

**Executive compensation: Executive attributes and group decision-making effects in South African state-owned enterprises.**

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## **Abstract**

Executive attributes and group decision-making effects are explored in the determination of executive compensation. A purposive sample was drawn, which comprised 20 respondents chosen for their expertise relating to executive remuneration in South African state-owned enterprises (SOEs). The study was carried out by conducting primary data collection through one-to-one interviews. Thematic analysis technique was utilised for data analysis. Findings in this study describe executive compensation as a fit between executive attributes and organisational strategic objectives, and multi-perspective engagement of all critical stakeholders of the organisation which includes internal and external sources.

Keywords: social influence, state-owned enterprises, executive compensation.

## Introduction

“Executive pay has provided fertile ground for much conceptual research originating in different disciplines and academic traditions” (Gomez-Mejia, Berronne and Franco-Santos, 2010:140). In general, the limited research that has explored issues of executive compensation tends to draw on economic or agency perspectives focusing on how executive pay varies with performance (Boivie, Bednar & Barker, 2012; Nulla, 2013). In the same way, previous studies have focussed on accounting measures and traditional performance measures such as return on assets, return on equity or market performance (stock return) as criteria for determining executive compensation (de Wet, 2012; Li, Lou, Wang & Yuan, 2013). Other studies have considered human capital factors such as the executive’s positional power and expert power (O'Reilly, Doerr, Caldwell & Chatman, 2014; Shin, 2013; Van Essen, Otten & Carberry, 2014), political ties and international experience (Peng, Sun, & Markoczy, 2015) as determinants of executive compensation. However, the one area that has been left largely unexplored is the process by which executive compensation is determined and how social and psychological mechanisms play a role in this process (Boivie et al., 2012).

Executive compensation has been put under scrutiny by both members of the public and the media (de Wet, 2012; KPMG Report, 2010). In the wake of the economic recession that took hold in 2008, some analysts, such as Mueller (2006: 625), cited excessive directors’ remuneration as a key contributing factor (de Wet, 2012). This is no surprise since executive compensation is a topical issue globally.

Developments in and around South African state-owned enterprises (SOEs) have been the subject of debate on the fairness of executive compensation (Schuitema, 2010; Speckman, 2011; Theunissen, 2010). Prior to this research, there has been limited, if any, empirical study on the process involved in setting executive remuneration, especially in the context of South African SOEs. More specifically, there is no clarity on the process involved in the determination of executive compensation in such institutions. The debate on executive compensation should therefore not focus primarily on how much executives are paid (Fleming & Schaupp, 2012; Scholtz & Smit, 2012; Theunissen, 2010) since such information only results in continued debates by members of the public over the exorbitant pay that executives receive. Rather, discourse on executive compensation should focus on the process and the elements considered in the determination of executive pay.

According to O'Reilly and Main (2010), the compensation-setting process in organisations relies on the deliberations of a small group of individuals responsible for it (e.g. the board and compensation committee). This paper argues that paying attention to the elements to be considered and the overall process involved is an effective measure and a solution to eliciting a standard practice according to which executive compensation could be determined in South African SOEs. Moreover, establishing a standard practice will help reduce the level of anxiety that normally overwhelms all parties that take part in the setting of executive compensation in South African SOEs.

In what follows, the second section places the discussion in the context of the literature reviewed and theoretical perspectives through which the process of executive compensation could be explained. The methodology followed in this research is discussed in the third section and the findings are presented in the fourth section.

## **Literature review**

The approach to executive compensation begins with the premise that the compensation-setting process in organisations relies on the deliberations of a small group of individuals responsible for this decision and, as such, this process is subject to the same processes that affect group decision-making in general (O'Reilly & Main, 2010). The theoretical perspective utilised as a framework for explaining the determination of executive compensation in this paper is the social comparison theory.

### **Social comparison theory**

In the literature on executive compensation, social comparison theory is related to what is known as equity theory (Otten, 2007). More importantly, this theory is based on the comparison, although this comparison is made at the top level of the firm, that is, among executives in the organisation and with executives outside the organisation (Boivie et al., 2012). Social comparison literature is focused on determining which individuals or groups are likely to serve as referents and evidence from executive compensation literature shows that there are a number of possible referents that decision makers can use when making comparisons. In setting executive pay, executives rely on normative judgments of their own

pay and experience and on judgments of the experience and pay of other executives (Gerakos, Ittner, & Moers, 2012).

