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Does Race Influence Executive Compensation in Chinese Firms?

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Abstract

Introduction

In this study, we considered the effects of Chinese cultural and political influences on executive compensation in Chinese firms. The chief focus of this study is on whether the race of executives or the racial composition of the compensation committee affects the average compensation of executives, though other factors such as sales, industry, and compensation committee size were also included in the model. Data was collected from Chinese firms listed on the New York Stock Exchange, with data for the companies gathered for the year 2009 and executive salaries collected for the year 2010.

INTRODUCTION

China has recently grown into a major participant in the global market, providing inexpensive labor and the opportunity for companies to make parts and products that are less expensive than they would be if they were produced anywhere else. Between 1990 and 2009 China's Gross Domestic Product (GDP) rose 536% (www.worldbank.org), and it is likely their economy will continue to grow. With China becoming increasingly involved in the manufacturing industry, investors are beginning to consider Chinese companies as viable investment opportunities, and the Chinese firms are beginning to list their stock on the New York Stock Exchange to realize the benefits of the U.S. capital market.

This paper explores an issue that should concern investors in stock of Chinese firms. It investigates executive compensation in listed Chinese firms and focuses on the relationship between whether the executives are Chinese and their executive compensation. The subject of race influencing compensation in Chinese firms is a topic that has not been sufficiently explored. Stockholders should be aware of the basis on which executives are being compensated since it is in their best interests if compensation is not based on executives being Chinese but is instead based on the merit of the executive's performance, as measured by the firm's financial performance.

In this study, we consider the effects of Chinese cultural and political influences on executive compensation in Chinese firms. The Chinese companies used in this study are listed on the New York Stock Exchange and therefore are held to similar reporting and disclosure standards as firms incorporated in the United States, though there are some standards that foreign companies do not have to conform to, such as revealing CEO compensation separately.

A review of past research studies and literature regarding factors that affect executive compensation as well as some possible ramifications of being an outsider in a Chinese firm are presented. Following this is a discussion of the empirical model as well as a description of the variables used. The final section presents the conclusion and features discussion of the implications and limitations of the research findings.

BACKGROUND: COMPENSATION COMMITTEE

While Chinese firms that are listed on the New York Stock Exchange have to abide by similar regulations regarding disclosure as firms based in the United States, they do not necessarily follow the same practices regarding corporate governance. Corporate governance is “traditionally defined as the ways in which a firm safeguards the interests of its financiers”, while the modern definition calls it “the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in the firm's relationship with its stakeholders.” (businessdictionary.com). Under traditional definitions, corporate governance includes the distribution of rewards to personnel within a firm, including the chief executive officer (“CEO”). Thus, examining corporate governance includes an analysis of executive compensation, a topic that has not been explored in depth for Chinese firms. The emergence of China as a global power has made it important to understand what factors affect the compensation of executives of Chinese firms, since investors want corporate governance decisions to serve their best interests.

Decisions about executive compensation are made by a company’s compensation committee, which is traditionally defined as “ [a] group of individuals that have been appointed to evaluate and set the pay rate for senior level management. The committee may also be involved in the selection of other compensation options such as stocks, bonuses, profit sharing, and additional perks.
The establishment of corporate goals, objectives, and awards relevant to compensation may also be handled by the committee” (businessdictionary.com).The compensation committee works on behalf of the stockholders in order to determine what compensation the executives should earn, ensuring it is

based on merit, which is defined in this study as positive firm financial performance. The compensation committee's role is to evaluate executive performance over the course of the business year and determine what compensation is appropriate.

In many listed Chinese companies, the compensation committee is a subgroup of the Board of Directors. While most Chinese companies follow this convention there are a few cases where a member is not on the board of directors but is on the compensation committee. There are also a few cases where the CEO is on the compensation committee but not the board of directors, though this was not the case for any of the firms examined in this study. Since the compensation committee decides the salary and stock options for executives, it plays the most important role in determining executive pay.

For American companies the Sarbanes-Oxley Act enacted in 2002 states that the compensation committee has to be composed entirely of independent directors, with standards set by the Securities and Exchange Commission. The goal of this requirement is to prevent personal relationships between the executives and the committee members from influencing executive compensation (Kalfen, boardmember.com.) To ensure compensation committee independence certain individuals cannot serve on it, such as those who have worked at the company within the last five years, family members of employees, and shareholders with significant ownership.

The independence of compensation committee members is very important, as the compensation committee determines compensation for the executives as well as other elected officers and directors. The compensation committee also reviews the executive's goals and performance in relation to those goals, and makes reports detailing their decision to the stockholders and the board of directors (Dixon, Meyer, www.bnet.com.) Chinese firms that are publicly listed on the New York Stock Exchange also have compensation committees. However, the regulations for non-American firms are slightly different, and do not require compensation committees to have independent directors, though many companies choose to appoint independent directors. Therefore, in China the political environment may encourage relationships that could affect the compensation of the executives, as non-independent board members are allowed to be on the compensation committee. For example, as stated in PetroChina Company Limited's Annual report "Under the NYSE corporate governance rule 303A.05, a listed company must have a compensation committee composed entirely of independent directors, with a written charter that covers certain minimum specified duties. A controlled company is not required to comply with this requirement. We are not required under the People's Republic of China Company Law to have a compensation committee." A controlled company is "is a company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company" (nasdaqomx.com.) This statement refers to the fact that controlled firms are not required to have a compensation committee composed of independent directors, or to even have a compensation committee at all, though in many cases the firms choose to comply with the SEC regulations American firms must comply with.

