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CEO compensation and characteristics of the boards of directors in European public utilities of the energy sector

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Abstract

The recent corporate scandals and the rise of financial crisis have led up to the light the issue of corporate governance and CEO compensation. Researchers, business people and politicians have focused on this topic analyzing the elements that can increase firm and social wealth, give incentives and reduce agency costs between managers and shareholders.

Although most of the studies focus on unregulated firms, this topic is more controversial and interesting in public utility case. After the privatization, most of public utilities listed, opening their capital to private investors that want that firm maximizes shareholder wealth. Nevertheless, these companies still work in a regulated environment which creates constraints on their behaviours and their governance. Moreover, directors have relationships with governments and politicians that can distort their decisions.

Using a unique dataset that includes governance, financial and market regulation variables I study corporate governance and CEO incentives in the energy sector.

The first chapter analyses the determinants of CEO compensation. In theory, the variable part of CEO compensation is an instrument that better aligns CEO interests with those of the shareholders. Contrary to the previous studies in unregulated case, I find a negative relation between the number of independent directors and the variable part of CEO compensation. This conclusion leads to deepen the role of independent directors. Since independent directors do not have connections with the company, they should be particularly effective in controlling CEOs' actions, avoiding rent expropriation.

The second chapter analyses the effects of board composition on firm performance, growth and dividend policy. I find that greater board independence reduces future firm performance and does not affect firm growth and dividends policy.

The third chapter examines CEO pay for performance sensitivity across regulated and unregulated firms within the energy sector. The study analyzes also the effect of different regulatory frameworks, in order to understand if external (regulation) and internal (compensation) incentives are powerful mechanisms that motivate CEOs.

1. The determinants of CEO compensation in the public utilities of the energy sector: An empirical analysis*

Abstract

Most empirical studies have examined the determinants of CEO compensation in unregulated firms in US. This paper analyses the determinants of CEO compensation, considering listed energy utilities of Italy, Spain and United Kingdom. Consistent with the previous studies the results show that the board size affects positively the variable part of CEO compensation and CEO total wealth, suggesting that larger boards are more susceptible to the influence of the CEO. Contrary to previous studies on unregulated firms, I find a negative relationship between the number of independent directors and the variable part of CEO compensation as well that the number of insider directors does not affect CEO compensation. Specifically, the results show that an increase in the number of independent directors leads to a decrease in the level and in the change of the variable part of CEO compensation, and in the level of total CEO wealth. These findings are consistent with the view that independent directors are more effective than other directors in monitoring CEO and in avoiding CEO rent extraction and excess CEO compensation. But, at the same time, they prefer to set a compensation that is less tied to firm performance and bonus.

JEL classification: G30; J33; L95
Keywords: Corporate governance; CEO compensation; Board-of-directors; Public utility

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2. The effectiveness of independent directors is not an issue of numbers: the case of energy utility in Europe[*]

Abstract

The introduction of corporate governance codes in Europe has stressed on the importance of boards of directors dominated by independent directors. Many commentators and institutional investors believe that independent directors are particularly effective in controlling CEO's actions, pushing him to take decisions to improve firm performance, growth and dividend policy. We conduct a study of whether independent directors and other board variables correlate with the performance, the growth and the dividend policy of European public utilities. We find evidence that independent directors reduce future firm performance and that they do not affect neither firm growth nor dividend policy. Using different econometric techniques and controlling for endogeneity, our results do not support the conventional wisdom of corporate governance codes that greater board independence improves firm results.

JEL classification: G30; L32, L95

Keywords: Corporate governance; Board-of-directors; Public utility, Firm performance, Board Independence.

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[*] The co-authors are Claudio Becagli, Research Fellow at University of Florence and Andrea Paci, Full Professor at University of Florence.
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3. Incentive regulation and incentive compensation: What has changed in the pattern of EU energy utilities?*

Abstract

This paper examines regulatory mechanisms and regulated firms' CEO compensations within public utilities using a panel of energy utilities in the largest European countries. We investigate the differences in CEO pay-for-performance sensitivity across regulated and unregulated firms as well as the impact of different regulation schemes – incentive regulation vs. rate-of-return regulation - on CEO monetary incentives. We employ three different measures of firm performance and find that there is a positive and statistically significant pay-for-performance relationship. Results show that regulated energy utilities link CEO compensation to firm performance, but sensitivity is lower with respect to unregulated companies. When we focus on regulatory schemes, we find no difference in across the CEO pay-sensitivities of firms under incentive regulation and RoR regulation, and also that CEOs of firms under incentive regulation are paid relatively more than CEOs of firms under cost-plus mechanisms. Overall, our results point out that CEO incentives are not very powerful and ought to be strengthened.

JEL classification: G30, J33, L51, M12

Key words: Incentive regulation, CEO pay for performance sensitivity, energy utilities

* The co-authors are Prof. Carlo Cambini and Prof. Laura Rondi, Polytechnic of Turin.