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CEO Pay and Company Performance in the Media Industry

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Abstract

This study examines the relationship between CEO pay and company performance in the media industry. The financial pressures facing media companies have been mounting in recent years as more people get their news for free on the internet and advertisers are moving more of their spending to less expensive online outlets. The emergence of the internet as a marketing medium and its effect on media companies shows up in the performance measures of the media company sample. The average return on assets over the five year sample period is 0.3 percent and the total annual return to stockholders is an average of -8.7 percent for the sample of media companies over a five year test period from 2004-2008. The results of the analysis indicate that the total compensation for the CEOs of media companies is not correlated to the downward pressure on company performance. The study finds that the performance variables of return on assets and annual stock returns are insignificant in explaining CEO pay.

Key words: CEO Pay, Agency Theory, Company Performance

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INTRODUCTION

There are many empirical studies that analyze executive pay and company performance relationship. Most studies show a positive but weak relationship between CEO compensation and company performance or no relationship at all. This study examines the CEO pay performance relationship for the media industry. The media industry revenues have taken a pounding with the loss of customers and advertisers through the emergence of the internet. This may possibly have a dampening effect on the compensation of top. At the same time there may be pressure on media companies to pay their CEOs well since they are in charge of talented people who demand high salaries in the competitive market place for talent. The study examines the relationship of the pay of CEOs and the performance of the companies in the media industry.

Agency theory refers to problems that arise when a principal hires an agent under conditions of incomplete and asymmetric information. The company owner, the shareholder, is the principal and the employee or executive is the agent. Duties are delegated to the agent or executive by the shareholders with the expectation that the agents will work in the best interests of the owners. Agency theory uses the assumption that agents prefer to pursue their own self interests over the owners' interests. When working in their own interests, executives, as agents, may perform activities that result in costs to company shareholders. Because of these costs, aligning the diverging interests of executives and shareholders is essential to maximize the wealth of company owners. One method in order to align these interests is through the compensation packages offered to top management. It appears that pay incentives are used in companies to reduce agency costs by compensating the CEO in a manner that encourages him or her to maximize the wealth of the shareholders.

The objective of this research is to test the relationship of CEO pay and company performance in the media industry. Specifically, this study uses a data set from multiple years (2004-2009) to determine this relationship. The study finds that the market performance measure, annual common stock returns, and the book based performance measure, return on assets, are not statistically related to total CEO compensation for the media companies in the sample. However, tenure of the company CEO and size of the company have a significant relationship with CEO pay for the sample of media CEOs. It may be that media corporations do not link CEO pay to firm performance because of the star effect where firms structure CEO compensation so it is not less than that of the talent employed by the organization.

The paper is divided into the following parts. First, the literature on the relationship of CEOs pay and company performance is reviewed. Next, I present the method used to test the CEO compensation and company performance relationship. Third, a discussion of the variables is presented. Fourth, the results of the analysis is discussed, and finally, a conclusion to the paper is offered.

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LITERATURE

A number of studies discovered a link between CEO pay and company performance. Research by Aggarwal and Samwick (2003) found CEO compensation was more sensitive to changes in shareholder wealth than the pay of executives in charge of company divisions. Core and Larcker (2002) argued that accounting profits and company stock returns both increased after implementing executive incentive pay plans. Boschen et al. (2003) discovered that unexpectedly good stock price performance provided positive, but diminishing, increases, in executive pay over several years. Other research by Leonard [1990] found that long-term incentive plans are associated with greater increases in ROE than in those firms without long-term incentive plans.

There were also those studies (Bebchuk and Fried, 2003 and Bebchuk and Fried, 2004) that found pay incentive to top management did not improved company performance because of lack of corporate governance. According to the research executives were able, because of inadequate corporate governance, to confiscate profits from their companies in order to increase their pay. A recent paper by Jensen and Murphy (2010) presented the idea that the compensation of the top executives of most public companies is virtually independent of performance of the firm. They proposed that on average, corporate America pays its most important leaders like bureaucrats.

METHOD

To test the relationship between CEO pay and company performance for the sample of media companies (Table 1), the following regression equation is used.

(1) $\text{CEO Pay}_{it} = \alpha_0 + \alpha_1 \text{Tenure}_{it} + \alpha_2 \text{Performance}_{it-1} + \alpha_3 \text{Size}_{it-1} + \alpha_4 \text{Leverage}_{it-1} + \boldsymbol{\varepsilon}_{it}$

The dependent variable, CEO Pay, is the amount of total compensation paid to the chief executive officer. It is expressed in natural logarithm to adjust for the non-normality of compensation distribution**.** There are four independent variables included in the model along with a constant. Tenure represents the number of years the CEO has been in his present position. Performance is measured with an accounting variable, return on assets (ROA), and a market measure, annual returns on common stock. The size variable is measured with the log of sales for each company. The ratio of total long term debt to total capitalization is used as the leverage varible. The performance measures, size and leverage variables are all lagged one period since CEOs are rewarded for past performance and lagging these variables takes this into account.