The premise of agency theory supports the relationship between the compensation committee and the shareholders. The board of directors works as an agent for the stockholders, who seek high firm financial performance, leading to increased stock prices to maximize their ownership wealth. As a subgroup of the board of directors, the compensation committee acts on behalf of the shareholders by determining the compensation of the executives, while making sure that the goals of the shareholders and executives are aligned (investorwords.com.) Agency theory suggests executive compensation is a reward for firm performance, as the better the firm's financial results the more the compensation committee, acting as an agent, will pay the executives in order to retain them to keep the firm on its upward trajectory, and thus meet shareholder goals.

BACKGROUND: CHINESE CULTURE

Geert Hofstede, an expert in how different cultures function, has found that China's focus on individualism is lower than that of any other Asian country. "The low individualism ranking is manifest in a close and committed member 'group', be that a family, extended family, or extended relationships. Loyalty in a collectivist culture is paramount. The society fosters strong relationships where everyone takes responsibility for fellow members of their group." (www.geert-hofstede.com) This collectivist culture stems from the teachings of Confucius. Confucius states that the needs of the group should be placed before the needs of the individual. It was only once Deng Xiaoping came into power that the collectivist culture started to erode, though the idea of putting the well being of the group ahead of the well being of the individual is still widely accepted in their culture today (Meisner, 447). Capitalism is still a relatively new concept in China, beginning only in 1976 when Deng Xiaoping became China's leader, which may mean that some individuals have not accepted the idea of compensating executives based on merit rather than rewarding them on the basis of their collectivist political connections (Meisner, 453-5.) China is not a capitalist country, though it has been moving in that direction since 1976. While Mao Zedong was reluctant to adopt capitalist business practices, Xiaoping adopted some capitalist tendencies during his time in power, while still retaining the power and control over business of the previous government (Meisner,457).

In China, being a member of the Chinese Communist Party ("CCP") can be very beneficial, leading to career advancement and job security. Since the CCP governs China, being a member or having a connection to members can lead to opportunities that would not be available otherwise. However, since the benefits of being a member are so highly known, the CCP cannot accept everyone who applies for membership, with only 77.995 million members as of December 2009 out of a total population of over 1.3 billion (www.chinatoday.com/org/cpc/.) Since the CCP is so selective, those who are not members often may try to create relationships with those who are members, seeking some benefit from the relationship in the future. Many people want to become a member of the CCP, though usually only those who have family connections or who are the top performers in school are granted membership (McGregor, 21). This may lead to a selection bias since it could be assumed that since the CCP only recruits the superior performers then they would merit higher compensation; however not all people who are offered a membership in the CCP choose to accept it, and since there is no list of CCP members readily available it is impossible to know which executives are members of the CCP and which are not. Since only Chinese residents are allowed to join the CCP, foreign (non-Chinese) executives and foreign (non-Chinese) board members cannot have any political clout. While their outsider non-Chinese status does not make them completely independent of political influences, it does make them more likely to be independent of political influences.

Given the political and cultural backdrop a compensation committee comprised of primarily Chinese members overseeing the activity of a non-Chinese executive may be more independent since they have no incentive to consider factors other than firm performance when deciding the executive's compensation (McGregor, 140.) In other words, there is reduced opportunity for the Chinese members to benefit politically or socially by treating a non-Chinese executive favorably, as there is a built in incentive of cultural affinity and party membership involved in determining the compensation of Chinese executives. There are possible other factors which may be corrupt that could benefit non-Chinese executives and give them the same opportunities as Chinese executives, though it would be difficult for a non-Chinese executive to create these opportunities. Further, the degree to which a compensation committee is comprised of non-Chinese members may also establish its independence for the same reason, regardless of the race of executives. The non-Chinese members of the compensation committee will not feel the political or societal pressure to reward either Chinese or non-Chinese executives with higher compensation than firm performance would otherwise warrant, as they would not have been raised in the Chinese culture, which emphasizes loyalty to a group.

This study explores whether the collectivist culture of China, both in terms of traditional Confucian values and the CCP, plays a role in influencing the compensation of Chinese executives. The lack of individualism coupled with strong loyalty to a group, such as their fellow Chinese, could influence the determination of compensation for Chinese executives, leading to increased pay. We specifically focus on whether the race of executives affects their compensation. In other words, does being a non-Chinese executive in a Chinese company affect the executive's compensation because the individual is outside the group? Further, the racial composition of the compensation committee is examined to determine whether the proportion of compensation committee members who are Chinese affects compensation of both Chinese and non-Chinese executives.