Further, social comparison theory on executive compensation finds expression in the fundamental and pervasive psychological process of social influence. A number of studies have demonstrated that executives can increase their pay beyond what is justified by economic determinants through exercising their social influence, providing rewards to the board members and ingratiating themselves with the board (O'Reilly et al., 2014).

According to O'Reilly and Main (2010), this social influence, also referred to as social capital, can provide important cues — such as the credibility and attractiveness of an executive — that people may use in place of hard facts when the judgment task is ambiguous when deciding on compensation. Similarly, Political connectedness can be treated as one form of "social capital", which consists of resources available through political social networks that an executive can use to influence policy decisions that are in the interest of the executive and the firm (Aslan & Grinstein, 2011). Furthermore, it is likely that the social comparison process of anchoring executive pay based on readily available and relevant comparison groups will help to increase executive compensation since individuals would rarely use social referents as justification to decrease their pay (Boivie et al., 2012).

Furthermore, the social capital of executives influences pay through a process in which executives with greater social status or connections than comparison groups receive more favourable compensation. However, from a social perspective, it is preferable if remuneration policies are acceptable to the members of the public. Heimann et al (2014) contend that a company with executive remuneration systems acceptable to laypeople acts in a more socially responsible way. Thus, the implication of social influence for the determination of executive compensation is that the acceptability of the compensation an executive receives involves more than just the interaction between the executive and the organisation. The determination of executive compensation may also extend to include the executives' influence and social network, and the expectations of third parties, such as members of the general public and what they deem reasonable. In light of the aforementioned discussion, the research questions for this paper can thus be stated as follows:

- a) How is executive compensation determined in the context of South African SOEs?

b) Who is involved in determining executive compensation in South African SOEs?

#### Goals of the study

By linking the social comparison theory to executive compensation, this paper sought to determine the process and elements considered important in decision-making, and the identification of all parties deemed necessary in determining executive compensation in the context of South African SOEs.

#### **Methodology**

To answer the research questions mentioned, rich data was required that could examine context-specific factors, drawn from the experiences and practices of key informants with regard to the determination of executive compensation in the context of South African SOEs. For this study, the researcher chose the qualitative method for gathering and analysing data. In addition, the researcher adopted a social constructivism and thematic analysis approach for achieving the aforementioned research objective. Social constructivism was adopted for this study since it deals with the construction of knowledge and therefore meaning through the involvement of agents in a social context. From a constructionist perspective, meaning and experience are socially produced and reproduced, rather than inherent in individuals (Burr, 1995).

#### Sampling

Participants were a panel of experts chosen to be interviewed. The selection of experts for the interview followed a non-probability sampling technique, namely purposive sampling. A sample was drawn which comprised 20 respondents (age range = 37 to 48, gender = 12 male and 8 female). Purposive sampling was designed to ensure that the participants in the selected sample were experts and opinion leaders in the field of executive compensation.

#### Data collection

Data were collected utilising data collection through one-to-one interviews with executives and experts in the field of executive compensation in South African SOEs. The interviews were all

tape-recorded and notes were taken during the interviews. The tape-recorded interviews were transcribed with the assistance of a professional transcriptionist.

Permission to undertake this research was sought by writing official letters of request and sending emails requesting permission to executive human resource (HR) managers of the SOEs.

#### Data analysis – thematic analysis

Making sense of the extensive amount of data involved an approach that was consistent with a narrative analysis and interpretation (Gabriel, 2000). Thus, thematic analysis as a method of data analysis was applied through the process of data coding. Overall, the transcriptions containing interview data were coded according to the topic, and the key emerging themes were generated by using thematic analysis accordingly (Yin, 1994).

### Results

The integration and interpretation of the findings are presented according to the themes that emerged during the presentation of respondents' perception of how executive compensation is determined and who is involved in the process in their specific organisations. The themes that emerged were categorised into two, namely the fit between leadership competence and the strategic objectives of the organisation, and multi-perspective engagement and influence on executive compensation.