Total CEO Compensation

The data for the companies (Table 2 and 4) in the sample is taken from *Forbes* magazine and Standard & Poor's Compustat data. The dependent variable, CEO pay, is taken from the *Forbes* annual article called, *Special Report CEO Compensation*, from the April issue for years 2006 through 2010. CEO tenure was also taken from the Forbes Special Report. To be included in the study a company must have their CEOs on Forbes Magazine's list of highest paid CEO and have data available on the S&P Compustat data base.

Total compensation for each CEO of the companies in the sample is used as the dependent variable and it includes salary and bonuses, other compensation, such as vested restricted stock grants and perks; and stock gains that are realized by exercising stock options, according to *Forbes*.

Tenure

CEO tenure is the number of years that each company's chief executive officer has held the position. I expect a positive relationship between CEO pay and tenure, but tenure's effect on CEO pay has differed in many studies. Deckop (1988) investigated tenure and its correlation to CEO compensation and found little or no effect on CEO pay. Hill and Phan (1991) found evidence that the relationship between CEO pay and common stock returns becomes weaker as tenure grows. This was consistent with the notion that tenure gives CEOs the power and time to tie their compensation packages to their own interests. Another prior study by Leonard [1990] concluded that top executive pay reflected the executive's human capital. The thinking is that a chief executive officer with greater human capital is expected to perform better, and, therefore, should be paid more. The study includes CEO tenure as an independent variable to explain CEO pay.

Size

Many studies include a size variable when explaining CEO pay because large firms are complicated and take a set of skills that may be available only to a limited number of people. Competition among companies for this scarce managerial talent may lead to increased CEO pay in larger firms (Tervio, 2008 and Nourayi, 2006) There have been many studies that investigate the relationship between company size and executive compensation that confirm a positive and significant relationship (Carpenter and Sanders, 2002; Conyon et al., 2000; Elston and Goldberg, 2003; and McKnight, 1996). CEOs may also want their pay tied to company size rather than company performance because firm size is more predictable than company performance (McKnight and Tomkins, 2004). This study includes the log of annual company sales as its size variable.

Leverage

Jensen (1986) found that companies use debt financing to eliminate agency problems in the firm so the executive is under the obligation to produce large enough flows to meet the obligation of the debt. From the literature it appears that financial leverage can help align the interests of top management with those of company owners and motivate management to improve firm performance in order to meet payments to creditors. Gu and Choi (2004) found a positive relationship between CEO cash compensation and the ratio of long-term debt to total capitalization for firms in the casino industry. Other studies have produced mixed results (Carr, 1997 and Finkelstein and Hambrick, 1989) on the relationship between leverage and executive compensation. Total long term debt to total capitalization is used an independent variable in the study to measure leverage and I expect to find a positive and significant relationship to CEO pay.

Company Performance

The explanatory variable, company performance (Performance), is measured in a two ways. I consider both accounting based and capital market based performance measures. The first measure is return on assets (ROA) defined as the operating earnings over the book value of total assets. The other performance measure, annual stock return, is the total returns on common stock including dividend yield and growth in price year over year. A number of studies (Sloan, 1993; Carpenter and Sanders, 2002; and Kerr and Bettis, 1987) have found some strong relationships between accounting-based measures and executive compensation. There were other studies (Coughlan and Schmidt, 1985; Murphy, 1985; and Conyon et al., 2000), that found that executive compensation is related more to market-based performance measures than to accounting-based ones. Some criticize using accounting measures because such measures encourage short term performance and are not linked to long term outcomes. Market-based pay incentives encourage long term performance but have been criticized for not encouraging short run performance (Hill et al., 1988). I use both measures in examining the relationship between CEO pay and company performance in the media industry.

RESULTS AND DISCUSSION

Table 2 summarizes total CEO compensation in the media industry over the years 2005 through 2009. Average total pay for media CEOs in the sample ranges from a low $10.8 million in 2005 to a high of $18.5 million in 2007. The highest paid CEO in the sample is Brian Roberts of Comcast with total compensation of $39.2 million in 2008. The lowest paid CEO is Mark Mays of Clear Channel Communications with total compensation of $900,000 in 2005 and 2006. Table 3 shows the average total CEO compensation for 2009 by industry. The industry labeled as conglomerates by *Forbes* in the *Special Report CEO Compensation* has the largest average total CEO pay of $19.2 million. Second largest total CEO pay by industry is Hotel, Restaurant & Leisure with $17.2 million for the average CEO. The average total compensation for media industry of $12.1 million is the fifth highest paid among the 24 industries listed. The average total compensation of CEOs for the industries listed is $8.9 million. Media CEOs receive over $3 million more pay than the average CEO from the Forbes Special Report in 2009.

