

CEO Compensation and Firm Performance

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In this study, we investigate the relationship between CEO compensation and firm performance. The variables used for firm performance are ROA, ROE and profit margin. Sample data consists of 96 companies belonging to different business sectors in Malaysia. Our results are consistent with previous studies. ROA and ROE have a strong positive significant relationship with CEO compensation whereas profit margins also have a positive significant relationship but weaker than CEO compensation. We also discuss the role of corporate governance in reducing agency conflicts between higher management and shareholders.

Key words: *CEO Compensation, Firm Performance, ROA, ROE, Profit margin, Agency conflict, Corporate Governance.*

Introduction

A Chief Executive Officer (CEO) is the highest position in a firm appointed by the board of directors. Very often CEOs must play a mediating role between the management and the board of directors. As the CEO's incentive schemes are usually dependent on a firm's performance, they often make short-term decisions to enhance the firm's performance. They try to do this by employing earnings management practices to increase the short-term performance over the current period. This behaviour can be explained by agency theory. Shareholder interest would be in the long-term of the firm with significant profits whereas the CEO's usually focus on the current incentives (Sadiq et al., 2019). Shareholders don't have the complete information regarding all the investment decisions and business activities and, they don't understand all business transactions. The CEO knows what decisions will be taken to improve the performance of the firm and increase the shareholder's wealth. To overcome these kinds of issues corporate boards should be comprised of educated and capable directors



who can understand the CEO's decision making and monitor their activities. It is reported in previous studies that CEOs are often involved in pursuing risk taking activities that have costs greater than returns for their private gain. To resolve this issue, it is suggested that the CEO's remuneration policy should be designed in such a way that it aligns with the performance of the firm so that the ultimate beneficiaries' are the shareholders.

Prior research has found that, the average compensation package of a large firm's CEO was 46 times that of the average employee during the mid-80s. Over the next decade, during the mid-90s that figure increased to 90 times the average employee's pay. Then, over the period from 2000 to 2002, the average salary of CEOs increased tremendously and became approximately 541 times the average employee's salary. Previously, the survey conducted on the CEO's compensation policy used data obtained from the S&P 500 US companies. O'Connell et al. (2018) reported the average CEO's compensation is around \$11.5 million a year in 2010. It has been a controversial topic since then, as the public start becoming critical about this issue (Schofield-Georgeson et al., 2018). The High Pay Commission argued that as this compensation policy has increased over the last decades, this will create inequality in the economy. It creates a huge division amongst employees when higher management's compensation is compared with the lower level staff and results in resentment amongst them.

Usually, the corporate board decides to fire or retain the CEO after a fall of stock prices or sometimes bad accounting performances. It is a very important decision to remove a key position personnel immediately as he/she may have been working with the firm for a long period of time and possess all the secrets and confidential information of the firm. The expert's advice is that, when evaluating the performance of the CEO, the board and directors shouldn't take into consideration any aspect that is beyond the control of the CEO. In previous studies, it was argued that the CEO's compensation should be aligned with the performance of the firm (Hermalin et al., 2017). It has been observed that most CEOs are fired due to the poor performance of the company when compared to their competitors.

In the United States, the public criticises the high level of CEO's compensation and incentives and this results in optimal contracting in the competitive labour market for another managerial talent. Some people foresee that these large compensation packages will result in powerful managers, setting up their own remuneration packages and extracting money from firms. Managerial talent has increased very rapidly in recent decades. Economic liberalisation improved the compensation policies and empowered the managers to fight for their rights (Jindal et al., 2019). In this study, we try to show the nexus between CEO compensation and firm performance. Dimitrios et al. (2016), report that a firms' performance is positively linked to the CEO's compensation. In some jurisdictions, the disclosures about CEO compensation are not mandatory.



In Malaysia, the CEO of Genting Berhad is the highest-paid CEO in Malaysia (Sew et al., 2016) and receives RM80.6 million annually as compensation (Ng et al., 2015). The CEO of IOI Corp Berhad is the second highest-paid CEO in Malaysia with a compensation package of RM39 million according to publicly available data from 2018 (Fong et al., 2015). Ever since the compensation packages of CEOs became controversial (Van Essen et al., 2015) other researchers have discussed this issue and tried to explain that a firm's performance is not the only element which determines the CEO's pay package. There are many other factors that influence the remuneration package like firm size, market condition, firm's policy, competitor's action, etc.

