

The Presence of Revenue Growth Metric in CEOs Incentive Compensation Programs A Grounded Theory Study

*التعاقد على مقياس نمو الإيرادات في خطط المكافآت التحفيزية للمديرين
منهج النظرية المجردة*

Haroun AZOUI, University of Mohamed Khider Biskra, azouiharoun@gmail.com

*Received: 30/08/2022; Accepted for reviewing: 15/02/2023 ; Accepted for
publishing: 31/12/2023*

Abstract:The aim of this study is to develop a classic grounded theory that explains why compensation committees include revenue growth metric in CEOs incentive compensation programs, and how they arrive at deciding to include it into those programs. Motivating the CEO to best achieve efficient RG emerged as the main concern, and to resolve it, selecting emerges as the core category, which accounts for the process leading to resolve the main concern. Selecting is based on two sub-categories: (1) contracting, (2) responding.

keyword:classic grounded theory; compensation committees; revenue growth; CEO incentive compensation program; performance metrics.

JEL classification code :**XN1, XN2**

المخلص: هدفت هذه الدراسة لتطوير نظرية مجردة كلاسيكية تفسر لماذا تختار لجان المكافآت مقياس نمو الإيرادات للتعاقد عليه في خطط مكافآت المديرين، وكيف يتم التوصل إلى اتخاذ قرار اختيار ذلك المقياس ليكون ضمن تلك الخطط. توصلت الدراسة إلى أن الانشغال الرئيسي للجان المكافآت هو السعي لتحفيز المدير بطريقة ملائمة لتحقيق هدف النمو الفعال كهدف استراتيجي. ولحل الانشغال الرئيسي تعتمد لجان المكافآت على الفئة الرئيسية التي تمت تسميتها بمصطلح الانتقاء كمفهوم يفسر السيرة التي تقود إلى اتخاذ قرار تضمين مقياس نمو الإيرادات في خطط مكافآت المديرين وتفعيله.

الكلمات المفتاحية: النظرية المجردة الكلاسيكية؛ لجان المكافآت؛ نمو الإيرادات؛ خطط مكافآت المديرين، مقياس الأداء.

التصنيف:

Corresponding author: Haroun AZOUI,

e-mail: azouiharoun@gmail.com

1. Introduction :

The Executive compensation has generated a spirited debate among academics and practitioners alike for almost a century. A good example of that would be one of the earliest empirical studies on this issue by Taussig and Baker (1925) that found little relationship between executive pay and firm performance (Gomez-Mejia & Wiseman, 1997). Before December 2006, where the United States Securities and Exchange Commission (hereafter SEC) issued new disclosure requirements on the compensation of chief executive officers (hereafter CEOs), our understanding of the contractual terms that govern CEO compensation and especially how the compensation committees tie CEOs compensation to performance was still incomplete. This fact has led researchers to doubt that such contracts optimally tie CEO compensation to company performance (Angelis & Grinstein, 2015).

In constructing the manager's contract, boards choose between multiple measures to capture manager effort. Boards tie CEO compensation to price-based measures of performance or accounting-based measures of performance when the measure provides a contractible signal of agent's effort (Sloan, 1993; Lambert and Larcker, 1987). When market or accounting-based performance measures are susceptible to shocks outside the manager's control, relative performance evaluation improves the risk-sharing benefits between managers and shareholders (Holmstrom, 1982).

Motivating managers through accounting-based compensation contracts is an important demand for accounting numbers. Although the empirical accounting literature has successfully established the usefulness of accounting metrics in compensating executives (e.g., Lambert and Larcker 1987; Sloan 1993), there are few studies on how specific accounting measures are used in compensation contracts. Consequently, a number of important questions remain unanswered: What is the role of accounting accruals in executive compensation contracts? What factors drive the use of specific accounting measures (e.g., sales, cash flows, earnings, and return on assets)? (Huang, Li, Ng, 2013). Although Huang, Li, Ng, 2013) noticed the lack in the extant literature and the necessity to bridge this gap, and found empirical evidence on which circumstances accounting measures (e.g., sales, cash flows, earnings, and return on assets) are preferred to determine CEOs bonuses, their study remains descriptive and did not explain the

concern that each measure is supposed to help resolve, and the process to resolve it.

