Restricting CEO Pay Backfires: Evidence from China

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The question

Should CEO Pay be Restricted?

Topical

Important

Interesting

Should be restricted: Bebchuk and Fried (2003, 2004), Bebchuk (2007)

Should not be restricted: Jensen and Murphy (1990), Kaplan (2007)

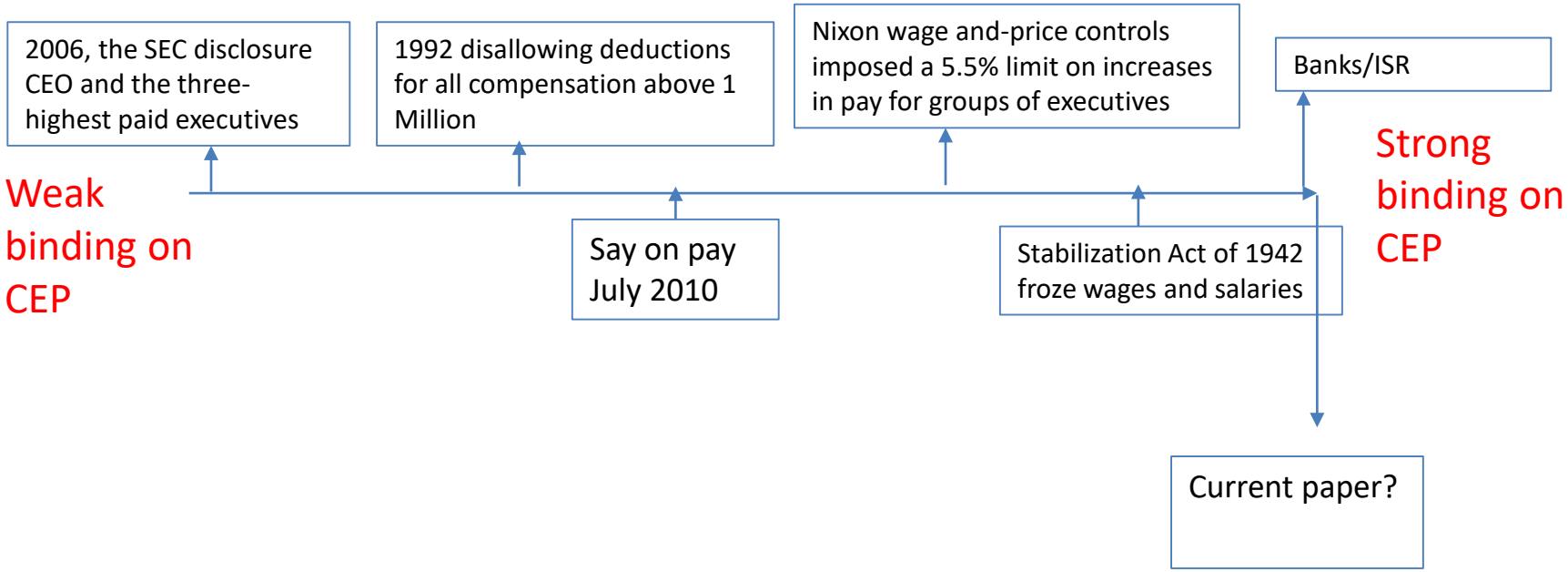
Essence of the Study

- In September 2009, the Government of China introduced regulated to limit executive salaries for the country's centrally administered state-owned enterprises (CSOE). No restriction on LSOE and private enterprises.
- Using matched sample analysis CSOE were adversely affected.
- Restricting CEP (corporate executive pay) leads to unintended consequences: more perks, tunneling, and worst performance.