RELEVANT STUDIES

According to "Executive Pay and Firm Performance: Methodological Considerations and Future Directions", which utilized data collected from ExecuComp in 2009, the link between performance and CEO compensation varies with what measurement of performance is used, providing evidence that firm performance is a large influencing factor on compensation (Florin, Hallock, Weber, 27.) They use multiple measures of performance, and find that return on assets ("ROA") and return on equity ("ROE") are significant in their relationship to CEO compensation (19).

In the study "Total Board Compensation, Governance, and Performance of Spanish Listed Companies", Rafel Crespi-Cladera and Carlos Gispert-Pellicer examine CEO compensation in large Spanish companies from 1990-1995. They also find that firm performance as measured by ROA and ROE as well as ownership concentration, defined as what percentage of the firm is publicly owned, can affect executive compensation. However, they found that accounting measures of firm performance have a much higher correlation with CEO compensation than market measures such as stock price (Crespi-Cladera, Gispert-Pellicer, 116.) They also consider the governance structure of a firm and how that could affect CEO compensation, and find that the looser the governance structure of a firm the higher the CEO compensation. This finding can be applied to Chinese firms, as their governance structures tend to be looser than American firms due to the lack of government regulation. Chinese companies listed on the New York Stock Exchange do have to comply with certain reporting standards, though many companies voluntarily comply with the same standards as American firms. However, newly listed firms often do not voluntarily comply with the SEC standards American firms must follow. An example of this is the company China Petroleum and Chemical Corporation, which, though it had been listed on the NYSE since 2000, did not list their compensation committee members until 2008.

The study “Executive Compensation, Firm Performance, and Corporate Governance in China: Evidence from Firms Listed in the Shanghai and Shenzhen Stock Exchange”, focused on listed firms from 1998-2002. Takao Kato and Cheryl Long discovered that “while there is evidence of increases in pay in relation to better firm performance, there is also evidence that in state owned firms the link between positive performance and increased pay is more tenuous, meaning that the state owned firm did not have to perform as well as a non state owned firm in order for the CEO to receive the same compensation” (Kato, Long, 2.) Their findings support the theory that in a country with low individualism, the CCP may reward its members by compensating them more than non-CCP members, looking out for the well being of the group members. The Chinese have traditionally not been very open to non-Chinese, especially considering that before the “Reform and Opening” (1976) China was closed off to all foreign countries (Meisner, 456.) Applying these findings to this study, non-Chinese executives may face similar discrimination from Chinese compensation committee members for not being Chinese or members of the CCP, which may in turn lead to their lower pay. Even ethnic minorities in China are allowed to become members of the CCP(http://www.chinatoday.com), so the discrimination is more likely to be directed at non-Chinese executives.

In the study "Board Control, Remuneration Committees, and Top Management Compensation", using data on large, publicly traded firms in the UK from 1991-1994, Martin Conyan and Simon Peck examine the relationships between the board of directors, compensation committee, and executive compensation. In their study they concluded that the higher proportion of independent members of the compensation committee the stronger the correlation between executive compensation and firm performance. They defined independent members as members of the compensation committee who were not executives of another company, since the members who were executives may feel more connected to the company executives and consequently increase their pay (Conyan, Peck, 147). The authors' concept of independence can be applied to corporate governance decisions by Chinese members of the compensation committee. These individuals are considered non-independent members (i.e. insiders), as they have a cultural affinity with Chinese executives. This membership in the same group (i.e. race) could lead to higher compensation rewarded to Chinese executives than non-Chinese executives.

In the study "Board Control and CEO Compensation" (1994), which included information from 193 firms from a cross section of industries, Brian Boyd found that CEO duality has a positive effect on executive compensation. When the CEO also serves as chairman of the board it gives the CEO a wider power base and a way for the CEO to actively lobby for a higher salary that may not be warranted given firm performance. Boyd also corroborates Conyan and Peck's argument, noting that a higher proportion of outside (i.e. independent) directors on the compensation committee leads to executive compensation that is more closely related to financial performance (Boyd, 336.) Again, their finding suggests that outsiders are more independent in assessing executive performance to determine executive compensation. Further, this finding can be applied to the collectivist culture of China where a greater number of Chinese members on the compensation committee could have an effect on executive compensation due to the cultural and political affinity the Chinese have towards each other. A company with a compensation committee composed of a majority of Chinese members could provide Chinese executives with increased lobbying power for their compensation. This advantage is due to their shared cultural knowledge and connection to the CCP, which non-Chinese executives cannot gain access to as easily as Chinese executives, since they would not have the opportunity to join the CCP.The collectivist cultural effect could thus undermine the independence of Chinese compensation committee members, enabling race to play a role in the committee's determination of executive compensation.

