EFFECTS OF FIRMS' PERFORMANCE ON EXECUTIVE COMPENSATION IN NIGERIA

BY
TONYE OGIRIKI
OPUDU DEREK OKUBOKEME

Abstract
This study examined the association between the effects of firms' financial performance on executive compensation in Nigeria. The existing literature presents different findings on the impact of executive compensation on firm performance and verse visa. The study hinged on these two important theories, the agency theory and stakeholder theory. In accomplishing the research objectives of this study, the audited annual financial statement of ten listed firms in the Nigerian stock exchange market were selected using the purposive sampling method and the study covers the range period from 2012-2015. Nevertheless, in analyzing the research hypotheses, the study adopted the use of both descriptive statistics and econometric technique using the panel least square regression method in the estimation of the regression equation. The findings from this study reveal that there is a significant positive relationship between firms' financial performance and executive compensation (director's emoluments) for the sampled firms.

Keywords
Financial Performance, Board Size, Executive Compensation, Nigeria, Remuneration, Agency theory, Stakeholder theory

Introduction
Corporate governance has become a contemporary issue in the world of business; it has also been a widespread topic for many studies in the finance literature. In order to solve agency theory problem, executive compensation is often used as an instrument to align both the managerial interests (agents) and that of the shareholders (principals) in the corporate setting (see Morgan & Poulsen, (2001)).

Recent studies showed that compensation contracts can actually motivate managers to embark on actions that maximize shareholders' interest and wealth (Osuji, (2012); Babalola, (2012); Park, (2010); and Walker, (2010)). And as such, if shareholders could directly observe and monitor the firm's growth opportunities and executives' actions then, no incentives would be necessary. The basic idea is to reward executives according to their performance with also the intention to attenuate the opportunistic behaviour of managers that is likely not acting in accordance to shareholders' interests. Executive compensation is potentially a powerful device by which to mitigate managerial opportunistic behaviour. Though, the practice in executive compensation during the past few decades raises a lot of doubt to its efficacy. It is still in debate whether the incentive compensation indeed improves the firm performance and/or risk taking.

However, it is also a known fact that corporate governance systems of firms largely differs from countries to countries (Shleifer & Vishny, 1997). The reason for these differences could be the law, politics, ethics, institutions or ownership structures in such a country. Therefore it is hard to say which governance system is the best (Shleifer & Vishny, 1997). Corporate governance deals with many mechanisms that are important for a firm, such as ownership structure, company law, board structure, et cetera. However, Shleifer & Vishny (1997) mention that the main concern for corporate governance lies in the agency problem, which can also be described as the separation of management and finance. The fundamental question of corporate governance is how to assure financiers that they get a return on their financial investment (Shleifer & Vishny, 1997).

Several studies have been carried out in the developed and developing countries (like America, Europe, Japan, China, Indian, Greece etc.) in attempt to investigate the relationship between executive compensation and firm performance like (Fama, 1983, Murphy 1999, Kato & Kubo,

(2006); Brunello, Graziano & Parigi, (2001); Hubbard & Palia, (1995), Osuji, (2012); Babalola, (2012); Park, (2010); and Walker, (2010)). The works of (Osuji, (2012); Babalola, (2012); Park, (2010); Walker, (2010); Coughlan & Schmidt, (1985) and Cheng & Farber, (2008)) they found a positive relationship between Executive Officers compensation and firm performance, whereas the study by (Boyd, 1994) and Yeo (1999) conclude that executive compensation has no significant impact on firm performance while the study by Core, Holthausen & Larcker, (1993) found a negative relationship between Executive Officers compensation and firm performance.

Due to the inclusive debate on the subject matter, economic differences and uniqueness nature of laws and business ethics in a developing country, it is expedient to carry out a further focus study on Nigeria firms since the concluded studies cannot be generalize. Randoy & Nielsen (2002) mentioned that the executive compensations in the developing countries and that of developed countries are not the same. Therefore, it is interesting and imperative to evaluate whether executive compensation has any effect on firms performance in Nigeria.