However, this subject is still very much under researched in Malaysia. Prior research conducted in Malaysia has not focused on the direct relationship between the CEO's pay and firm performance. Most of our current literature is based on prior studies conducted in developed economies like the US and UK. One of the prior studies suggests that a significant factor in determining CEO pay would be the firm size (Oberholzer et al., 2015). Irani et al. (2017) report that in China the CEO pay was restricted to a maximum of 10% of the corporate earnings during 2001-2003. Only 20% could be increased and that has to be explained by the growth in the firm's size and performance.

Literature Review

Corporate governance plays an important role in enhancing transparency of the firm's performance regarding shareholder security. In 2002, the regulatory body in the UK introduced the CEO pay report to monitor the investor's power and compare it with the director's pay. Likewise, in 2003, the Australian Securities Exchange (ASE) amended the disclosure policy regarding CEO pay to enhance transparency to the public. Suitably qualified management with the relevant skills will guide the firm to perform better. Agency conflict also exist in this literature between the interest of managers and the shareholders. Strong corporate governance structures can help resolve this issue by restricting the management to work in favour of shareholders.

As discussed earlier, there is a lot of literature available on this topic utilising data from the US and UK. The UK literature on the compensation of CEOs was limited as they only focused on the cash component. Ntim et al. (2015) used the company's data from 1988 to 1993, consisting of 213 large UK companies, where he considered the cash compensation and presented it to the remuneration committee. The results were not strong and there were mixed findings.

It is commonly understood that a CEO's pay will increase in tandem with the performance of the firm. Usually, firms use the performance base incentive policy. Therefore, CEO pay has a

positive relationship with firm profitability. Fallatah et al. (2015) explains that Return on Equity (ROE) is the best measure to find the relationship between CEO pay and firm performance. However, in Malaysia, due to the uncertainty which exists regarding which aspect of the compensation package is to be used, people haven't done much research on the relationship between CEO pay and firm performance.

CEO Compensation and Firm Performance

Over the last two decades it has become increasingly apparent that top management is overpaid (Martin et al., 2019) and as a result CEO pay has become a very controversial topic for the corporate world (Gill et al., 2018). Over the past 20 years, it has become apparent that the increased compensation of CEOs was the most discussed topic in the public and had a tremendous effect on the average employee and the shareholders. Van Essen et al. (2015) mentioned in his study that the public has an opinion that the CEO pay shouldn't only be tied up with firm performance. There are other factors that may impact the compensation package. SEO et al. (2015) suggested that CEO pay shouldn't be linked to stock price because there are many techniques to temporarily boost stock prices such as earnings management and, in some cases, even ending up as fraudulent behaviour.

Malik et al., (2019) suggests that the pay component of the compensation package may be designed in such a way that motivates the CEO to work in the favour of shareholders and discourage risk taking activities that may put the firm into problems which adversely affect the firm's performance. Fondas et al. (2017) explains that the CEO may attract incentives such as stock options, cash bonuses, performance bonuses and stock ownership, and can engage in activities that can create increased risk for the firm. Tripathi et al. (2018) also suggest that some of the CEOs focus on short-term returns instead of long-term returns that can be damaging for the firm.

Different studies have different suggestions depending on the region from where the data is collected. Some studies suggest that the interest of shareholders and management can be aligned by offering the stock to the management at attractive prices or in terms of incentives and make them the owner of the company. Rolle et al. (2016) illustrate the benefits of aligning the CEO pay with company performance. He demonstrated that if the CEO is not the sole owner of the firm than he will have the incentive to take actions in such a manner that reduces the firm's value. In addition to that, Al-Najjar et al. (2017) demonstrated that long-term incentive policies are smaller in quantum but greater in terms of an increase of equity whereas the short-term incentive policy is usually for the present only and sometimes leaves the firm stuck in problems.

The sensitivity of performance-related pay incentives has been the focus of many prior studies. The sensitivity of performance-related pay is defined as the degree of change in the wealth of shareholders and the CEO. The objective is to encourage the CEO to work in the best interest of shareholders. This will enable the firm to stand strong and fight for survival in the competitive capital market. Those firms who fail to design the CEO compensation policy and to align it with the interest of shareholders may bear higher costs and face obstacles in the long run compared to those firms whose managers are working for the interest of their shareholders. (Melsom et al., 2016) proposed that the sensitivity of performance-related pay be identified by analysing the change in shareholder's return with the change in CEO remuneration.

