How non-monetary characteristics of firms affect CEO compensation

It is not the CEOs of the most prestigious firms who receive the highest financial rewards. Rather, CEOs accept lower salaries in favor of public recognition and future career benefits that come with the employment in a widely admired firm.

CEO compensation is a hotly debated topic in business research. Empirical studies suggest that “superstar CEOs” often receive much higher pay than their less famous peers. A related question, which has not yet been asked is whether “superstar firms” pay their CEOs more or less than other firms. Being at the helm of a widely admired firm rewards the CEO with prestige, and possibly also with bright future career prospects. In an empirical study using US data, Florens Focke, Ernst Maug, and Alexandra Niessen-Ruenzi test whether CEOs of superstar firms are willing to accept lower pay in return for the non-monetary benefits that come from being the CEO of a superstar firm.

They identify superstar firms as those firms appearing in Fortune’s “America’s Most Admired Companies” list, which is published annually by the renowned US business magazine Fortune. They further obtain data on the remuneration of US executives. The results imply that firm prestige indeed has a negative impact on CEO compensation. CEOs of firms included in the „Most Admired Companies” list receive approximately eight percent less pay than CEOs of non-ranked, but otherwise comparable, firms.

CEOs sacrifice some salary for improved social status and future career benefits

The authors propose two potential explanations for their finding. First, CEOs of superstar firms may be willing to work for less because they value the enhancement of their social status and prestige that comes with their position. Second, being at the helm of a superstar firm may improve the future career prospects of the CEO and may thus result in higher income in future jobs. Thus, the CEOs may be willing to sacrifice some current salary for these future benefits.

To explore the first explanation, data on social status preferences is required. The authors obtain state-level data on status preferences from the General Social Survey (GSS), a regular survey of values held by the US population. Analysis of these data reveals that the relation between firm prestige and CEO pay is indeed stronger in states where preferences for status are more pronounced. This finding implies that the lower pay of CEOs of superstar firms is at least partially compensated by the non-monetary benefit of higher social status.

To explore the second explanation, the authors collect data on CEOs’ employment after their tenure as CEO of a superstar firm. They are indeed more likely to obtain board seats and executive directorships than former CEOs of otherwise comparable non-superstar firms. The authors estimate that the future career benefits account for about half of the reduced pay the CEOs of prestigious firms accept during their tenure at those firms.

Strong boards of directors are able to induce CEOs to accept lower pay

Obviously, even CEOs of superstar firms prefer more money to less, and will therefore not voluntarily make salary concessions. CEO compensation is determined in a bargaining process between the prospective CEO and the board of directors of the firm. The authors of the paper hypothesize that stronger and more independent boards are more likely to extract pay concessions from a future CEO. They collect data on board composition and find that, indeed, strong and independent boards are better able to induce CEOs to accept lower pay for the benefit of working for a prestigious firm.

Another channel the authors explore is public attention. The media probably pay more attention to
CEO salaries at firms ranked in the most admired companies list. The anticipation of negative publicity may induce boards not to grant the CEOs excessive salaries. The authors obtain a measure for the visibility of firms, the number of articles in four national newspapers mentioning the firm, but do not find that the visibility of the firm affects the relation between firm prestige and CEO pay. Thus, while board composition and structure seems to matter for the pay-setting process, media attention apparently does not.

The punchline of the article is that prestige improves the bargaining power of the firm vis-a-vis the CEO. Prestigious firms can offer their CEOs lower remuneration by factoring in the non-monetary benefit of social status and the value of the future career benefits that working for a superstar firm entails. Potential CEOs, on the other hand, should anticipate that they may earn less when working for a superstar firm. Consequently, those solely looking for the highest financial rewards may choose to work for less prestigious employers.