In sum, the research on accounting-based performance measures have sought to examine whether the accounting-based performance explain the link between CEO compensation and company performance or not, and what makes accounting-based performance measures preferred in managerial contracts to link CEO compensation to company's performance. This stream of research has adopted deductive approach, and relies on quantitative research strategy; the researchers draw on agency and tournament theories to model the relationships between executive compensation and financial performance using various panel regression models to examine the existence of any relationships between the modeled variables. The rationale behind this methodological choice is the inability to observe directly the CEOs compensation contract terms due to the lack of any obligation to disclose the content of these contracts. However, since December 2006 things have changed when the SEC has issued new disclosure rules on executive compensation, requiring enhanced disclosure of the contractual terms of CEO pay. Among the disclosed items are the performance measures in the performance-based awards used to assess CEO performance and the reliance on relative performance evaluation. So the ability to observe directly the CEO compensation contract terms became possible and the examination of the directly observable variable or data will lead to a better understanding of the phenomenon than only drawing inferences from the outcomes. Many studies, since then, initiate the use of new data disclosed in annual companies' proxy statements, (De Angelis & Grinstein, 2015; 2019; Murphy & Sandino, 2019) but the epistemological stand and methodological choice remain unchanged, the post-positivism paradigm and quantitative research strategy are still predominant and preferred by researchers.

This study adopts a different view to study the use of accounting-based performance measures in CEOs incentive compensation programs as it seeks to understand why the compensation committees and the CEOs select the revenue growth metric as an accounting-based performance measure to agree upon determining a part of CEO incentive compensation, and how they arrive at such a decision. Therefore, unlike the prevalent studies on the subject, this study relies on the classic grounded theory methodology using qualitative research

strategy to generate a substantial theory that explains the presence of revenue growth metric in CEOs incentive compensation programs.

2. Methodology:

Classic grounded theory methodology is well suited in areas where little is known; it allows the researcher to focus more on exploring and the emergence of theory from empirical data. We still don't know enough about the perspectives of using accounting-based measures, especially the RG, in CEOs compensation plans. The concern surrounding the use of RG metric in CEOs incentive compensation programs; thus, grounded theory methodology will be convenient to this research aim.

2.1. Method:the methodological procedures delineated in grounded theory, as proposed by Glaser and Strauss (1967), are simultaneous and iterative process of data collection, coding, and constant comparative analysis to generate a theory, which has to show "the relation between concepts which emerged from the population by constant comparing and then are related to each other by a theoretical code" (Glaser, 2016). Classic grounded theory requires approaching the area of study without defined problem or question (Glaser & Strauss, 1967).To do so, I started my study with abstract wonderment of what is the concern companies try to resolve using RG metric in their CEOs incentive compensation programs, and what is the core process that continually resolves the main concern of those companies.

Not to preconceive and staying open is indispensable to the discovery or the emergence of grounded theory (Glaser & Strauss, 1967).To comply with, I made every effort to acknowledge and limit any preconceptions concerning the area under study. On the other hand, the investigated area remains understudied, and the extant literature is predominantly based on deductive approach or what is known as optimal contracting view suggested mainly by (Jensen &Meckling, 1976; Jensen & Murphy, 1990); or based on inductive description as in The rent extraction view suggested by (Bebchuk& Fried, 2004). Moreover, the extant body of knowledge deals, almost, with the legitimacy of CEOs compensation with regard to companies' performance, not with the concerns surrounding the selection of metrics a CEO incentive compensation program is based upon and the processes to resolve them. Thus, in part, the lack of theories explaining

the specific use of specific accounting measures helped me set aside preconceptions.

2.2. DataCollection: Grounded theory methodology is known from its dictum “all is data” (Glaser, 2001; 2007). However, interviewing participants and observation are the predominant data collection methods. This study is one of the few studies based only on documents to generate classic grounded theory.