Previously many studies have found a positive relationship between firm performance and CEO compensation. Kaur et al., (2018) explained the relationship between firm performance and the stock owned by the CEO. The more the stock owned by the CEO the better the performance would be. Stock ownership by the CEO aligns the interest of the CEO and shareholders, which results in the reduction of conflict of interest and minimises the principal-agent conflict. (Matousek et al., 2016) found that an increase of a one percent in CEO pay results in an increase of around ten percent of the firm's value. In the same way Raithatha et al., (2016) found a positive relationship between CEO compensation and the company's worth. They found that a CEO earns an extra US\$0.026 as salary for every US\$100 increase in the companies' worth. They also report that the salary and bonus both will change by US\$0.002 on every positive change of \$100 and the total compensation on average would be increased by 0.003 on every positive change of \$100 in shareholder's wealth. These results show that the relationship between CEO pay and firm performance is positive but not attractive in terms of dollar value for the CEO. These results also show that the remuneration policy for the CEO is very weak and they are not getting what they deserve. As with the earlier studies, these results only reflect the amount of the direct pay incentive.

Sew et al., (2016) discussed the CEO Incentive policy in an environment where the activity of setting prices for products is influenced by government regulatory bodies and is based on sales maximisation instead of profit maximisation. In China, managers are not punished by the board for making negative profits or decreasing the profit and are neither rewarded for the increasing profit where the sales growth is declining (Setiawan et al., 2017). Their incentive policy is based on incremental sales.

Buigut et al., (2015) argued that CEO compensation may be enhanced by positive firm performance but it does not have a significant impact on CEO pay, further he argued that larger business groups have the capacity to appoint better qualified and experienced managers as compared to small companies. Moreover, firms with the director's ownership create

greater confidentiality issues for managers and enable the directors to enhance their wealth (Sadiq et al., 2019).

Conflict of Interest

Conflict of interest issues arise where the principal-agent relationship exists. This theory (also known as agency problem) is defined as the relationship of two people in which one is the entity (the principal) and the other is a person or entity (the agent) who takes actions or makes a decision on behalf of the Principal. Agency relation will appear when the firm hires a person or company to perform business activities on behalf of the principal.

(Mukherjee et al., 2018) explained the principal-agent theory as the conflict that exists between the managers and the shareholders for their own benefits. Sometimes the benefits fall in a different direction for both and the managers have the authority to make decisions on behalf of the firm. (Mukherjee et al., 2018), explained that ownership structure also plays an important role in the development of agency conflict as it creates mismanagement that results from the negligence of other staff. Usually in these kind of cases managers came from the family and friends that create incompetence and allows the firm to lose control. Moreover, negligence arises due to mismanagement by the managers as they are unaware of the operation and have no idea how to run the business. Control can be explained by the procedure of checking that creates visibility and transparency in the business transaction to save the firm from fraud. It is also the factor that positively influences the principal-agent problem (Hitt et al., 2018). Sikavica et al., (2015) explained the difference between ownership management and ownership control. From this it was found that it is management's responsibility to set up strong and strictly controlled corporation under the umbrella of strong corporate governance.

In the business market, agency conflict arises mainly between equity holders and managers and between debt holders and equity holders. Such conflicts always create problems for both the principal and the agent. This kind of conflict affects corporate governance and becomes the reason to diminish the company's image in the market.

In organisations where agency conflict exists, the agency bears the cost in an effort to minimise the conflict. Bonuses and incentives are the kinds of agency costs used to minimise conflict due to the relationship of principal and agent. Extra incentives and bonuses motivate the management to work in a direction that is favourable for the shareholders. Some other studies also suggest the remedy of a principal agent problem by linking the CEO's pay, such as bonuses, restricted stock and stock options with the performance of the firm (Malik et al., 2019). There have been many prior studies that tried to find solutions to the principal-agent problem however this issue still exists in different forms.

Duru et al. (2016) argued that since managers don't have complete ownership of the firm hence, they don't get the total income gained by the firm, they don't put their best efforts to increase the firm performance. It is observed that as a result of the agency problem, both parties are always trying to maximise their own interest.

Sheikh et al., (2018) argued that managers used to invest the companies' reserves in some risky projects that are not suitable for investing. That may be reserved for financing the firm's cash flows and bring a positive impact for shareholders. It can also be used to give dividends to shareholders instead of investing in high risk low return projects. To make sure that managers are working in the right direction, the firm must establish monitoring activities at a cost.

Haug et al., (2018) explained that there are two main stakeholders, the lenders and the shareholders whose interests cannot be compromised by weak corporate governance structures. Ultimately corporate governance is all about maintaining the shareholders' interest and saving their financier's money. The ideal condition would be when debt over equity ratio is in a healthy position and increasing, the shareholders are satisfied with the efficiency and effectiveness of managers. In this situation, the excess cash flow returns all realised debts to shareholders and the running costs and future projects would be in a positive NPV.