Literature Review

Agency theory states that both market and non-market mechanisms could be used to promote the alignment of interest of managers and stakeholders. The theory further emphasizes that the managerial labour market and the market for corporate takeover exert pressures both within and outside the firm so as to align the interests of both manager and shareholders. According to Alchian and Demsetz, (1972), firms are formed to internalize the high transaction costs of constantly negotiating new contracts. They further found that the information costs explain the rise of firms. However, Fama, (1983) argued that Alchian and Demsetz"z model of the firm had the right idea, but failed to completely eliminate the entrepreneur from their theory". He further explained that "The Striking insight of Alcahian and Dernsetz, (1972) and Jensen and Meckling, (1976) is in viewing the firm as a set of contracts among factors of production. In effect, the firm is viewed as a team whose members act from self-interest but realize that their destinies depend to some extent on the survival of the team in its competition with other teams.

According to him, each firm is faced with a market for its services that provides alternative opportunities. In the case of management motivation toward performance, he conclude that shareholders can take their wealth elsewhere for a better return or managers who do well can be promoted.

Theoretical Perspectives

Agency theory

The focus point of the agency theory is that one party delegates work to a second party. The parties that are involved are called the principal and the agent. In other words, the principal stands for the owners/shareholders of a firm and the agents are the managers (Guilding, Warnken, Ardill & Fredline, 2005). Thus, managers are hired by the owners of a firm to create greater performance and returns for the company. However, in practice this is not always the case.

Problems can arise between the agent and the principal, which could result in poor firm performance. The number one reason for the rise of problems between managers and owners are the different interests they have (Hill & Jones, 1992).

Stakeholder theory

The term stakeholder refers to any group or individual who has a legitimate claim on the firm. A firm has many stakeholders, several of them are: stockholders, employees, suppliers, managers, customers et cetera. Each of these groups can be seen as supplying the firm with critical resources, and in exchange each expects its interests to be satisfied (Hill & Jones, 1992). A separation is made between internal and external stakeholders. According to Van Puyvelde, Caers, Bois & Jegers (2012), managers are internal stakeholders and customers or suppliers are examples of external stakeholders.

Every stakeholder of a firm creates value for the company. Since managers are considered to be stakeholders of a firm, the Executive Officers are also included in this consideration. Thus changing the compensation structure or setting appropriate incentives for the Executive Officers can give positive results to the firm.

Empirical Evidence of Executive Compensation and Firm Performance

It is the responsibility of board of directors to determine executive compensation amounts and forward same to shareholders for approval, usually at the annual general shareholders' meeting (Basu, Hwang, Mitsudome & Weintrop, 2007). There are several forms executive compensations, ranging from fixed basic salary, cash bonuses, share-based payments, stock options etc. all these remunerations given by firms are based on Executive Officers performance, especially cash bonuses. Conversely, Firms also embark on incentive programs in order to align interests between the Executive Officers and shareholders. For that purpose, Executive Officers are then given the right to buy or receive company shares or stock options; this process eventually leads to the share-based payments and stock option payments to Executive Officers.

The work of Finkelstein & Boyd (1998) revealed that there is a positive relationship between Executive Officers compensation and firm performance. The deduction of their findings stated that firm performance is higher when manager discretion and Executive Officers pay are aligned. This is supported by Shaw & Zhang (2010), who find that Executive Officers cash compensation is positively related to firm performance. Carpenter & Sanders (2002), also deduce that the pay-performance relation is significant and positive. These relationships are primarily explained by the alignment of Executive Officers and shareholders' interests by using efficient compensation contracts. The agency theory as well state and supports, that incentive schemes in the form of financial rewards to the Executive Officers would bridge the gap and reduce the difference in alignment.

Gao & Li (2015) comparative study on the Executive Officers pay-performance sensitivity in private and public firms. Their findings show that in both private and public firms the relation between Executive Officers compensation and firm accounting performance is positive. Appropriate Executive Officers compensation contracts are given as the main reason for this impact. Kuo, Li & Yu (2013), focus on the share-based pay to Executive Officers and its impact on firm performance. They find that an increase in share-based pay has beneficial effects on firm performance. This is because Executive Officers who earn share-based payments are more motivated to increase performance, since it can result in a higher remuneration. This increase in performance is also supported by the stakeholder theory, which suggested that when Executive Officers buy or receive company shares it positively influences firm performance.

Ozkan (2011) examined the link between Executive Officers pay and firm performance for firms in the UK. A positive and significant link between executive cash compensation and firm performance was found. There was also a positive relation between total compensation and firm performance, but this was not significant. The reason for the positive relationship is the mitigation of the conflict of interest between the Executive Officers and the principal by using appropriate compensation packages. Brunello et al. (2001) did research on Italian firms, and conclude that executive pay is positively linked to firm performance.