#### Fit between leadership competence and organisational strategic intent

In this category, the respondents were requested to comment on how executive compensation was determined in their organisations. The main theme that emerged from the interviews was the need to consider the fit between individual competence and the realisation of the organisations' strategic intent. Sub-themes that emerged were categorised into three, namely the display of leadership and professional skills, the interplay between formal educational qualifications and experience, and consideration of experience over the age of the executive in decision-making.

Box 1 indicates the broad theme and the sub-themes, including examples of original responses that were analysed.

Theme	Sub-themes	Response
<b>Fit between individual competence and organisational strategic objectives</b>	Display of leadership and professional skills	<p><i>"... the best talent at that level with emphasis on both your technical and your leadership capabilities ... the complexity of the role" (RP8)</i></p> <p><i>"... able to work at the highest level and they must also be able to work at the lowest level." (RP4)</i></p>
	Formal educational qualifications vs experience	<p><i>"... somebody that is able to leverage relationships, this is somebody that is a strategist ..." (RP5)</i></p> <p><i>"... we look at the experience ... what the incumbent has done previously ..." (RP9)</i></p> <p><i>"... It all depends on the minimum entry requirements ... it should always be aligned with your minimum entry requirements for that particular position." (RP3)</i></p>

#### Display of leadership and professional skills

Research participants expressed the need for an executive to demonstrate the necessary leadership qualities that are critical to the realisation of the organisational strategic intent. Executives are expected to have a vision for the business and to be able to translate that vision into the strategy of the organisation. An executive is also expected to serve as a link between the business and all critical stakeholders of the organisation. Thus, an executive is expected to establish good interpersonal relationships and demonstrate effective communication and leadership skills within and beyond the organisation.

However, what makes an SOE unique among other organisations in both the public and the private sector is that in pursuance of his or her role, an executive is expected to act in a developmental manner that is inclusive and considerate of the welfare of society in general. This means that an executive should be driven by the need to fulfil the social and economic mandate of the SOE. And in turn, the executive will be rewarded accordingly.

#### Formal educational qualifications vs relevant experience

Another sub-theme that emerged during the interviews was consideration of the educational qualifications of the incumbent executive. Most research respondents expected executives to possess a formal educational qualification. However, qualifications were not considered in



isolation, but only to the extent that they contributed to the skills and ability of the incumbent, enabling effective and efficient execution of tasks and realisation of the organisations' business mandate. Moreover, the level of qualification was perceived as a differentiator between an executive and his or her subordinates, and as giving an incumbent the edge over less qualified incumbents in terms of the speed with which problems were expected to be resolved.

Similarly, some of the research respondents were of the opinion that educational qualifications in relation to previous job experience were even more relevant and contributed more positively to executive compensation than just educational qualifications in isolation. Research respondents described job experience as including not only what the incumbent had previously done, but also what the incumbent was bringing to the organisation.

#### Experience vs age as a determinant of executive compensation

Another sub-theme that emerged during the interviews is that of age versus experience.

Box 2 indicates the broad theme and the sub-themes, including examples of original responses that were analysed.

Theme	Sub-theme	Response
<b>Fit between individual competence and organisational strategic objectives (cont...)</b>	The value of experience vs age in the determination of executive compensation	<p><i>"We do not look at age. We look purely at the job." (RP2)</i></p> <p><i>"... sometimes experience is the reflection of maturity ... but I wouldn't say age ..." (RP1)</i></p> <p><i>"Age of an incumbent should never be taken into consideration ... it depends on the experience ... rather than age." (RP4)</i></p> <p><i>"... it's how you slice the cake rather than really putting in a differentiator or a way of discriminating among the two because the older guy might have experience ... but the younger guy might be bringing a lot of new ideas, fresh ideas ..." (RP5)</i></p> <p><i>"It is purely based on the knowledge and on what you could offer as an incumbent ..." (RP19)</i></p>

Most respondents mentioned that they did not consider age in determining the compensation of an executive, but rather the experience relevant to the job. Some research participants perceived the age of an executive as having an indirect influence, depending on how it is

perceived. Research participants asserted that although the age of an executive did not play a major role, it was nevertheless a reflection of maturity and could also be an indicator of the level of experience that an incumbent had. The difference between an older executive and a younger executive was considered to be the difference between experience and new ideas. The difference between the two was that the older executive would tap into institutional knowledge in addressing some of the challenges, while a younger executive would bring the latest and innovating ways of tackling problems into the organisation. However, in hindsight, experience and innovation were not mutually exclusive, but the two were perceived as complementary in influencing compensation.

