Influence of CEO Compensation Peers on a Firm's Strategic Emphasis

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Abstract

Very little is known about how CEOs' psychological processes regarding their incentives influence firms' strategic choices. Drawing on social comparison and signaling theories, we argue that if the compensation of a focal CEO lags behind the compensation of their peer CEOs (i.e., the CEOs of their compensation peer firms that serve as a benchmark for the focal CEO's compensation), the focal CEO's focus may shift to short-term goals of increasing social recognition and visibility, thus shifting the firm's strategic emphasis towards value appropriation. Testing our hypotheses on a sample of 1,502 unique firms between 2006 and 2019, we find that that an increase in compensation lag among peers is associated with an increase in strategic emphasis and that this effect is weaker when there are corporate governance mechanisms in place, (i.e., when the focal firm has a higher analyst coverage and a higher proportion of independent board members). The effects are stronger when considering compensation lag relative to peer CEOs of compensation peer firms in the same industry.

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