Corporate Governance

Strong corporate governance structures are an important aspect of governance to maintain the shareholder's wealth and act as early warning system to keep the firm out of danger. Saha et al., 2018 noted that there is a big difference between Western countries' and Asian countries' business structures in terms of the relationship between corporate governance and firm's stock value. Their analysis indicates that the western world has a strong practice of corporate governance whereas Asian countries have very weak practices. In Asia, there are very few countries that have strong corporate governance practices like Malaysia, Indonesia, Singapore, and Thailand. Previous empirical analyses also showed that the lower the standard of governance the stronger the association of governance and firm value.

Boling et al., (2016) mentioned in their study that the previous researchers indicated that the effectiveness of the board mainly depended on the autonomy of the board members. An effective board helps the firm to reduce the probability of financial fraud. It was also observed that non-financial reporting fraud is lower if the proportion of outside independent directors on the board is significant. The positions of CEO and the chairman of the Board shouldn't be held by the same individual since both positions are important and if the same individual occupies both positions he/she may be motivated more by self-interest rather than

the best interests of the whole firm (Boling et al., 2016). Boling et al., (2016) explained in the board size results that the board size is inversely proportional to the profit. If the board size is bigger the profit would be lower.

Research studies have not found any relationship between corporate governance and firm performance (Arora et al., 2016). However, another study investigated the association of corporate governance and firm performance; they found the relationship was positive (Arora et al., 2016). There are many reasons for these results. Sometimes the data collected from the public survey is not authentic or has a limited scope. There are some other tools that are driven from accounting like earnings per share (EPS), return on asset (ROA), return on capital employed (ROCE), return on equity (ROE) however, the problem is that these tools are not enough to measure the performance of the firm (Jermias et al., 2018). A few years back the Australian Security Exchange (ASX) reformed the Corporate Governance with greater disclosure of CEO remuneration packages and reinforced it to the firms (Nelson et al., 2018). Nelson et al., (2018) also discussed that the disclosure of the compensation of all the newly appointed CEO becomes mandatory in 2003 for all the listed companies.

Effective corporate governance played a vital role in the performance of the firm and increased the stock value in the market. But there is still a missing factor. As previous studies showed, various results related to corporate governance and firm performance where it could be significant or non-significant and positive or negative, depending on the sample data. Past research demonstrated that effective corporate governance bound the CEO to perform in favour of the firm that results in an increase in performance.

Hypothesis

The empirical research evidence between the relationship of CEO compensation with firm performance showed scattered results. According to agency theory, the association between CEO compensation and firm performance played an important role for the corporate success. One of the studies from the United States had an empirical results that showed the significant relationship of CEO pay and firm performance (Ntim et al., 2019). By aligning the managerial interest with shareholder interest, the firm can minimise its agency cost and receive a positive feedback from both parties. (Al Shammari et al., 2018) argued that the performance of the company directly related to the compensation of managerial staff. (Al-Najjar et al., 2017) discussed that stock return and operating performance can be affected by excessive CEO compensation. (NELSON et al., 2018) showed evidence of research in Malaysia in which the remuneration of directors significantly related with the return on asset (ROA). (Oberholzer et al., 2015) showed that return on equity (ROE) which is the performance variable has a positive and significant relation that is based on the relationship of CEO pay and firm performance. Profit margin which is also known as return on sale can

be calculated by dividing the net profit with the revenue. Therefore, we believed that Malaysian companies have a significant relationship between CEO pay and profit margin, ROE and ROA. So, the study proposed the below hypothesis.

- H1
 - i. CEO compensation and ROA has a significant relationship
 - ii. CEO compensation and ROA has no significant relationship
- H2
 - i. CEO compensation and ROE has a significant relationship
 - ii. CEO compensation and ROE has no significant relationship
- H3
 - i. CEO compensation and profit margin has a significant relationship
 - ii. CEO compensation and profit margin has no significant relationship

Methodology

Data Sample

For this study, we collected the data from the non-financial companies listed on Bursa Malaysia during the financial period of 2011 to 2016. These firms belong to six non-financial business sectors, listed on Bursa Malaysia namely, the Construction sector, the Health care sector, Hotel sector, Properties sector, Utility sector, and Plantation sector. This data does not include the information of financial institutions because it does not meet the criteria for empirical analysis. Bursa Malaysia has more than 900 companies listed on it. We took 96 listed companies from the different business sectors. Financial institutions and the firms who haven't provided a complete annual report and those firms whose data is missing for the study variables are not included in our study as followed by previous researchers.