Yudan Zheng's study "The Effect of CEO Tenure on CEO Compensation: Evidence from Inside CEOs vs. Outside CEOs", which examines non-financial and non-utilities firms from 1993-2005, considers the effect of being an insider or an outsider on CEO compensation. Zheng considers the difference in compensation of CEOs who are 'insiders' (those who were employed by the firm before they were CEOs and were promoted from within to the position) versus those who are 'outsiders' (those who were not employed by the firm and were brought in from an outside company to become CEO). Zheng found that CEOs who were outsiders typically received less pay than those who were insiders. Zheng acknowledged the reason may be because the board of directors was less sure about the outside CEO's ability since they had had no prior experience within the company. As time passes and the board grew more certain of the CEO's abilities, the compensation may become higher (Zheng, 5). For insider CEOs there was also the key opportunity to create relationships with board members before they became CEO, which might be another contributing factor to the pay gap (Zheng, 6). These findings apply to this study, since Chinese executives have the potential to be insiders as Zheng defines them, working their way up through the company, while it is unlikely that a non-Chinese executive would be an insider as defined in this way. The lack of opportunity to be an insider, coupled with the lack of connections to the CCP may explain the difference, if any, in compensation of Chinese and non-Chinese executives.

Studies have examined the role of ethnicity in executive compensation, such as “Executive Minority Employment and Compensation Gap in the S&P 500: Is Compensation Disparity More Prevalent in Certain Industries,” by Jason W. Toney, which uses data from 2008 and 2009. Toney finds that the income gap between the compensation of white CEOs and minority CEOs is minimal, and that if anything the minority CEOs are receiving slightly higher compensation (Toney, 20.) Toney argues that the slightly higher wages of minority CEOs is due to the unique skill set that they possess, such as abilities to perform under pressure and certain management skills, such as the ability to motivate employees (Toney, 20). The same argument could be made for non-Chinese executives in Chinese firms. These ‘minority’ outsider executives have a different skill set than the insider executives such as resiliency, intuitive knowledge about how to best run a company and management skills that cannot be taught, which suggests that firms may be willing to compensate an outsider executive more in order to gain access to their skills (Toney, 20). Toney’s study raises the counterargument to the potential effect of the collectivist culture on executive compensation in Chinese firms. Rather than the strong cultural affinity Chinese feel towards other Chinese being a factor favorably influencing the compensation of Chinese executives, if compensation of non-Chinese executives proves to be higher it may be because of the unique skill sets the outsider executives possess that would result in more favorable compensation of non-Chinese executives.

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HYPOTHESES

Compensation as a reward for meritorious performance is a new concept in China since the Chinese government did not allow capitalistic practices to be incorporated into businesses until recently.

This could be the underlying reason why political and cultural factors potentially play a significant role in influencing the determination of executive compensation (Firth, 784). In addition to firm financial performance, the collectivist and communist culture may help explain the differences in executive compensation in Chinese firms.

Chinese executives may be compensated more than their non-Chinese counterparts, especially if the compensation committee is composed of a majority of Chinese members. The strong cultural affinity Chinese feel with other Chinese may influence them to compensate Chinese executives at a higher level than non-Chinese executives. While prior studies have focused on CEO compensation, this study examines the average compensation of multiple executives in Chinese firms, since CEO compensation is not separately disclosed by Chinese listed firms. The chief focus of this study is on whether the race of executives or the racial composition of the compensation committee affects the average compensation of executives.

Hypothesis 1. Average executive compensation will be positively associated with a higher proportion of Chinese executives.

Based on prior studies by Zheng (2010), Kato and Long (2004), and Florin, Hallock and Weber (2010), it is expected that average executive compensation will be higher in companies in which there is a higher proportion of Chinese executives. This is expected because the Chinese executives have a cultural advantage over the non-Chinese executives, in the form of collectivism and potential membership in the CCP which will influence the compensation committee to award Chinese executives higher compensation. Chinese executives have the potential to work their way up through the firm to a position of prominence, which non-Chinese executives would not be as likely to do.

Hypothesis 2. Average executive compensation will be positively associated with a higher proportion of Chinese members on the compensation committee.

A higher proportion of Chinese members on the compensation committee will lead to higher average executive compensation because of the cultural affinity Chinese individuals feel towards each other. They will be acting similar to the non-independent members in the study by Conyan and Peck (1998). Since there is a cultural connection the Chinese compensation committee members share with Chinese executives, the Chinese compensation committee members will not be as independent, and will therefore award Chinese executives higher compensation.

The standard model that is used to test these hypotheses is:

Log (Average Executive Compensation 2010) = β_0 *+* β_1*executives (proportion Chinese) +* β_2*compensation committee (proportion Chinese) +*β_3*compensation committee characteristics +* β_4*financial performance +* β_5*industry +* β_6*executives (proportion Chinese)*compensation committee (proportion Chinese) +* β_7*sales*

<u>METHOD AND MEASUREMENT</u>

Data was collected from 72 Chinese firms listed on the New York Stock Exchange website database of firms by country. Data for the companies was gathered for the year 2009, with executive salaries collected for the year 2010. Not all of these firms disclosed all data for both years 2009 and 2010, which resulted in the exclusion of 18 companies from the sample. From those firms that did have data for 2009 and 2010, some did not disclose executive compensation separately but instead disclosed executive and board of directors compensation as an aggregate number, resulting in the exclusion of another 24 firms, reducing the sample size to 30. A summary of exclusions is shown in Table 1.