Multiple stakeholders perspective engagement as a determinant of executive compensation.

Box 3 indicates the broad theme and the sub-themes, including examples of original responses that were analysed.

Theme	Sub-theme	Response
<b>Multiple perspectives and influence on executive compensation</b>	Varying influence of internal and external sources, which include the HR Division, the CEO, CFO, board of directors and external consultants	<p>"... "...human capital ... the CEO ... the accounting officer..." (RP13)</p> <p>"... remuneration and benefits division within HR ... head of the department ... then go to our GM thereafter it will go to our CEO (RP4)</p> <p>"... the role and influence of external consultants will remain ... but I think it is not a question of that the organisation cannot survive without them".RP2)</p> <p>"... the board approval in most cases is being based on what the consultant has ...recommended."(RP10)</p> <p>"... a decision that is remuneration related for both the executives and general staff should always be approved by the board."(RP5)</p>

In this category, the research participants were requested to describe who develops executive compensation in their organisations. Investigations into the research participants' responses revealed that multiple stakeholders were involved internally and externally. Internally, the HR division was the first point of contact in determining the pay package of an executive. The HR division would submit any proposal on compensation to the chief executive officer (CEO). The proposed package would then be referred to the board of directors, in which the human capital committee/remuneration committee is located, for a final decision.

However, research participants also mentioned that they had strict codes of practice for the members of the board and that one single person could not influence executive compensation. That is, when deciding on executive compensation, all the inputs from various parties, including the HR division, the human capital committee/remuneration committee and the CEO would be considered as a collective together with the chair of the committee of the board of directors.

However, in some institutions, depending on the size of the organisation, for the smaller-sized enterprises the CEO (managing director) and the chief financial officer were the only two people who were members of the board of the remuneration committee. When making decisions on remuneration that affected them, they were excluded from the discussions of the overall board of directors so that they could not influence the discussions. However, before the final implementation, the Minister as the accountable government official and a critical stakeholder would have to confirm the total executive remuneration structure in the organisation.

Externally, research participants explained that as different organisations they needed to benchmark themselves with what was happening in their market environment because they wanted to remain competitive. To that effect, the HR division employed the services of an external consultant to advise on the latest trends in compensation. Overall, the CEO, the HR division, the human capital committee/remuneration committee and the external consultant are responsible for the determination of executive compensation in South African SOEs. Thus, decision-making in terms of determining executive compensation is a collective exercise in South African SOEs.

## **Discussion**

This article highlighted the application of the social process and social comparison theory in particular, as a framework that describes how executive compensation is determined and who is involved in the process of decision-making in the context of South African SOEs. An assessment of the theories and an overview of the current literature show signs of convergence in terms of eliciting the level of social influence as an element that characterises the process involved in determining executive compensation. The process is described in

terms of the fit between individual competence and the organisation, as well as the multi-stakeholder perspective and engagement with all the critical sources in the determination of executive compensation.

#### Fit between individual competence and organisational strategic intent

Based on the research participants' responses, it would seem that there is a reciprocal relationship between the initiatives and effort expended by an executive and the achievement of organisational objectives. It would appear that the organisation would compensate behaviour that facilitates the delivery of the social mandate and welfare of society, as expected in South African SOEs.

Further, it would appear that an executive should be a socially oriented person to be able to succeed in his or her role. The executive is expected to be able to achieve organisational goals by establishing and maintaining social networks located both within and beyond the organisation. Such social networks include a political network that would enable the organisation to make all the important political connections required to influence policy decisions that are in the interest of the executive and the enterprise.

The findings seem to relate to previous studies. For example, according to Aslan and Grinstein (2011), politics are an important determinant of firm performance because government policies affect expected future cash flows and firms must operate within the bounds of regulation constraints. Thus, executives are recognised and rewarded for the political networks, influence and leadership role they demonstrate in translating the vision of their organisations to be adopted by employees and accepted by the shareholders and the third parties in communities they serve.