CEO's Compensation

To analyse the performance of the firm concerning the CEO's compensation, we collected all the data from the annual reports of the firms. CEO compensation mainly included salary, bonus, allowances, rents, fees, credit card bills, and other incentives.

In this study, our objective was to compare the CEO pay with the total remuneration of executive directors. We will only consider the average level of compensation for the CEO, which is usually in the form of cash and described as salary and other direct compensation. Whereas the direct compensation includes salary, bonus and share options.

Firm's Performance

As mentioned above, in this paper we measured the firm performance through profitability ratios including return on asset (ROA), return on equity (ROE) and profit margin ratio. Jong et al., (2018) mentioned the relationship of CEO pay and firm performance in his study. According to previous research CEO pay helps to resolve the problem of agency theory. Aligning managerial incentives with shareholder interest is the best way to resolve the agency issue.

Regression Model

The appropriate model used to test H1 is as under:

Eq 1: The link between CEO compensation and ROA

$$(ROA)_f = \alpha + \beta \log(CEO_COMP)_f$$

The above equation 1 represents the first hypothesis H1. This equation is used to find the relationship between CEO compensation and ROA where alpha is a constant.

EQ 2: The link between CEO compensation and ROE

$$(ROE)_f = \alpha + \beta \log(CEO_COMP)_f$$

The above equation 2 represents the first hypothesis H2. This equation is used to find the relationship between CEO compensation and ROE where alpha is a constant.

EQ 3: The link between CEO compensation and profit margin

$$(PM)_f = \alpha + \beta \log(CEO_COMP)_f$$

The above equation 3 represents the first hypothesis H3. This equation is used to find the relationship between CEO compensation and profit margin where alpha is a constant.

Results

Descriptive Analysis

Table 1 below shows the descriptive analysis for the dependent variable that is firm performance where the independent variable is CEO compensation during the period 2011 to 2016 for those companies that are listed on Bursa Malaysia. The results explain the

independent variable as it has a mean value of 14.03 that has an amount of RM 1,856,789. It shows that from 2011 to 2016 the CEO pay of the selected 96 companies has a mean of RM 1,856,789. The median of the independent variable reported being 14.13 with the compensation value of RM 1,356,968. Apart from all that, the maximum value of an independent variable is 17.01 which would be equal to RM 25,258,256 whereas the minimum amount is 9.49 and that would be the lowest Compensation of CEO which is equal to RM 14,000. Standard deviation is used to show the variation exists in the results from the average. Table 1 below shows that the standard deviation of CEO compensation is 0.99 and the value is RM 2,019,753.

In Table 1 below, the results of the dependent variable also summarised. The descriptive analysis shows the mean value of ROAf, ROEf, and PMf are 0.06, 0.1 and 0.06 respectively. This indicates that ROEf has an increment of 4% as compared to ROAf and PMf. The median of dependent variables is 0.06, 0.09 and 0.06 respectively. Therefore, ROEf has the highest value which is 0.09. The maximum value of ROAf, ROEf, and PMf are 0.59, 2.13 and 2.72 respectively. Whereas the minimum values of ROAf, ROEf, and PMf are -0.43, -0.92 and -0.51 respectively which shows that the Profit margin has the lowest value. The maximum and minimum amount of profit margin has the highest and lowest and the standard deviation of PMf is also the highest value that is 0.26 that demonstrates that it has the highest variance amongst the dependent variable.

Table 1: Descriptive Analysis

Variable	Obs	Mean	Med	Max.	Min.	Std. Dev
Dependent						
ROAf	380	0.06	0.06	0.59	-0.43	0.097
ROEf	380	0.1	0.09	2.13	-0.92	0.25
PMf	380	0.06	0.06	2.72	-2.51	0.26
Independent						
CEO COMP	380	1,856,798	1,356,968	25,258,256	14,000	2,019,753
log CEO COMP	380	14.03	14.13	17.01	9.49	0.99

Correlation Analysis

Table 2 below contains the results of the Pearson correlation analysis. Pearson correlation analysis is used to find the correlation between the dependent variable and the independent variable. Table 2 represents the correlation analysis of 96 companies listed on Bursa

Malaysia. Results obtained from the correlation are positive and significant and also indicate that CEO compensation is strongly correlated with ROAf and ROEf with the coefficient value of 0.345 and 0.312 respectively. However, the relationship of CEO compensation and profit margin is weak with the coefficient value of 0.081.

