# Increased CEO compensation linked to decreased financial performance of firms

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(Phys.org) —New research in a study from the David Eccles School of Business at the University of Utah found that CEOs who receive higher incentive pay often lead their companies to decreased financial performance. Specifically, the study discovered that the highest paid CEOs earn significantly lower stock returns for up to three years.

Additionally, CEOs with an average compensation of more than $20 million are linked to an average yearly loss of $1.4 billion for their organizations.

"It has become well established in academic research that businesses are racing to pay their executives more and more," said Mike Cooper, professor of finance at the David Eccles School of Business and lead author of the study. His co-authors are Purdue University's Huseyin Gulen and P. Ragha Vendra Rau of the University of Cambridge.

"They want to have a glamorous, highly paid CEO," Cooper said. "However, this runs counterintuitive to what is actually smart business. Businesses should be careful to control overzealous investment and takeover activities of highly paid CEOs if they want to ensure the best financial future for their business."

Using sophisticated statistical analysis, the study creates a deeper understanding of the link between executive pay and financial performance and reveals that the more executives are paid, the more they exhibit overconfidence in their decision-making. This overconfidence leads to increased risk-taking behaviors, such as aggressive mergers and acquisitions, investments in bad projects, and wasteful spending.

The study also found CEOs who receive high pay often have longer tenure and have consistently worse long-term returns by approximately 12 percent, a particularly toxic combination when compared to executives with shorter tenure. Cooper postulates that these managers with long tenure are skilled in negotiating the complicated politics of the boardroom, so they are able to remove any barriers to advancing their agendas.

"Pay contracts should incentivize executives to operate in their firm's best interest," said Cooper. "While this study doesn't prove that increased pay is necessarily bad, it does show there is a link between increased pay and decreased financial performance. Businesses should reexamine how they approach executive compensation and incentives to maximize the financial performance of their business."

Provided by University of Utah

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