Table 1:

Reason for Exclusion	Total
No Data for Selected Years	18
Board of Directors and Executive Compensation as Aggregate Amount	24
Total	42

Average executive compensation is defined as the average monetary compensation, excluding stock options and any other forms of compensation that may be awarded. It is determined by taking the total amount of cash compensation awarded to the executive board as disclosed in the annual report of a company divided by the total number of executives listed in the annual report. Some amounts were disclosed in RMB(renminbi), and were converted to dollars using the exchange rate for December 2010, which was 6.60231 RMB for every dollar (x-rates.com). This currency was converted in order to make it easier for those not familiar with the Chinese currency to understand the amounts

The variable Executives (proportion Chinese) is a major focus of this study. Being non-Chinese in a Chinese firm could have a positive effect on average executive compensation, but it also has the greater potential to have a negative effect on average executive compensation. Since non-Chinese executives are not likely to work their way up through the firm, there would have to be some sort of incentive to lure the non-Chinese executives away from their previous position, and this could manifest itself in the form of greater cash compensation. However, since the non- Chinese executives would not have the same cultural connections that Chinese executives would have, this could prompt the compensation committee to award the non-Chinese executive lower cash compensation. While there are two possible ways being non-Chinese could affect executive compensation, it is expected that being

Chinese would have a positive effect on the cash compensation of the executives. As Hofstede has stated, collectivist cultures such as China are very loyal to one another and are wary of admitting outsiders into their cultural group (www.geert-hofstede.com.) Since China has such a collectivist culture they would likely award the Chinese executives higher compensation than the non-Chinese executives, as they would feel more of a connection to the Chinese executives, and would feel the need to band together and award them higher pay than the non-Chinese executives.

The second important focus of this model is the composition of the compensation committee, specifically the proportion of Chinese members. This variable was determined by reviewing disclosures in the annual reports and counting how many of the members were Chinese and how many were non-Chinese. This information was determined by the names of the executives. The proportion of Chinese members is expected to have a positive effect on executive compensation, as the Chinese members of the compensation committee are likely to feel more of an affinity towards Chinese executives and compensate them at a higher level than they would non-Chinese executives. Similarly, there is also the chance that non-Chinese compensation committee members will award non-Chinese executives with a higher salary.

The model also includes a variable which interacts the variable Executives (proportion Chinese) with the variable compensation committee (proportion Chinese) and measures the similarity of the composition of the compensation committee to the executives to determine its impact on average executive compensation. This results in a measure between 0 and 1, with 1 being defined as 100% similarity between executives and the compensation committee (i.e. the compensation committee is composed of all Chinese members and the executives are all Chinese). This variable is expected to have a positive impact on average executive compensation, as the more similar the compensation committee and the executives are the more likely the committee members will grant higher compensation based on cultural similarities and political background, such as being a member of the CCP.

Two other compensation committee variables are also included in the model. These are percentage of independent compensation committee members and average number of other board directorships held by committee members, since these are factors that typically influence executive compensation, as shown in previous studies.

The percent of the compensation committee that is independent is expected to have a negative effect on executive compensation, as independent compensation committee members are more likely to award compensation objectively. Chinese firms are not required to have independent directors on the compensation committee, though many firms choose to appoint independent directors. This variable was calculated by dividing the number of independent members of the compensation committee by the total number of members on the committee. Information about members was the average number of other board directorships held by compensation committee members is expected to have a positive impact on executive compensation, as the more directorships the compensation committee members hold the less time they would have to evaluate the executive's performance and compensate them accordingly. This circumstance could in turn cause members with more outside board commitments to relax their evaluation, and to award higher compensation than they would if they were devoting their attention to fewer firms. This variable was calculated by reviewing disclosures in the annual report and counting the number of other directorships the members of the board of directors served on, then adding them together and dividing by the number of committee members to create an average number. The average number of directorships was used instead of a total number as a way to account for the differences in size of committee.

Financial performance is measured by return on equity. Financial performance is expected to have a positive impact on average executives' compensation, as the better a company is doing financially the more likely the compensation committee is to grant the executives with higher financial reward. While compensation committees often consider non financial factors such as CEO influence within the firm and the environment of the firm, three financial factors - return on assets, return on equity, and return on sales - are also relevant in determining CEO compensation (Ittner, Larcker, Rajan, 235, 246.)

The industry of the firm is another variable that may influence average executive compensation, since executive compensation standards could vary from industry to industry.

Finally, sales is included in the model as a proxy for firm size. This factor is expected to have a positive effect on executive compensation. The larger the sales, the larger the company is likely to be, which suggests there would be a higher level of executive compensation. Sales is measured in billions of dollars. Some firms disclosed the sales figure in both RMB and dollars, and they noted that they used the December 2009 exchange rate to convert sales figures to dollars. Since these firms used the year end exchange rate, this rate was also used to convert RMB to dollars for firms that did not provide the sales figure in US dollars. This exchange rate was 6.83 RMB for every dollar.