The decision on which slice or slices of data in grounded theory study depends on what data directs to get theoretical saturation. In grounded theory it is believed that “Different kinds of data give the analyst different views or vantage points from which to understand a category and to develop its properties; these different views we have called slices of data.” (Glaser & Strauss, 1967, p.65). Notwithstanding, the relevance, availability, and accessibility to data are bounds of decision on the collection of slices of data.

This study is based only on a document called: proxy statement. Proxy statement is a document that contains the information that the SEC, pursuant to section 14(a) of the Securities Exchange Act of 1934, requires companies to provide to shareholders so they can make informed decisions about matters that will be brought up at an annual or special stockholders meeting. Issues covered in a proxy statement must disclose all important facts about the issues on which shareholders are asked to vote, it can include financial performance, proposals for new additions to the board of directors, information on directors and executives’ compensation plans as salaries, equity-based compensation, bonuses and option plans, and any declarations made by the company’s management (see <https://www.sec.gov>).

I have chosen this data slice because of: its relevance to the study aim; its availability; and the ease of accessibility. The document is considered relevant after checking the aim of its issuance which is to disclose to the shareholders, specially, and the public, in general, the main decisions made by the management within the company’s surrounding context (as mentioned above). So the document is an official report elaborated carefully by the management to account for shareholders about managerial issues entrusted to them. The CEO compensation plan, which represents a managerial phenomenon under study, is one among those issues.

The document is publicly available on two sources: on companies' websites, and on SEC website. All visitors are allowed to download the document for free. Since proxy statements are publicly available; the illustrating quotations are referred to their companies contrary to what is used with interviewees' quotes which are anonymously presented for research ethical considerations. The intent was to help readers to notice some aspects like size, industry, and company life cycle, but not to break the rule Glaser points out as describing grounded theory as "general and abstract of the study population by time, place and people." (Glaser, 2016, p 3)

The ease of accessibility is a major bound when deciding on data slices, given the geographic distances, possibility to have appointments with interviewees, time frame, financial and institutional support. The researcher depending on his or her position from the accessibility's bounds will decide on the appropriate data slices. In my case, using internet access to download the companies' annual proxy statements was the appropriate mode of accessibility

2.3. Dataanalysis: In grounded theory the process of collecting and coding data, comparing incidents identified in the data with each other and with emerging concepts, writing memos is iterative. (Glaser 1967). To start the analysis of any company's proxy statement I needed to go through the entire document and see if there is any potential incidents in relation to the study subject, and focus in particular on the section entitled: CEO Compensation: discussion and analysis. (Hereafter CCDA); because, as the section title indicates, it is the document's part that is dedicated to disclose and explain the reasons and objectives of each compensation element, the way of its calculation and the payments to the company's CEO and other executives.

After deciding on 2018 HP Inc. proxy statement as purposely selected document to start the data collection, I have been gleaning any phrase or paragraph (hereafter incident) that bears disclosures about CEO compensation in relation to revenue. Just after, I started the open coding phase which results in few initial substantive codes. Where to go next for collecting more data to get theoretical saturation was guided by making use of the principle of classic grounded theory, the concurrent analysis directed what data to collect next, and in which group it was likely to be found (Glaser, 1998).So, the next documents to analyze were those of the companies disclosed on 2018 HP Inc.

proxy statement as its peer group in that fiscal year. Each document was analyzed by making the same steps as the first document; going through the entire document then focusing on CCDA section. Advance, in open coding and in comparing incidents and codes to each other, gives rise to the emergence of some initial categories.

After analyzing the first set of data, more data were needed, so from which sources the next data will be gathered was a frequently asked question. I had no plausible choice except moving from the peers of HP Inc. to the peers of the peers. To do so, I randomly pick any company in the list of the HP Inc.'s peer group, and check its list of companies that constituting its peer group, and then I download their 2018 proxy statements from their websites. Some companies compel me to move through years 2019, 2020 to observe the pattern in their proxy statements for consecutive years. The second set of data was largely broader than the first one. The rationale behind this way of sampling is twofold; the first is that the sample is determined by the data itself. The second is that moving from a company to its peers then to the peers of the peers involves the idea that these companies have at least some common characteristics and concerns, as size, industry sector, attracting investors, competition for talent, and so on. Finally I end up with sample consists of 21 companies registered in Standard and Poor's 500 Stock Index (S&P 500).