Summary statistics are shown for the independent variables in Table 4 for a period from 2004 through 2008. The average tenure for the CEO in the sample is 7.8 years. Average return on assets over a five year period from 2004 through 2008 is a meager 0.3 percent and the average total return on common stock is a -8.7 percent demonstrating what a difficult period the companies in the media industry went through. Comparing the performance of the firms to the total CEO compensation from Tables 2-4 does not seem to support a strong relationship between CEO pay and company performance.

Table 5 displays the results for two regression equations. According to results both equations the performance measures, ROA in Equation 1 and total stock returns in Equation 2 are insignificant in explaining CEO compensation although CEO tenure and company sales coefficients were both positive and significant in explaining CEO pay. The leverage variable is insignificant in both the equations and has a negative sign on its coefficient which is at odds with the hypothesis.

One reason there is no evidence of a relationship between CEO total compensation and company performance for media firms may be because of the star effect. Companies may not want their CEOs to make less than the talent they employ. CBS, for example, pays daytime courtroom star, Judge Judy Sheindlin, more than $40 million a year. Firms may make the decision that top managers need to make enough compensation to give the appearance or signal to the talent that the CEO is in charge of the company.

CONCLUSION

This study examines the CEO pay performance relationship for the media industry. The financial pressures facing media companies have been mounting in recent years as more people get their news for free on the internet and advertisers have moved more of their spending to less expensive online outlets. The emergence of the internet as a marketing medium and its effect on media companies shows up in the performance measures of the media company sample. The average return on assets over the five year sample period is 0.3 percent and the total annual return to stockholders is an average -8.7 percent for the sample of media companies over a five year test period. The results of the analysis indicate that the total compensation for the CEOs of media companies is not correlated to the downward pressure on company performance. The performance variables of return on assets and total annual stock returns are insignificant in explaining CEO pay.

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Table 1

Companies in Sample
Cablevision Systems
CBS
CC Media Holdings
Charter Communications
Comcast
DirecTV
Walt Disney
RR Donnelly & Sons
Interpublic Group
McGraw-Hills Companies
News Corp
Omnicom Group
Time Warner

Table 2 - CEO Total Compensation for Media Industry

(in $millions)

	Mean	Median	Standard Deviation	Maximum	Minimum
2005	$ 10.8	$ 10.6	8.2%	$ 24.7	$ 0.9
2006	$ 15.3	$ 13.0	11.5%	$ 37.8	$ 0.9
2007	$ 18.5	$ 20.7	13.5%	$ 39.0	$ 2.6
2008	$ 17.1	$ 11.9	12.9%	$ 39.2	$ 4.2
2009	$ 12.1	$ 14.9	7.8%	$ 26.5	$ 1.5

Table 3

Average Total CEO Compensation by Industry For 2009

Industry	Total CEO Pay
Aerospace	$ 9.8 million
Banking	3.5
Business Services	6.3
Chemicals	6.0
Conglomerates	19.2
Construction	7.0
Consumer Durables	5.2
Diversified Financials	9.3
Drugs and Biotech	15.2
Food Drink & Tobacco	8.7
Food Markets	1.8
Health Care Equipment & Service	8.5
Hotel, Restaurant & Leisure	17.2
Household & Personal Products	8.0
Insurance	7.3
Materials	9.3
Oil & Gas Operations	16.8
Retailing	8.4
Semiconductors	5.7
Software & Services	4.5
Technology, Hardware & Equipment	5.7
Telecommunication Services	9.1
Transportation	5.6
Utilities	8.1
Media	$ 12.1 million
Average for All Industries	$ 8.9 million

Table 4 - Summary Statistics 2005-2008

Mean	Median	Standard Deviation

Tenure	7.8 yrs	4 yrs	8.3%
ROA	0.3%	3.03%	10.0%
Total Stock Returns	-8.7%	-9.1%	38.6%
Sales	$16.7 billion	$11.6 billion	$10.0 billion
Debt Ratio	24.8%	35.5%	31.8%

Table 5 Regressions Results

Dependent Variable – Log of Total CEO Compensation

	Regression 1		Regression 2	
	ROA as Performance Variable		Total Returns as Performance Variable	
	Coefficient	t-stat	Coefficient	t-stat
Constant	-4.331**	- 2.87	-4.205***	-2.72
Tenure	0.050***	4.12	0.052***	4.42
ROA	0.002	0.22		
Total Returns			0.004	1.62
Ln(Sales)	0.656***	3.89	6.888**	3.41
Leverage	-0.003	-0.01	-0.010	- 0.004
Adj. R^2	.37		.40	
N	65		65	

* Significant at an α = .05 ** significant at an α = .025 *** significant at an α = .01