The exchange rate used to convert sales from RMB to dollars is different from the one used to convert executive compensation from RMB to dollars because the variable sales is from 2009, which means the December 2009 exchange rate is used. However, executive compensation is from 2010, which is why the December 2010 exchange rate was used in that conversion.

DESCRIPTIVE STATISTICS

Table 2 presents a breakdown of the descriptive results for the variables included in the sample data:

Table 2:

Variable Name	Mean	Standard Deviation
Average Executive Compensation	$ 1,057,951	$ 735,908
Percent of Chinese Executives	95.56%	9.59%
Percent of Chinese Compensation Committee Members	72.72%	32.14%
Percent of Independent Compensation Committee Members	86.10%	28.65%
Average Number of Other Directorships	2.3608	1.5726
Return on Equity	0.1830	0.5863
Industry (Manufacturing)	0.4118	0.4996
Percent of Chinese Executives X Percent of Chinese Compensation Committee Members	69.67%	31.51%
Sales (in billions)	$33.78	$84.22

In the sample of 30 firms, the executive boards were composed on average of 95% Chinese members, with an average of 73% of the members of the compensation committee being Chinese. There was an average of 86% of the compensation committee members being composed entirely of independent members, which is possible because Chinese firms do not have to comply with the same standards as American firms, allowing them to have compensation committee members who are not independent. On average a compensation committee member served on 2.3 other boards. Industry was broken into two categories, manufacturing and service industries, with 51% of the firms in the sample belonging to the manufacturing industry and 49% belonging to the service industry.

EMPIRICAL RESULTS

Table 3 shows the empirical results of the standard model testing the role of race on executive compensation. The standard model resulted in an r^2 of .2443 and an adjusted r^2 of -.0436.

Table 3:

Variable	Parameter Estimate	Standard Error	T Value	Pr>ltl
Percent of Chinese Executives	-0.6415	3.9730	-0.1600	0.8733
Percent of Chinese Compensation Committee Members	-0.0529	4.2306	-0.0100	0.9901
Percent of Independent Compensation Committee Members	0.6036	0.8293	0.7300	0.4748
Average Number of Other Directorships	0.1715	0.0939	1.8300	0.0822
Return on Equity	0.3420	0.3820	0.9000	0.3808
Industry (Manufacturing)	-0.2457	0.3273	-0.7500	0.4611
Percent of Chinese Executives X Percent of Chinese Compensation Committee Members	-0.1946	4.4885	-0.0400	0.9658
Sales (in billions)	-0.0000000000000000027	0.0000000000000000017	-1.5700	0.1324

Our study finds that the only statistically significant variables are average number of other board positions held by the compensation committee members, which is statistically significant at the 10% level, and sales, which is also statistically significant at the 10% level. For every additional board of directors a member of the compensation committee serves on, the executive's cash compensation increases by 17%. This finding is consistent with previous studies. Since it was assumed that sales would have a positive effect on executive compensation, the p value of .1324 is divided by two to create a one tailed test, leaving sales with a p value of .0662. Although significant, the coefficient is small, so for every additional billion dollars in sales, the average executive compensation decreases by

0. 0000000000000027%. Therefore, the real impact of sales is not significant in this study.

This study does not find that the race of either the executives or the members of the compensation committee plays a statistically significant role in influencing executive compensation, and therefore we cannot conclude that race affects executive compensation in Chinese companies. The percent of Chinese executives' variable had a very high p-value, indicating that the proportion of Chinese executives has no statistically significant effect on average executive compensation. The coefficient for this variable was negative, which was not expected, but had this variable been statistically significant a higher percentage of Chinese executives would have a negative effect on average executive compensation.

The percentage of Chinese compensation committee members also has a very high p-value, which again indicates that the proportion of Chinese members on the compensation committee does not affect average executive compensation. This variable also had a negative sign, so had the variable been statistically significant, the higher the percentage of Chinese members on the compensation committee would have caused a decrease in average executive compensation. This relationship was not expected.

The interaction variable, the percent of Chinese executives multiplied by the percent of Chinese members on the compensation committee was not statistically significant. Since neither variable was statistically significant on its own, it is not surprising that the interaction variable was also statistically insignificant. This variable had a high p-value of .96, and the coefficient had a negative sign, so had it been statistically significant this variable would have a negative effect on average executive compensation in Chinese publically listed firms. The expected outcome of this variable is not supported by this model, since it was expected to have a positive effect on executive compensation.

The independence of the compensation committee was slightly more significant than the previous three variables, but it was still not statistically significant enough to explain any variation in executive pay. This is likely because a high percentage (86%) of the compensation committees examined in this study were independent. This variable had a positive coefficient, so had compensation committee independence been statistically significant, a higher level of compensation committee independence would lead to higher average executive cash compensation, which is not what the previous studies would have suggested.

Sales is a proxy for size of the company, and this variable is statistically significant at the 10% level. This variable also has a negative coefficient, so the higher the sales, and thus the larger the company, the lower the average executive compensation. This outcome is contrary to results of previous studies that suggested that larger companies would pay higher executive compensation.

