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## CEO Pay: Changing Sensitivities Across Tenure Levels

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## CEO PAY: CHANGING SENSITIVITIES ACROSS TENURE LEVELS

Research that will appear later this year in the *Journal of Management* shows that CEO pay sensitivity is closely related to the CEO's tenure within the firm. As CEO tenure increases, the relationship between the CEO's variable based pay and future firm performance decreases, but the relationship between salary and future firm performance increases. Specifically, bonus pay was positively associated with shareholder return for the CEO's first nine years and negative thereafter; and salary was negatively related to shareholder return during the first three years, and positively related to shareholder return after the CEO had been with the firm for nine years.

### Key Takeaways:

- CEO sensitivity to pay type changes with tenure.
- The value of performance-based compensation declines with CEO tenure. For the first three years of a CEO's tenure, stock options are positively related to firm performance
- The benefits of salary based pay increases with CEO tenure. For the first nine years salary is negatively associated with shareholder return, however after twelve years, the CEO's salary is positively associated with firm performance.

Using data on CEOs in S&P 500 companies between 1998 and 2005, researchers found that stock options are positively related to firm performance for the CEO's first three years, but are likely to have a negative return in year six and later. Additionally, CEOs receiving high bonuses were associated with firms with greater shareholder return than those receiving low bonuses for the first twelve years of their tenure,

but not thereafter. In contrast, salary was negatively associated with shareholder return for the first three years of a CEO's tenure, but positively associated with shareholder return after nine years of a CEO's tenure.

The research team also performed robustness tests by examining curvilinear interactions, but did not see any differences in results. The team also found that CEO salary deviations were unrelated to the results. Similarly, controlling for restricted stock also did not alter their overall conclusions.

Their analysis statistically controlled for environmental factors (e.g., industry, year), firm factors (e.g., firm size, firm volatility, prior firm performance), and CEO factors (e.g., CEO firm-specific wealth, CEO salary deviations from the average, CEO age, CEO gender, and CEO role on the Board), because each of these factors has been shown to affect firm performance.

Source: Hou, W., Priem, R. L., Goranova, M. (In press). Does one size fit all? Investigating pay-future performance relationships over the "Seasons" of CEO tenure. *Journal of Management*, In Press.



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