Journal of Economics and Business 70 (2013) 71–91

Contents lists available at ScienceDirect

Journal of Economics and Business

Director compensation in emerging markets: A case study of Thailand

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ARTICLE INFO

Article history:
Received 7 June 2012
Received in revised form 5 May 2013
Accepted 8 May 2013

Keywords:
Corporate governance
Director compensation
Ownership concentration
Family firms
Thailand

ABSTRACT

Director compensation in emerging markets is an important issue because of the endemic information asymmetry and weak corporate governance. Using a unique sample of Thai corporations between 2002 and 2008, I find that director compensation is greater in family firms and that executive pay is primarily driven by corporate performance. However, this positive performance-pay relation is attenuated when directors own large shareholdings in their corporation. Finally, standard governance structures such as non-executive directors and splitting the CEO/chairman role are found to have little impact on Thai executive pay.

1. Introduction

Agency theory has attracted the interest of academics, investors and market regulators since Jensen and Meckling (1976), who argued that there are natural conflicts of interest between managers and shareholders. These conflicts of interest can, nevertheless, be mitigated through appropriate incentive mechanisms. Previous research in this area has primarily focused on the effect of CEO compensation on firm performance (Boyd, 1994; Jensen & Murphy, 1990).

The board of directors is a corporate structure that, in theory, helps to solve the agency problems inherent in managing an organization. As a primary internal control mechanism, the board plays a significant role in safeguarding shareholder interests by designing appropriate executive compensation contracts and monitoring CEO behavior (Conyon & Peck, 1998; Hermalin & Weisbach, 2003). Typically,

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http://dx.doi.org/10.1016/j.jeconbus.2013.05.001

shareholders do not escape agency problems by delegating solutions to the board since directors are themselves agents whose interests are not necessarily aligned with those of shareholders (Hermalin & Weisbach, 1991). This problem can commonly be found in developed countries, where many firms are widely held.

La Porta, Lopez-de-Silanes, and Shleifer (1999) indicate that a large proportion of public and private firms around the world are family-controlled. This can produce an intense concentration of management and firm benefits by unifying the board of directors and management team. However, in family firms, there is a danger that controlling shareholders can expropriate wealth from minority investors because of the close links between management and the controlling owner (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2002). This type of relationship in family firms is different from that where ownership and control is separated – typically in Anglo-American economies (Dogan & Smyth, 2002). However, the variations in ownership structure can lead to differences in executive compensation. In widely held firms, directors may exploit the weakness of individual investors and control their own compensation structure. However, the problem may also be prevalent in closely held firms, where executives can be compensated for pursuing policies that are beneficial only to the largest shareholders.

Existing empirical evidence of the relationship between director compensation and firm performance is varied. For example, Gregg, Machin, and Szymanski (1993), Conyon (1995) and Doucouliagos, Haman, and Askary (2007) find no relationship between director compensation and firm performance, whereas Conyon and Leech (1994) and Barontini and Bozzi (2011) report a positive pay-performance relationship. Further, Dogan and Smyth (2002) show that the relationship between director compensation and firm performance is ambiguous. More recent studies attempt to investigate the influence of family control on the relationship between director compensation and firm performance as a result of the uniqueness of agency costs in family firms. The cases in question are Barontini and Bozzi (2011) and Connelly, Limpaphayom, and Sullivan (2012). Barontini and Bozzi (2011) report sub-optimal compensation practices as a result of the inverse relationship between board compensation and subsequent firm performance in founder-family firms in Italy. Also, high ownership concentration is associated with lower board pay. Connelly et al. (2012a) analyze the influence of family ownership on board compensation in two sub-samples of low and high family ownership Thai listed firms. Thai firms with high levels of family ownership exhibit a strong positive link between director compensation and performance. Likewise, Cheung, Stouraitis, and Wong (2005) confirm family control to be associated with low executive compensation when the chairman holds a small percentage of the firm's shares, and with high executive compensation when the chairman owns significant shareholdings. However, as far as can be ascertained, no scientific literature investigates the relationship between director compensation and firm performance by analyzing family and non-family firms separately and with time-series analysis.

The main goal in this paper is to ascertain whether the relationship between director compensation and firm performance depends on the dominance of family ownership within an emerging market, Thailand. Claessens, Djankov, and Lang (2000) report that family dominated firms are widespread in emerging Asian countries. Thai-listed firms have the highest ownership concentration of the nine East Asian corporations. Further, Laoniramai (2012) documents that Thai listed firms have particular characteristics and ownership structures which are typically strong family-controlled structures. An analysis of Thai listed firms reveals an environment characterized by high family ownership, which is common in other emerging markets, but which adopts foreign corporate governance principles, i.e. the principles of corporate governance of the OECD and an Anglo-Saxon legal approach. Although adopting the U.S. Sarbanes-Oxley Act in 2002, the Stock Exchange of Thailand (SET) and the Thai Securities and Exchange Commission (SEC) emphasize the board of directors' role, rather than top executives' direct responsibilities for certification of financial statement as well as the effectiveness of internal control (Budsaratragoon, Hillier, & Lhaopadchan, 2012).

Thai family firms are defined by the Stock Exchange of Thailand as those in which family members (including anyone who has a blood relationship or in-law relationship) hold a minimum of 25% of total stock equity. According to the Public Limited Companies Act, at this level of shareholdings, an investor has sufficient voting power to significantly influence firm strategy (Wiwattanakantang, 2001b). The scope of analysis also looks at the evolution of director compensation and board characteristics since