Some nice things to say about this paper

- Well written and well structured, easy to read
- Literature review to the point, places the paper in context
- DiD approach is the most natural way to assess the effect of the 2009 regulation

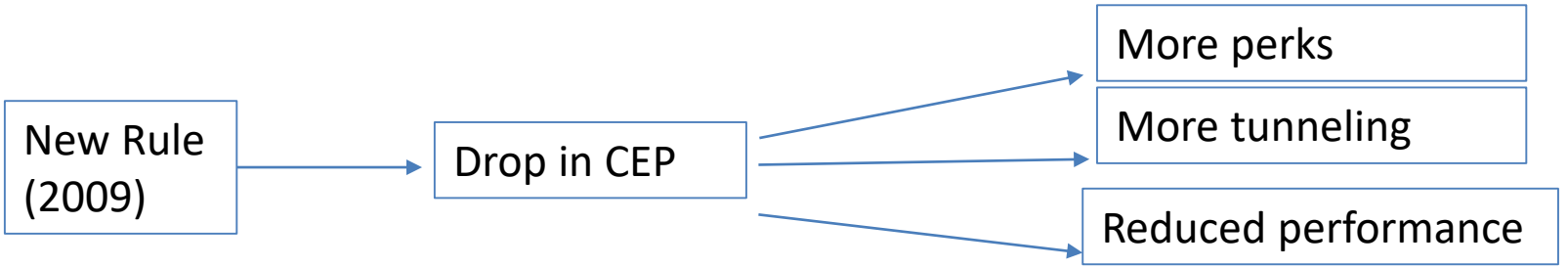
Exposition: China's new regulation, where does it fit?



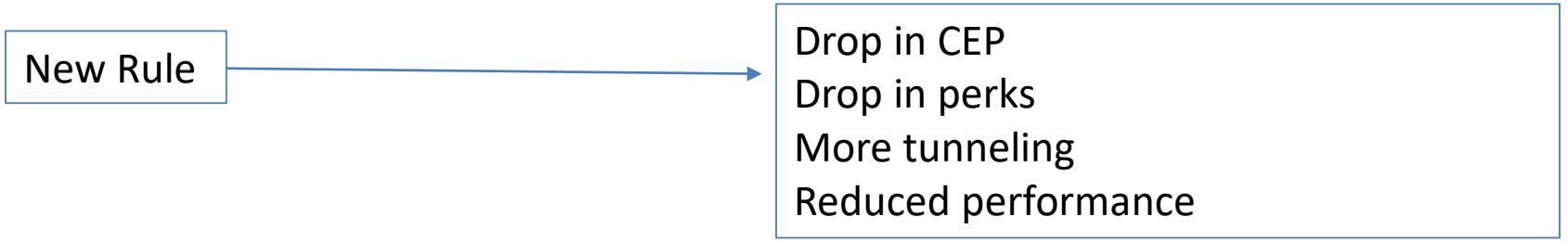
The Guideline of the Chinese Government refers only to basic salary, bonuses – not stock and options compensation – it discusses the need to reduce disparity with employees. Paper talks about a formula, and suggests that the excerpt refers that executive are allowed to be paid about 5-7.5 salary (nothing about bonuses) ; all together it does not seem very binding. So, perhaps downplay – seems more like disclosure/say on pay than a binding issue.

Inferring the effect of liquidity on repurchases

Ideal experiment



Actual experiment



The casual link from drop in CEP to consequences is broken
Evidence that all occurred after 2009 in CSOE firms.
But no evidence that the drop in CEP caused it (which is still something, but not as good)

Suggestion: Match CSOE firms – those that drop versus not drop in pay

Matching and other stuff:

- CSOE (central state owned enterprise), LSOE, Private. A better matching would be CSOE versus LSOE
- Matching unclear: one to one (with replacement) PS, currently a black box (sometimes 1 match, sometimes 2 – not clear why, sizes of companies is different, etc.)
- Small firm bias (Executive that are paid $140 a year, how important are such firms)

Overall

- Important, clear, interesting
- Suggestions:

Exposition – how binding is the rule?

Did procedure – PSM, and through drop in CEP (as an instrument) rather than just events after 2009