As I advanced in analyzing the data collected from the peers of HP Inc.'s peers, selecting emerged as core category, I moved to the selective coding phase while remaining open to any new code that could arise. During this phase, categories began to encompass under new categories that tend to be more abstract than before and some relationships between categories started to emerge.

Writing memos was done simultaneously and concurrently since the beginning of coding. Reviewing memos and comparing them to each other was helpful to discover some theoretical codes. Nevertheless, sorting the theory as coherent body of concepts wouldn't have been possible before resorting to the use of "six C's" technique. The "six C's" help to distinguish data into general categories: causes, contexts, contingencies, consequences, covariance and conditions (Glaser, 1978). So the technique helped me to realize what drives what, what constitutes context factors, what are the conditions. For example, I couldn't realize the relationship between: accountability and

controllability until they are classified as requirements (conditions) to responsabilizing and are mutually affected.

The analysis of data was continuing until getting theoretical saturation which is reached when no new code emerges from data.

3. The theory of presence of RG in CEOs incentive compensation programs:

the main concern, which recurrently manifests throughout the expressions used by the compensation committees in the CCDA sections in companies' annual proxy statements to disclosure: the reasons to select the CEOs compensation metrics; objectives they set; and the context in which the company operates—is how to appropriately motivate the company's CEO to best achieve efficient RG as a strategic goal, in such a way that current and potential investors, and third parties, would perceive it as in line with their expectations. The compensation committees try to resolve their main concern by selecting RG as a CEO performance metric, and including it in the CEO incentive compensation program.

As the core category, the concept of selecting accounts for the decision made by the contracting parties (compensation committee and CEO), which is based on a process leading to qualifying RG metric to be included in CEO incentive compensation program to motivate the company's CEO in order to best achieve the efficient RG as a strategic goal.

Selecting has two main dimensions (sub-categories): (1) contracting which performs with the help of three sub-sub-categories: consenting, generating desirable behavior, and responsabilizing; (2) responding, which is influenced by two sub-sub-categories: informing investors, and being congruent. While compensation committees engage in contracting to activate selecting, responding is a consideration of environmental factors that represent investors' need to information and their beliefs about companies' valuation.

3.1. Contracting: selecting represents a decision on strategic choice, contacting is the set of conditions and actions the contacting parties count upon to substantiate that choice and put it into action. The contracting parties are the compensation committee that acts on behalf of the stockholders and the CEO who works for his or her own behalf. The contracting subject is about delegating necessary decision making authority from stockholders to the CEO to achieve the contracted goals.

So, the CEO engages in undertaking the mission instead of acquiring the right to be compensated in accordance with what the parties concluded.

Contracting performs with the help of three sub-sub-categories: consenting, generating desirable behavior, and responsabilizing.

3.1.1. Consenting: contracting needs a pre-contracting phase, which requires consent on the characteristics of RG metric; because these characteristics provide the rationale behind qualifying RG metric to be selected and contracted for. The contracting parties consent to that RG metric is aligned to strategy and is able to capture the CEO initiatives and reflect their outcomes.

Alignment to strategy: The most challenging issue companies face, after deciding on the appropriate strategy, is how to implement it successfully. The implementation involves, among other things, selecting the metric(s) that can guide the daily actions towards achieving the strategic goals. The strategic goal that compensation committees announce when they select R.G. metric as a CEO performance-based compensation metric is: efficient growth. They mean by efficient growth increasing revenue in accordance with resources allowing considerations; the revenue growth should be the result of sacrificing a reasonable amount of company's resources and in accordance with revenue development policy guidelines, which frames the strategic RG initiatives and holds them within the company's suitable area of actions, thus being shielded from repercussions of unsuitable actions.