ABOUT ALEXANDRA NIESSEN-RUENZI

Alexandra Niessen-Ruenzi is Professor of Finance at the University of Mannheim. Her research interests are in the fields of corporate governance, corporate finance, and mutual funds. A special focus is on gender differences on financial markets. Professor Niessen-Ruenzi’s research has appeared in top ranked academic journals such as Journal of Financial Economics, Review of Financial Studies, and Management Science. She holds a PhD in Finance and has been a visiting scholar at several renowned institutions such as Kellogg School of Management, Northwestern University, and Haas School of Business, UC Berkeley.
Digital tax index shows that Germany trails behind

Germany’s tax environment is unattractive for investments in digital business models. The reasons are high tax rates and a lack of incentives for investments in innovation.

In 2015, more than 70 billion Euros were invested in information and communications technologies in Germany and the trend is upwards. Prospering digital business increases productivity and represents an important factor for economic growth. Germany has a very good standing as a location for investments. A recent study by the consulting firm A.T. Kearney ranks Germany as the world’s second attractive country for investments, topped only by the US and followed by China.

However, the conditions for investments in digital business are not at par with those for investment in general. A study by the University of Mannheim, joint with the Centre for European Economic Research (ZEW) and supported by the accounting firm PricewaterhouseCoopers (PwC), concludes that, in terms of taxation, Germany trails behind. German tax regulation comprises high tax rates and does not offer significant tax incentives for investments in digital business. The result is a very high effective average tax rate of more than 22 percent. In contrast, some other countries provide tax incentives that result in negative effective tax rates, i.e. an effective subsidization of investments in digital business models.

International expansion strongly depends on the attractiveness of the tax environment

In their study “Steuerliche Standortattraktivität digitaler Geschäftsmodelle” (Locational Tax Attractiveness for Digital Business Models, short: Digital Tax Index) the authors examine the attractiveness for digital investments of the tax system in 33 countries. While previous research has shown that there are important differences in relevant aspects of the taxation rules, the present study is the first quantitative study in the field that takes the impact of taxation explicitly into account. It thereby closes an important research gap. According to the study which was led by Christoph Spengel, the decision where to locate an investment can have important implications for the tax burdens of companies with digital business models. The findings of the study also have important implications for fiscal policy because the design of the tax system may have implications for the investment decisions of digital firms.

One main objective of the study is to create a digital tax index for the year 2017, based on the international tax legislation effective in the fiscal year 2016. With their index the authors intend to establish a valid and objective measure that allows for international comparison of taxation rules. It calculates the effective tax burden as well as the cost of capital for investments in digital business models based on domestic and international factors for 33 countries, including the EU member countries as well as Japan, Canada, Norway, Switzerland and the United States. It serves as a benchmark for decision makers in policy and business, helping them to assess the tax environment during the ongoing digitalization of the economy.

German tax regulation does not offer relevant tax incentives for investments in digital business

Ireland, a country known for low corporate tax rates, is heading the index list. However, even countries with moderate or even high tax rates, such as
Italy, Hungary, Belgium and Norway, hold good positions in the ranking. These countries offer tax rebates for research and development of digital companies, and they tax profits from intangible assets at more favorable rates. Other countries subsidize computer hardware or have advantageous depreciation rules for tax purposes. Germany currently does not apply any of these incentives. Together with the US (rank 32) and Japan (rank 33), Germany (rank 31) is at the bottom of the list.

Tax incentives for research, development and innovation have a particularly strong impact on the effective tax burden of digital companies since these firms invest in innovation. The country-specific design of such special tax regimes and the extent to which the rules are applicable to digital business models are therefore highly relevant. Similarly, generous depreciation rules for digital capital goods (as in effect in Denmark and France) can favorably affect the cost of capital and, in consequence, the attractiveness of a location for digital business models.