Mohammed & Phil (2013) findings revealed that there is no relationship between Executive Officers compensation and firm performance. The work of Leone, Wu & Zimmerman (2006) was another study that supported the lack of relationship between Executive Officers compensation and firm performance. They concluded that executive compensation of Executive Officers has no significant relationship with firm performance.

Development of Hypothesis

The alignment of interest between managers and principal could be realized by setting appropriate incentive system for top executives as suggested by agency theory and stakeholder theory.

These systems reward top executives financially for maximizing shareholders' interests. As such, many studies find a positive relationship between executive compensation and firm performance. Like the works of Goa & Li (2015), Ozkan (2011) and Darrough, Huang & Plehn-Dujowich (2013) findings show that Executive Officers compensation and firm performance have a positive relationship. Therefore, based on the theories and findings of previous empirical studies, the hypotheses to be tested in this study are stated below in their null forms

H1: There is no relationship between financial performance and executive compensation of firms in Nigeria.

Methodology

In accomplishing the research objectives of this study, the audited annual financial statement of listed Firms covering the period 2012-2015 was analyzed. The choice of these periods arises based on the constraint of time given to the researcher for this study. However, a total of 10 listed Firms in the Nigerian stock exchange market were selected and analyzed for the study using the purposive sampling method. Nevertheless, in analyzing the research hypotheses, the study adopted the use of both descriptive statistics and econometric analysis using the pooled ordinary least square regression analysis method in the estimation of the Regression Equation.

Specifications of the Econometric Model

The data are to be analyzed using the regression analysis which could be termed to be a statistical technique used to find relationships between variables for the purpose of predicting future values. Using the formula:

$ExComp_{it} = F(ROA_{it}, ROE_{it}, SDIR_{it}, FSIZE_{it}, PBT_{it}, LEV_{it}, U_t)$ .... (1)

This can be written in explicit form as:

$ExComp_{it} = \beta 0 + \beta_1 ROA_{it} + \beta_2 ROE_{it} + \beta_3 SDIR_{it} + \beta_4 FSIZE_{it} + \beta_5 PBT_{it} + B_6 LEV_{it} + \mu_{it}$

Where:
ExComp=Executive compensation. This is measured by Directors' Emolument or remunration.
ROA=Return on Asset. This is computed by dividing profit after tax by the total assets of the Firm which is a proxy for firm performance.
ROE=Return on Equity. This is computed by dividing profit after tax by the total equity of the Firm. It is another proxy for firm performance.
SDIR=Board of Directors size is measured as the number of board members in an organization.
FSIZE=Size of the Firm represented as Total Assets, it is used as the control variable. It includes both the non-current and current assets of an organization.
PBT=Profit before tax, it is also used as a control variable.
 LEV=Leverage which is define as the ratio of total debts over total assets. That is Total liabilities/total Assets of the Firm. This is also used as a control variable for this study.
β=Coefficient of parameter
it=Time coefficient
μ=Error term

A priori specification
The expectations for the co-efficient of the model: $\beta1>0$, $\beta2<0$.
RESULTS AND DISCUSSION

Summary of Descriptive Statistics.
Table 4.2: Summary of Descriptive Statistics

	LOG(EXCOMP)	LOG(ROA)	LOG(ROE)	LOG(SDIR)	LOG(FSIZE)	LOG(PBT)	LOG(LEV)
Mean	12.12764	-3.027191	-2.048359	2.330425	17.94689	15.66020	-0.546263
Median	12.22321	-3.025461	-1.978556	2.397895	18.08700	15.86083	-0.474422
Maximum	14.24833	-0.618782	0.982902	2.708050	20.66809	18.30106	-0.050136
Minimum	10.15813	-5.744604	-6.265901	1.945910	12.53627	9.811098	-2.531998
Std. Dev.	1.111574	1.125510	1.401928	0.207584	1.602296	1.538936	0.426520
Skewness	-0.136351	0.028412	-0.559672	-0.005108	-1.185960	-1.641638	-2.533632
Kurtosis	2.234121	2.763987	3.700506	2.306149	5.297229	7.062997	12.78663
Jarque-Bera	1.101563	0.098219	2.906069	0.802556	18.17210	42.06876	202.4253
Probability	0.576499	0.952077	0.233860	0.669464	0.000113	0.000000	0.000000
Sum	485.1057	-121.0876	-81.93435	93.21700	717.8757	579.4274	-21.85051
Sum Sq. Dev.	48.18831	49.40412	76.65070	1.680557	100.1268	85.25967	7.094869
Observations	40	40	40	40	40	37	40