ROE was the only financial variable included in the model, and this was also statistically insignificant, implying that financial measures such as ROE do not explain any variation in average executive cash compensation. A possible reason that ROE is insignificant is that cash compensation does not include any stock related components of the compensation package. ROE had a positive coefficient, so had it been statistically significant, the higher the ROE the higher the average executive cash compensation. This is consistent with previous studies, as a higher ROE would indicate the company is doing well financially and is generating profit for its shareholders, resulting in the executives being rewarded with higher compensation.

Industry was a dummy variable which was also statistically insignificant, indicating that executives in the manufacturing industry are not compensated at a level different from their executive counterparts in the service industry. The coefficient on the variable was negative, so had it been statistically significant executives of firms in the manufacturing industry would be compensated at a lower level than executives who worked in the service industry.

The lack of significance of variables other than average number of other board of directorships and sales shows that the theories previously discussed in this paper are not supported, and race is not a factor influencing average executive cash compensation of publically listed Chinese firms. This outcome does not hold with the findings in other papers, as previously conducted research indicated that insider status could affect compensation, although whether it would have a positive or negative impact was uncertain. The lack of impact race has on average executive cash compensation is surprising when the collectivist culture of the Chinese is considered, as this culture dictates that individuals help their fellow Chinese at the expense of outsiders. The political connections between Chinese would also be expected to come into play, as members of the CCP would be expected to receive higher compensation than their outsider counterparts. However, the effects of these political and cultural influences on the determination of executive compensation were not supported by the findings of this study.

ADDITIONAL STATISTICAL ANALYSIS

Two additional models were examined, one which included a sample size of 54 companies that used aggregate average executive and board of director's cash compensation as the dependent variable and one that kept the original sample size of 30 firms but included an additional variable for state owned companies. Neither of these models produced statistically significant results at the 10% level.

The first additional model[1] included aggregate average compensation of the board of directors as well as the executives, and this model was not found to explain the variance in compensation any better than the model that only included average executive cash compensation. Although it was a larger sample size, no variables were found to be statistically significant. Furthermore, with both the standard model and this model, even when percent of Chinese executives, percent of Chinese compensation committee members, and the interaction variable were individually regressed with average executive compensation, each one was found to be statistically insignificant at the 10% level.

The second additional model[2] also included state owned as a variable, which was found to be statistically significant at the 10% level. However, this outcome is of limited use since only 2 out of 30 firms in the sample were state owned. It is not surprising that this variable is statistically significant, as state owned firms are more likely to reward their executives with higher compensation regardless of firm performance. The political connections and outside relationships between compensation committee members and executives as well as the likelihood of membership in the CCP would influence the compensation committee members to award the executives higher cash compensation. This outcome is supported by Geert Hofstede's findings on the collectivist culture of China and would be especially prevalent within the CCP, as the CCP is very active in supporting its members.

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[1] See Table 4 in appendix for results from this model.
[2] See Table 5 in Appendix for results from this model.

LIMITATIONS OF STUDY

While the empirical results of this study found that only two of the variables in the standard model were statistically significant, there are some limitations to the study that may have caused these results. One of the most striking limitations is the small sample size. For the standard model that used average cash compensation of the executives as the dependent variable, the sample size was only 30 firms. For the additional model that used aggregate average executive and board of director cash compensation, the sample size was only 54 firms. Unfortunately, the sample size was limited by the information available on the New York Stock Exchange website.

Another limitation of the study is that Chinese firms do not have to fully comply with U.S. standards and thus they did not disclose CEO compensation separately. Instead executive compensation was disclosed as an aggregate number, which is why this study examines average compensation of executives and race of those executives as a proportion of the group.

This study is further limited because it is only examining average cash compensation of the executives, and is not considering additional forms of compensation such as stock options, which can be a large portion of the total executive compensation package. This again is due to the limited disclosure of the Chinese firms, as oftentimes they did not reveal any form of compensation except the cash compensation amount. This limitation may contribute to the reason the financial variable is not statistically significant, as the entire compensation package is not being considered. If the non cash compensation were included the financial variable (ROE) might be significant in determining overall compensation.

There were also some variables that were excluded from this study that represent limitations. The number of meetings the compensation committees held was unavailable, as the different reporting standards the Chinese firms abide by do not require that the number of meetings are disclosed. Another variable that was omitted was the percentage of the firms that were state owned. Two of the firms in the sample size of 30 were completely state owned.[3] However if a state owned firm is the majority shareholder in a non-state owned firm, the “non-state owned” firm is still operating under some degree of state ownership. Therefore, accurate data about non-state owned firms is not readily available. Consequently this variable cannot be effectively used in the study. Party membership was another variable that had to be excluded since the CCP does not make a list of members in the party readily available, and it would be extremely difficult to try and determine whether each executive and compensation committee member was a member of the CCP. The tenure of the executives is also a variable that was omitted, as it would be extremely difficult to discover the tenure of each executive, as this information was often not listed in the annual report.