Table 2: Correlation Analysis

Variable	CEO Comp	ROA	ROE	Profit Margin	significance
$\beta \log_{ROI}(\text{CEO_COMP})_f$	1	0.345**	0.312**	0.082*	
ROAf	0.345**	1	0.878**	0.512**	0.000
ROEf	0.312**	0.879**	1	0.337**	0.000
PMf	0.081*	0.552**	0.337**	1	0.080

* Significant at the 5% level, ** significant at the 1% level

Regression Analysis

In this study, we have 3 dependent variables (ROAf), (ROEf) and PMf and 1 independent variable CEO compensation. Tables 3.1, 3.2 and 3.3 below are shown with the regression model that will be used to test our hypothesis H1, H2, and H3.

Table 3.1: Regression analysis for Eq 1 (ROAf)

Variable		Coefficient	t-statistic
C		-0.433**	-7.213
$\beta \log_{ROI}(\text{CEO_COMP})_f$		0.036**	8.01
Adjusted R ²		0.199	
F-statistic		68.104	
Prob (F- statistic)	0.000		
Observation		480	

* Significant at the 5% level, ** significant at the 1% level

Table 3.1 above contains the regression results of CEO compensation as an independent variable and ROA as the dependent variable. The t-statistic for slope was 0.05 critical alpha level, $t = 8.01$, $p < 0.05$. Therefore, in H1, we accepted the first hypothesis that is CEO pay has a significant relationship with ROA and rejected the second hypothesis that is CEO pay has no significant relationship with ROA. Earlier studies by Patel et al., (2018) showed the positive relationship between CEO pay and ROA which is consistent with our findings.

Table 3.2: Regression analysis for Eq 2 (ROEf)

Variable		Coefficient	t-statistic
C		-0.997**	-6.831
$\beta \log_{10}(\text{CEO_COMP})f$		0.079**	7.458
Adjusted R ²		0.098	
F-statistic		54.504	
prob (F- statistic)	0.000		
Observation		480	

* Significant at the 5% level, ** significant at the 1% level

Table 3.2 above contains the regression results of CEO compensation as an independent variable and ROA as the dependent variable. The t-statistic for slope was 0.05 critical alpha level, $t = 7.458$, $p < 0.05$. Therefore, in H2, we accepted the first hypothesis that is CEO pay has a significant relationship with ROE and rejected the second hypothesis that is CEO pay has no significant relationship with ROE. Earlier studies by Oberholzer et al., (2015) found a positive relationship between CEO pay and ROE which is consistent with our findings.

Table 3.3: Regression analysis for Eq 3(PMf)

Variable		Coefficient	t-statistic
C		-0.253	-1.502
$\beta \log_{10}(\text{CEO_COMP})f$		0.023*	1.932
Adjusted R ²		0.006	
F-statistic		3.413	
prob (F- statistic)	0.073		
Observation		480	

* Significant at the 5% level, ** significant at the 1% level

Table 3.2 above contains the regression results of CEO compensation as an independent variable and ROA as the dependent variable. We performed the regression of 96 companies over a period of 5 years and results show that the t-statistic for slope was 0.1 critical alpha level, $t = 1.932$, $p < 0.07$. Therefore, we concluded that there is a weak but positive relationship between CEO compensation and profit margin in H3. We accepted the first hypothesis that CEO pay has a significant relationship with profit margin and rejected the second hypothesis that is CEO pay has no significant relationship with the profit margin. Earlier studies by



Saidu et al., 2017 found a positive relationship between CEO pay and ROE which is consistent with our findings.

Conclusion

The conflicts between top management and shareholders can be explained by agency theory. It is suggested by prior research in corporate governance that this conflict can be mitigated by enhancing the compensation package of top management and aligning the benefits of top management with the shareholder's interest. CEO pay plays a vital role in the development and performance of the firm. It has been shown in our study, that CEO pay is tied to firm performance. In our study, we employed three independent variables return on asset (ROA), return on equity (ROE) and profit margin (PM) and found that all the results are significantly positive. Return on asset (ROA) and return on equity (ROE) have a strong positive relationship while profit margin also has a positive relationship albeit weaker. We developed three hypotheses to prove that CEO compensation relates to firm performance and each hypothesis consists of two statements, one was favourable and the others were unfavourable. All the unfavourable statements were rejected. These results are consistent with most previous studies.



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