)	0.0721*** (8.70)	0.113*** (11.57)
LnNI	0.157*** (30.43)	0.161*** (22.69)	0.164*** (21.12)			
LnOP				0.150*** (28.23)	0.153*** (21.62)	0.156*** (19.03)
_cons	8.856*** (96.81)	9.643*** (80.97)	8.267*** (54.52)	9.056*** (95.34)	9.871*** (79.25)	8.563*** (53.95)
N	12480	5814	6666	11605	5298	6307
Adjusted R <sup>2</sup>	0.38	0.42	0.34	0.37	0.41	0.32

Source: Stata generated from China Stock Market & Accounting Research Database.

Based on fine goodness of model fit, the influence of directors with foreign experience on executive compensation is positive and remarkable, which support hypothesis one. Results show that the CEOs whose board has foreign experience are paid about 12% more than CEOs whose board does not. Notably, the impact of directors with foreign experience on SOEs is significantly higher than that in private enterprises, with a 5% difference in coefficient.

As stated above, some scholar attribute the rise in executive compensation to the gap between CEO pay at home and abroad, others believe that it may due to the transform of perks to cash payment. However, it is also possible that managing directors purposely recruit new directors with foreign experience to justify

the rise in compensation, or the new directors with foreign experience recruited has the desire to raise their compensation if they are the members of the management team. To evaluate the introduction of directors with foreign experience on salary management, we further study its impact on executive pay-performance link.

## 6.2. Test of Hypothesis 2

**Table 6** presents results of the regression with model 2. To evaluate the impact

**Table 6.** Test of Hypothesis 2.

2-46-8	Net Income			Operating Profit		
	(1)	(2)	(3)	(4)	(5)	(6)
2-8	Full Sample	State	Private	Full Sample	State	Private
FE	0.124*** (11.12)	0.193*** (10.80)	0.124*** (8.16)	0.125*** (10.92)	0.199*** (10.94)	0.126*** (8.03)
Central	-0.245*** (-17.45)	-0.273*** (-14.24)	-0.253*** (-11.74)	-0.247*** (-17.03)	-0.279*** (-14.02)	-0.262*** (-11.82)
West	-0.212*** (-14.39)	-0.277*** (-14.23)	-0.158*** (-6.67)	-0.200*** (-13.06)	-0.277*** (-13.55)	-0.140*** (-5.75)
Lshare	-0.00492*** (-13.82)	-0.00673*** (-13.54)	-0.00361*** (-7.06)	-0.00504*** (-13.70)	-0.00679*** (-13.12)	-0.00385*** (-7.30)
Duality	0.0706*** (5.63)	0.0711*** (2.68)	0.105*** (6.97)	0.0739*** (5.72)	0.0961*** (3.53)	0.106*** (6.86)
Indd	-0.175* (-1.84)	-0.252* (-1.95)	0.157 (1.16)	-0.243** (-2.51)	-0.304** (-2.30)	0.0866 (0.63)
Leverage	0.0645 (1.05)	-0.0774 (-1.16)	0.259* (1.85)	0.00931 (0.14)	-0.181** (-2.57)	0.288** (1.97)
LnSize	0.109*** (18.86)	0.0779*** (9.51)	0.119*** (12.98)	0.107*** (17.84)	0.0753*** (9.13)	0.112*** (11.48)
LnNI	0.157*** (30.37)	0.158*** (22.04)	0.163*** (21.00)			
FE*lnNI	0.00114 (0.15)	-0.0345*** (-3.48)	0.0306*** (2.63)			
LnOP				0.150*** (28.22)	0.150*** (21.20)	0.155*** (18.81)
FE*lnOP				0.00219 (0.30)	-0.0332*** (-3.34)	0.0286** (2.40)
_cons	8.857*** (97.10)	9.633*** (81.64)	8.301*** (54.75)	9.059*** (95.66)	9.848*** (79.73)	8.604*** (54.06)
N	12480	5814	6666	11605	5298	6307
Adjusted R <sup>2</sup>	0.382	0.426	0.342	0.367	0.413	0.324

Source: Stata generated from China Stock Market & Accounting Research Database.

of the introduction of directors with foreign experience on firm's pay-performance link, we introduce the interaction of foreign experience and log of net income. We have center foreign experience and log of net income before multiplication (interaction) to avoid serious multicollinearity. As stated above, we substitute net income for operating income to test robustness of the result. Columns 1 to 3 use net income as performance indicator and columns 4 to 6 use operating profit instead to check robustness. Columns 1 and 4 test the effect on the full sample, columns 2 and 4 present the result on merely SOEs, and columns 3 and 6 present result on merely private enterprises.