Source: Authors' computation using E Views 9.0

Summarized descriptive statistics revealed that executive compensation in terms of log of total executive emolument (EXCOMP), log of return on assets (ROA), log of return on equity (ROE), log of board size of directors (SDIR), log of firm size (FSIZE), log of profit before tax and log of leverage ratio (LEV) are reported in Table 4.2. Normality test uses the null hypothesis of normality against the alternative hypothesis of non-normality. This shows that if the probability value is less than the Jacque Bera chi-square at 5% level of significance, the null hypothesis of the regression is not rejected. Given the results in Table 4.2, it is apparent that the hypothesis that all the variables are normally distributed except return on assets (ROA) and cannot be rejected since all the probabilities are less than the Jarque Bera chi-square distribution. They pass the significance test at the 5 percent level.

The executive remuneration was disclosed by firms and the average Executive Officers were paid a fixed amount of N12.127 million annually (median = N12.223 million). The lowest remuneration paid to Executive Officer is an amount of N10.158 million, and the highest remuneration is N14.248 million. There is a reasonable difference in the minimum and the maximum values. However the majority of the values are close to each other. These values indicate that several Executive Officers received much higher amounts in variable compensation. The average ROA for a firm is -3.027% (median = -3.025%) and for ROE the mean is -2.048% (median = -1.978%). Not all firms had a positive ROA and ROE. The table shows that the minimum ROA is -5.744%. For the ROE the minimum is also a negative value, namely -6.269%. The maximum value of ROA for a specific firm is -0.618%. For the ROE this rate is 0.982%. This means that the performance of firms differ quite a lot. This explains the differences in mean and median for both ROE and ROA.

Next to the independent and dependent variables, this research included several control variables. The average firms leverage ratio is -0.546 (median = -0.474). The mean and median are close to each other, which also mean that most firms have leverage ratios that are close to each other.

Correlation Analysis
Table 4:3 Correlation Test Result

	LOG(EXCOMP)	LOG(ROA)	LOG(ROE)	LOG(SDIR)	LOG(FSIZE)	LOG(PBT)	LOG(LEV)
LOG(EXCOMP)	1.000000	-0.098110	0.078997	0.256663	0.717603	0.441042	-0.061720
LOG(ROA)	-0.098110	1.000000	0.433929	0.077534	0.194773	0.371027	0.031948
LOG(ROE)	0.078997	0.433929	1.000000	0.147200	0.325366	0.537955	0.342656
LOG(SDIR)	0.256663	0.077534	0.147200	1.000000	0.180963	0.203123	0.066394
LOG(FSIZE)	0.717603	0.194773	0.325366	0.180963	1.000000	0.755697	0.013935
LOG(PBT)	0.441042	0.371027	0.537955	0.203123	0.755697	1.000000	0.146104
LOG(LEV)	-0.061720	0.031948	0.342656	0.066394	0.013935	0.146104	1.000000

The correlation analysis is the step before the regression. In this analysis attention has to be paid to variables that show significant correlations that will be put in the same model for the regression analysis. The correlations of the variables are presented in Table 4.2. The dependent variable of total executive compensation show non-significant correlations with both performance measures of ROA and ROE. However, there are some significant correlations that have to be mentioned. LOGEXCOMP shows a strong positive significant correlation with LOGFSIZE, a weak positive correlation with LOGSDIR and LOGPBT as (0.718, 0.257, 0.441) respectively. ROA also shows a weak positive significant correlation with ROE (0.434), while LOGFSIZE reveals a strong positive correlation LOGPBT as (0.756) and LOGPBT shows a strong positive correlation with LOGROE as (0.538). These indicate that an increase in any of the positive variables will leads to a better performance of the correlated variable.
Another important significant correlation is between leverage ratio and Excomp, with a significant negative correlation of -0.062. This means that an increase in one variable can leads to a decrease in the other variable.