Furthermore, it would seem that the level of education also plays a major role in the determination of executive compensation. Educational qualifications have been regarded as the enablers that facilitate the translation of the vision into the strategic intent of the organisation since the research participants perceive educational qualifications as giving an incumbent the edge in terms of the speed with which problems are resolved. However, it would also appear that qualifications are not considered in isolation but only to the extent to

which they contribute to the skills and ability of the incumbent to perform tasks and realise the organisations' objectives.

The skills and experience that derive from accumulated education were perceived as an asset at both the individual and organisational level, demonstrated through the executives' influence and social network with other critical stakeholders of the organisation. The organisation would reward the executive accordingly. The findings seem to corroborate previous studies. For example, Greve et al. (2010) contend that more education and experience put the executive in a better position in terms of compensation. It can be assumed that with adequate education, an executive is able to establish more of the networks and engage with critical stakeholders necessary for the realisation of the strategic objectives of the organisation.

Therefore, educational qualifications would have a reciprocal effect to the extent that they would assist the incumbent to gain access to resources available through political social networks that an executive can use to satisfy expectations. Ng and Feldman (2010) concludes that an executive with a greater amount of human capital, that is social capital, is better able to perform his/her job and, as a result, is paid more.

#### Multiple stakeholder perspectives as a determinant of executive compensation

Based on the findings, it would seem that decision-making when designing, developing and implementing executive compensation is an interactive process that involves the interlocking of opinions and suggestions from all critical stakeholders of the organisation. The behaviour that has been displayed in the determination of executive compensation seems to be explained better by the social comparison theory, which places emphasis on the collectivist approach that aims at establishing parity in executive compensation.

Much of the social comparison literature is focused on determining which individuals or groups are likely to serve as referents. Evidence from the CEO compensation literature shows that individuals can use a number of possible referents when making comparisons. The behaviour displayed seems to suggest that executives with comparable jobs could have an impact on the level of compensation that an executive would receive.

The findings of the current study seem to concur with those of previous studies. For example, Trevor (2011:171) contends that the context in which pay is determined is not a 'closed system', but a fluid open system of a variety of contextual properties acting at multiple levels of the company and influencing, profoundly, the outcomes of the pay determination process. Four categories of pressure are present, including external competitive, external institutional, internal structural and internal institutional. The pressures all have an influence at all levels of the pay determination process but are more influential at some levels than others. Thus, the context for the determination of pay at the operational level is primarily characterised by internal structural and internal institutional variables pervasive at that level.

### Practical implications

The social approach seems to provide a more detailed description of the nature and application of executive compensation from a human and social perspective than other sciences, namely the economic and financial sciences. Through social theory, individual executives could be compared by the level of effort expended to achieve organisational objectives.

In addition, by helping one to understand better how the process of social comparison is likely to result in increased executive compensation, the social perspective makes a number of significant contributions to executive compensation literature. First, it develops a theory regarding the social mechanisms through which pay increases are transmitted. Second, unlike the economic perspective, which focuses on the dynamics of the market, the social perspective demonstrates how executive compensation is determined through an informal and formal process of social influence in the form of the internal processes within the organisational and external sources in the form of consultants and members of the public.

Therefore, for practical purposes, the broader theoretical framework that serves as a basis for understanding the concept of executive compensation in SOEs is underpinned by the fundamental processes influence in the determination of executive compensation in South African SOEs.

## **Conclusion**

The approach adopted in this paper was intended to provide a more detailed description of the nature and application of executive compensation from a process perspective than the economic and financial sciences would do. While the economic and financial sciences put emphasis on economic or agency perspectives focusing on how executive pay varies with performance. The social approach takes into consideration the level of competence expected from an individual executive to warrant a certain level of executive pay. On the other hand, the social approach highlights the interaction between the individual executive, the organisation and members of the general public who may have an influence in the determination of executive compensation.

Given that a selected individual or group becomes the basis for judging the equity of compensation, the choice of a specific referent individual or group is crucial. A more conclusive understanding of executive pay would be based on consideration of executive pay as an outcome of socially constructed arrangements in which the parties involved have considerable discretion to influence the outcomes. However, the crucial question remains whether it is possible to compare and match executives rand for rand, as executives' skills are unique to individuals.

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