The results on full sample show that the coefficient of the interaction is not significant. We should investigate the result on SOEs and private enterprises separately.

The result on private enterprises shows that the presence of directors with foreign experience increases the pay performance sensitivity by 0.03, which indicates that a 1% increase in net income may results in a 0.19% increase in compensation of executives whose board has foreign experience while only a 0.16% increase in those whose board has no foreign experience. This result supported hypothesis two, suggesting that directors with foreign experience are more profit-orientation and thus more likely to base executive compensation on their performance. A closer alignment of executives and shareholders' interest indicates better governance and less agency costs.

However, the result towards SOEs shows that the interaction is negatively and significantly related to executive compensation. The coefficient of  $-0.03$  suggests that a 1% increase in net income may results in a 0.13% increase in compensation of executives whose board has foreign experience while a 0.16% increase in those whose board has no foreign experience. This result indicates that there may be possible collusion between the incumbent directors and the new one to manipulate the compensation scheme, which increases their compensation and lower pay-performance link to guarantee a steady well pay. If this is the case, the effect of directors with foreign experience on CEO pay will depend on the relationship between those directors and the management team.

To test whether there may be possible collusion and higher managerial power to influence CEO compensation scheme after the introduction of directors with foreign experience, we want to study the effect of directors with foreign experience based on their relationship with the management team. If the those directors take management positions in the company, they may have higher incentive to manipulate CEO pay with their managerial power; in contrast, if they are members of the compensation committee, which is intended to be independent of the management and executive directors, the negative effect on pay performance sensitivity may be lower or disappear. Note that here we do not simply divide them into insiders and outsiders because the independent directors' position is to be questioned in China. Under the direct independent director pay system, the nomination of independent directors usually rests with the board

and the determination of their compensation rests with the enterprise rather than a third party. Therefore, the nomination and compensation setting process are black-box operation, which renders the independent position of “independent directors” questionable.

In the following test, we substitute variable FE into variables FE-SC and FE-Exe separately for further analysis. FE-SC is a dummy variable that takes a value of 1 if there is at least one director with foreign experience in the compensation committee; FE-Exe is also a dummy variable that take a value of 1 if there is at least one director with foreign experience in the management team. **Table 7** displays the regression result after the substitution. Columns 1 to 3 display the result of SOEs and Columns 4 to 6 display the result of private enterprises as comparison.

Result of SOEs shows the impact of executive directors with foreign experience on pay-performance is negative and those directors with foreign experience in compensation committee have no effect on pay-performance.

As expected, the role of directors in the company has great influence on CEO pay. In many enterprises, chairman of the board is the same person as CEO. We documented that duality exists in 26% of the companies in our sample. In this case, the board has larger incentive to increase their own salary and sacrifices the interest of other shareholders. For example, the sky-high salary of CEOs of Pingan Company was largely due to their important position in the board, which gives them excessive managerial power. Since directors with foreign experience may have a higher claim on compensation due to the overall low CEO salaries in China or their excess expense and effort spent on acquiring foreign experience, it is very likely that they collude with the existing directors to push the compensation higher and smoother.

But why the results differ on SOEs and private enterprises? We contribute the difference to the various objectives imposed by a serious of regulations on SOEs other than profit-maximization. The directors/executives with foreign experience may hope to smooth their compensation by manipulation of compensation scheme. Those various social objectives can be excuses against unsatisfactory performance. Moreover, the absence of major investor (state) makes insider control possible, which results in excess executive on-the-job consumption, shortsightedness, self-interest, and pay without performance.