Regressions
Dependent Variable: EXCOMP
Method: Panel Least Squares
Date: 05/15/18   Time: 13:59
Sample (adjusted): 2013 2015
Periods included: 3
Cross-sections included: 10
Total panel (balanced) observations: 30

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	39026.97	184087.6	0.212002	0.8341
ROA	-201318.6	333868.4	-0.602988	0.5527
ROE	-55053.05	175396.3	-0.313878	0.7566
SDIR	-1579.344	12402.64	-0.127339	0.8998
FSIZE	0.001424	0.000185	7.684515	0.0000
PBT	0.001237	0.005785	0.213809	0.8327
LEV	117543.5	187931.2	0.625460	0.5381

ECM(-1)	5836.834	9741.891	0.599148	0.5552

R-squared	0.879002	Mean dependent var	338690.4
Adjusted R-squared	0.840503	S.D. dependent var	363959.9
S.E. of regression	145355.0	Akaike info criterion	26.83492
Sum squared resid	4.65E+11	Schwarz criterion	27.20858
Log likelihood	-394.5239	Hannan-Quinn criter.	26.95446
F-statistic	22.83162	Durbin-Watson stat	0.950444
Prob(F-statistic)	0.000000		

The analytical results of the empirical findings are shown in Table 4.3 which X-ray the relationship between executive compensation and financial performance in Nigeria firms. The panel least square output will be used to test Ho_1. The error correction term tells us the speed at which our model returns to equilibrium following short run fluctuations. The adjusted R^2 value of 0.879 means that the value of the dependent variable can be explained by about 87% of the independent variables. This value can be considered sufficient because the executive compensation of the selected firms is also influenced by other factors besides financial performance and board size. In the same vein, the Fisher- statistics values from the table is reflected as 1.714 at 5% significance level. In comparing this figure with the panel regression analysis result, the F statistic value reported in Table 4.3 indicate 22.831. This means that the F-statistic output is greater than the table value. (The table value is derived as: DF=N-K. Where, N=30, K=7 and the Degree of Freedom=23 at 5% level of significance. Therefore, the table value=1.714).

Consequently, the implication is to reject null hypotheses. This is because F-statistic output is greater than the computed table value. This outcome suggests clearly that simultaneously the explanatory variables are significantly associated with the dependent variable (i.e. executive compensation). In other words, the F-statistics prove the validity of the estimated models which are statistically significant at 5% as shown by the F-probabilities. This also implies that all the alternate hypotheses are valid. This outcome implies that an increase in the financial performance of the sampled firms will also lead to an increase in the emoluments of the directors. This outcome supports the methodological position of Ozkan (2011), Tosi, Misangyi, Fanelli, Waldman & Yammarino (2004) and Brunello et al (2001) where they observed a significant positive relationship between total Executive Officers compensation and company performance.

The empirical findings from our research are in consistent with our a-prior expectation (i.e. β1>0), a significant positive relationship was observed between firms financial performance and the executive compensation (director's emoluments) for the sampled firms.
However, consistent with our a-prior expectation (i.e. β2<0), findings on the second hypothesis suggest that there is a significant negative association between board size and the executive compensation (i.e. director's emoluments) for the sampled firms. This outcome is evident in the probability and t-statistics values of (P>|t|=0.899 and -0.127). This outcome basically implies that there is an inverse relationship between board size and corporate executive compensation (i.e. director's emoluments) for the sampled firms. Finally, the Durbin-Watson statistics, a rule of thumb for the measure of autocorrelation is greater than R^2 (0.950444>0.879002), thus indicating the absence of first order autocorrelation. We also arrived at this conclusion because the F-statistics of 22.83162 is greater than the F-probability which is statistically zero. Thus we conclude that financial performance factors influences executive compensation in Nigeria.

Conclusion

This study basically examined the effect of financial performance measures and board size on executive compensation of selected firms in Nigeria. Findings from the empirical results show that financial performance of firms significantly impacts on executive compensation. That is, as the financial performance of firms improves, director's emoluments also tend to increase. However, the study observed a significant negative relationship between board size and Executive Officers compensation (i.e. director's emoluments) for the sampled firms.

Limitation of Study

This study basically considered only the purposeful sampled size of the selected firms and only four years annual report was used, that alone is a major limitation in this study. Hence further research is suggested in this study area which could possibly address the observed limitations of this study, by further examining other corporate governance variables not considered in this study.

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