ABOUT CHRISTOPH SPENGE

Christoph Spengel is a Professor for International Taxation at the University of Mannheim and a Research Associate at the Centre for European Economic Research (ZEW). Moreover, he is appointed member of the Scientific Council of the Federal Ministry of Finance, international research fellow at Oxford University, Said Business School, appointed member of several expert groups on company taxation headed by the European Commission, member of the Scientific Tax Council at Ernst & Young and Academic Director of Mannheim Master of Accounting and Taxation at Mannheim Business School. His main research interests are in the areas of international taxation, company taxation in the European Union, financial and tax accounting, and innovation and taxation.
How to leverage the potential of startup suppliers?

Collaborations between buying firms and new venture suppliers require specific management capabilities. Certain practices help “big players” and startups to streamline their business relationship.

Many studies in management research investigate the relationships between buying firms and their suppliers. As the speed of innovation is accelerating, scholars are focusing on a new stream in this field of research at the intersection of supply chain management and entrepreneurship. They try to understand and improve buyer-supplier relationships between established firms and new entrepreneurial ventures. Together with two co-authors, Christoph Bode has published a study generating a set of propositions how buying firms should approach and integrate new venture suppliers in order to tap their performance potentials. They argue that the standard purchasing processes are often not adapted to the needs of new venture partners, and therefore are too rigid for the specific requirements of startups.

Young organizations have competitive disadvantages in the market. They possess fewer routines and fewer resources than incumbent suppliers do. Furthermore, they have to learn new roles as social actors and suffer from a low level of legitimacy, as they do not have a proven track record of accomplishments. These circumstances make the formation of buyer-supplier relationships with new ventures more uncertain. In addition, suppliers that are new to the market often do not feel treated on equal terms, and they may struggle with inflexible requirements imposed on them by incumbent firms.

Buying firms can accommodate specific demands of new venture suppliers

Bode and his co-authors suggest that buying firms should develop supply-chain-related capabilities to accommodate startup-specific demands and thus leverage the potential of the new venture-suppliers. The profit would be on both sides: On the one hand, purchasing firms could stimulate their own future business growth by providing innovative products and progressive technology. On the other hand, new venture suppliers benefit from the business relation with a renowned company. They get an entry to the market, enhance their financial performance, and strengthen their competitive position.

The authors call the capability to consider new ventures’ organizational features and manage these suppliers adequately “new venture partnering capability”. It reflects the buying firm’s capacity to gear its supplier management – evaluation, development, communication, and governance – towards new ventures. Previous experience with new venture suppliers and sufficient resources for the management process are a good foundation for high new venture partnering capability. However, buying
firms must complement these preconditions with the willingness to adjust their current procedures actively.

The study determines a set of success factors that are likely to play a key role in leveraging the capabilities of new venture suppliers. It derives practical implications for both established buyers and new venture supplying firms. The recommendations are based on the assumption that buyer-supplier relationships between established firms and new ventures differ significantly from buyer-supplier relationships between two established firms.

Commitment and flexibility on both sides

Assessment agility is one of six key success factors Bode and his co-researchers identify. Firms should select their business partners carefully and put emphasis on compatible strategic orientation. Furthermore, high commitment and flexibility on both sides help to overcome differences in the needs of the partnering firms. The study also reveals that new ventures require a certain degree of freedom to perform effectively. Buying firms should find a balance between contract-based agreements that provide some legal protection and trust-based relationship management.

Moreover, the study shows that successful new venture partnering is also a matter of frequent and appropriate communication. Experienced buyers should refrain from aggressively exercising power over the new venture. Both sides should value the benefits of a fruitful collaboration and demonstrate a “give-and-take” mentality. The reward would be a strengthening of both the buying firm’s and the supplier’s competitive positions.


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Christoph Bode is a Professor and holds the Endowed Chair of Procurement at the University of Mannheim. His research interests lie in the areas of procurement and supply chain management with a special focus on risk and disruptions, interfirm relationships, innovation, and sustainability. His research in these areas has been published in leading journals, such as the Academy of Management Journal, Journal of Operations Management, or Organizational Research Methods. Prior to joining the faculty in Mannheim he was affiliated with Tilburg University and with ETH Zurich.