## 7. Conclusion

Executive compensation is long under dispute for its extremely high price and opaque arrangement mechanism. In this paper, we examine the impact of a particular board characteristic—oversea background on executive compensation. After an empirical study on a data set of Chinese listed company from 2008 to 2014, we found that CEOs whose board has foreign experience are paid about 12% more than CEOs whose board does not, which is possibly due to a convergence with international CEO pay, a more transparent compensation settlement

**Table 7.** Further Analysis.

	State			Private		
2-46-8	(1)	(2)	(3)	(4)	(5)	(6)
2-8	FE	FE-SC	FE-Exe	FE	FE-SC	FE-Exe
FE	0.193*** (10.80)			0.124*** (8.16)		
FE-SC		0.169*** (8.10)			0.102*** (4.83)	
FE-Exe			0.243*** (4.16)			0.0711*** (2.99)
Central	-0.273*** (-14.24)	-0.286*** (-13.89)	-0.283*** (-14.02)	-0.253*** (-11.74)	-0.249*** (-10.29)	-0.238*** (-10.84)
West	-0.277*** (-14.23)	-0.304*** (-14.99)	-0.279*** (-13.95)	-0.158*** (-6.67)	-0.157*** (-5.81)	-0.151*** (-6.16)
Lshare	-0.00673*** (-13.54)	-0.00628*** (-11.99)	-0.00696*** (-13.33)	-0.00361*** (-7.06)	-0.00338*** (-5.77)	-0.00327*** (-6.27)
Duality	0.0711*** (2.68)	0.0770*** (2.71)	0.0678** (2.50)	0.105*** (6.97)	0.102*** (5.80)	0.0948*** (6.23)
Indd	-0.252* (-1.95)	-0.137 (-0.98)	-0.291** (-2.15)	0.157 (1.16)	0.221 (1.43)	0.208 (1.50)
Leverage	-0.0774 (-1.16)	-0.0842 (-1.20)	-0.0868 (-1.27)	0.259* (1.85)	0.281* (1.89)	0.210 (1.46)
Lnsiz	0.0779*** (9.51)	0.0834*** (9.63)	0.0827*** (9.57)	0.119*** (12.98)	0.123*** (12.72)	0.118*** (12.76)
LnNI	0.158*** (22.04)	0.158*** (21.21)	0.161*** (20.95)	0.163*** (21.00)	0.153*** (18.81)	0.168*** (21.39)
FE*lnNI	-0.0345*** (-3.48)			0.0306*** (2.63)		
FE-SC*lnNI		0.0166 (1.30)			0.0363** (2.38)	
FE-Exe*lnNI			-0.0985*** (-3.10)			-0.0342* (-1.72)
_cons	9.633*** (81.64)	9.490*** (72.80)	9.525*** (74.71)	8.301*** (54.75)	8.385*** (50.68)	8.237*** (52.46)
N	5814	5146	5476	6666	5145	6430
Adjusted R <sup>2</sup>	0.43	0.42	0.42	0.34	0.34	0.33

Source: Stata generated from China Stock Market &amp; Accounting Research Database.



that transform perks into cash or the desire to hire high quality CEOs. But higher salary can also be the result of larger managerial power given that directors with foreign experience may expect a convergence to the international pay level. To evaluate the role of directors with oversea background in compensation arrangement, we further examine their impact on the executive pay-performance link. Result shows that the impact depends on the company's equity nature. In private firms, a board with foreign experience is more likely to raise the pay performance sensitivity of executives as a means to pursue greater firm performance and reduce agency costs. In state-owned enterprises, however, the introduction of directors with foreign experience seems to lower pay-performance link—governance condition was worse-off. After carrying out a test that takes the role of directors with foreign experience in the company into consideration, we ascribe the negative influence on pay-performance link to the CEOs' incentive to manipulate compensation scheme so as to avoid plenty of non-market factors that affect SOEs where the largest shareholder is absent.

Our analysis is subject to several limitations. In this paper, we do not examine the effect of foreign shareholders on executive compensation. Future study could separate these two effects. Moreover, future study can also examine the executive compensation stickiness or other indicators to evaluate the effect of directors with foreign experience on firm's compensation management. We consider these exciting areas for future research.

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