A further limitation is that the determination of race was based solely on the names of the executives and compensation committee members. It is possible that some of the Chinese executives were not actually from China but were born to Chinese parents in a foreign country, which could cause them to be seen in much the same way as non-Chinese.

Unfortunately, since China is still a developing country and has only recently become a force to be reckoned with on a global scale, the information publically available even for listed Chinese firms is extremely limited. This study only included firms listed on the New York Stock Exchange in an effort to make sure the information utilized in the study was reliable. Since these firms are only recently listed on the NYSE, many firms do not fully comply with the same disclosure standards as American firms. As

[3] Also, in the sample of 54 firms, the number of state owned firms remained at 2.

China becomes a larger global presence, Chinese firms will be required to reveal more information, which may make it easier to conduct a study of this nature. Chinese firms that want to be listed on the NYSE will soon have to fully comply with the same standards as other firms that are listed on the NYSE, and may therefore disclose CEO compensation separately, as well as forms of non-cash CEO compensation. It also seems likely that more Chinese firms will want to be listed on the NYSE, which would increase the amount of data available.

CONCLUSION

This study set out to determine if the race of the executive board and the compensation committee influences executive compensation in Chinese public companies, with the expectation that race would be a significant variable. The results of the study do not support the hypotheses, as none of the variables that dealt with race were statistically significant. Thus, we cannot conclude that the race of the executive board or the compensation committee affects the average cash compensation of the executives.

While the main focus of the study turned out to be statistically insignificant, this is potentially good news for investors in these firms. Since the race of the compensation committee and the executive board does not impact average executive compensation this suggests that executives are not being compensated for being Chinese, a reason that has no bearing on their ability to lead a company. However this raises the question if the only variables that were found to be relevant are average number of other board directorships held by compensation committee members and sales, then what other factors influence the average executive cash compensation? Before this question can be effectively answered for Chinese firms there will need to be further studies with a larger sample size, including variables that were not able to be included in this study given the limited disclosure of Chinese firms currently listed on the NYSE.

While the results of this study were unexpected, this lends credence to the desirable outcome that there may be objectivity in determining the compensation of executives in Chinese publically listed firms. Although it is unclear what factors influence executive cash compensation in these firms, our results suggest that the race of the executives and the race of the compensation committee members are not factors that are associated with average executive cash compensation.

This study did not deliver the expected results concerning race, but there is further research that could be conducted in this area, especially concerning the issue of race and its influence on executive compensation in other countries. While the effect of race on CEO compensation has been examined in U.S. firms, less research in this area has been done in other countries, and it could be an interesting avenue to pursue in the future.

As China’s economy continues to grow, it will become more of a global force and interest in Chinese firms will expand. While future studies may focus on different aspects of Chinese corporate governance and the compensation of its executives, there is no doubt that with the growth of Chinese corporations as viable investments globally, studies such as this one will become more prevalent.

APPENDIX

Table 4: Model that included Executive and Board of Director Compensation. This model had an r^2 of .0332 and an adjusted r^2 of -.1387. The sample size for this model was 54. When run with the additional variable state owned, there were still no statistically significant results at the 10% level.

Variable	Parameter Estimate	Standard Error	T Value	Pr > |t|
Percent of Chinese Executives and Directors	1.53103	3.48943	0.44	0.6629
Percent of Chinese Compensation Committee Members	0.91624	4.03874	0.23	0.8216
Average Other Directorships	0.02943	0.10295	0.29	0.7763
Percent of Independent Compensation Committee Members	0.64057	0.76478	0.84	0.4067
Sales (billions)	-0.0000000000000000098	0.0000000000000001401	-0.07	0.9445
ROE	0.07582	0.43882	0.17	0.8636
Percent of Chinese Executives and Directors X Percent of Chinese Compensation Committee Members	-0.86639	4.63342	-0.19	0.8525
Industry (Manufacturing)	0.04213	0.44927	0.09	0.9257

Table 5: The standard model with the additional variable state owned. This model has an r^2 of .3383 and an adjusted r^2 of .0405. Much like the variable sales, state owned is presumed to have a positive effect on executive compensation, which would mean the pr >|t| would be divided by 2, making it .055 and statistically significant at the 10% level.

Variable	Parameter Estimate	Standard Error	T Value	Pr > |t|
Percent of Chinese Executives	-0.21368	3.81831	-0.06	0.96
Percent of Chinese Compensation Committee Members	0.74857	4.08445	0.18	0.86
Percent of Independent Compensation Committee Members	0.91311	0.81637	1.12	0.28
Average Number of Other Directorships	0.10568	0.09805	1.08	0.29
Return on Equity	0.47619	0.37524	1.27	0.22
Industry (Manufacturing)	-0.2787	0.31419	-0.89	0.39
Percent of Chinese Executives X Percent of Chinese Compensation Committee Members	-1.28049	4.35198	-0.29	0.77
Sales (billions)	-0.0000000000000000214	0.0000000000000000114	-1.87	0.08
State Owned	1.06877	0.63035	1.7	0.11

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