Growth efficiency assessment is made with reference to return measures as return on invested capital, cash flow and profitability Ratios; and by contextualizing the outcomes within benchmarking peer group. Moreover, achieving RG goal cannot be perceived as a company's success feature unless it is reached in accordance with revenue development policy. The guidelines of revenue development policy aim to make clear the revenue development initiatives, which may result in good or bad repercussions; as achieving revenue growth can be reached in different ways: increasing prices, volume or some combination of them. So the overpricing may result in customers backlash and force prices to rollback, thus destroy long term shareholders value creation.

Seeking revenue growth efficiency is not risk-free; it may induce CEO to not engage in initiatives that decrease short term revenue even when those initiatives may be in the company's best long-term RG. This potential behavior may be due to seeking to enhance efficient ratios through restraining the denominators, which represent capital expenditures. Revenue development policy is the reference that frames the alignment of RG initiatives to company's strategy. "The metrics used ... have undergone changes over the years to support our business strategies. ..., the Committee has continually reviewed the metrics used in our performance-based plans and adopted metrics consistent with our strategies on efficiency ..."(Ford 2019 Proxy Statement, p.42).

Reflectiveness: RG metric is seen as capable to reflect the success of strategic initiatives that have been engaged in pursuit to efficient RG as strategic goal. Contrasting realized revenue to target one, which represents the ambitious goals, is the means by which the success of strategic initiatives is assessed. Strategic initiatives are beyond operating activities that ultimately result in long term stockholders value; thus capturing the interim effect of strategic initiatives helps in assessing how far a CEO succeeds in the creation of long-term stockholder value. The contracting parties refer to reflectiveness and consent to it, as a fundamental characteristic to qualify RG metric to be selected as a CEO performance-based compensation metric: "The organic sales growth measure was selected because it reflects the underlying momentum of the Company's business." (Colgate 2019 Proxy Statement, p.35) Another company provides more details:

Total Revenue reflects the extent to which we are able to attract and retain customers and the level of penetration of our products and services in key markets. The committee views this measure as an important indicator of Verizon's growth and success in realizing its strategic initiatives.(Verizon communication 2019 Proxy Statement, p.38)

The capability to reflect constitutes a source to inform both management and investors about the company's objectives and the advancements toward it, as emphasizes this company "... revenue, [and other metrics]– are meaningful measures of our performance that we use both internally to measure our performance and externally to report to investors and that we believe are strongly correlated to shareholder returns in both the short and long term." (Comcast Corporation 2020 Notice of Annual Meeting of Shareholders, p.46). Seeing reflectiveness

as a source of information will help in making informed decisions by current and potential investors, as well as assessing CEO's achievements by compensation committee to reward her or him appropriately.

3.1.2. Generating desirable behavior: it has become obvious that “without being able to modify people's behavior effectively no company can survive or grow” (Christiansen, 2006, p120). Murphy & Jensen the most known in the field, comment the observed CEO's bonus plans as:

Almost all CEO and executive bonus plans have serious design flaws that limit their benefits dramatically. Such poorly designed executive bonus plans destroy value by providing incentives to manipulate the timing of earnings, mislead the board about organizational capabilities, take on excessive (or insufficient) risk, forgo profitable projects, and ignore the cost of capital (Murphy & Jensen, 2011, p. 1).

The compensation committees consider that generating desirable behavior by means of compensating the CEO upon RG metric can be attainable relying on RG metric's driving capability which is obtained from RG's incentive power; this power is continually fueled by rewarding and is regulated by balancing considerations.

Driving capability: a performance driver is a measure that encompasses a set of actions that generate desirable outcomes. Some scholars (Kaplan and Norton, 2000) suggest that the achievement of any strategic goal needs a strategic map that makes explicit the series of hypotheses between causes and effects that lead to the desirable outcomes.

Compensation committees count upon the RG's driving capability to generate desirable behavior; because they believe that selecting RG as a performance driver will help the CEO to focus on the set of actions that ultimately result in the company efficient RG as a strategic goal, which was already considered, in its turn, as one of long term stockholders value drivers. The focus is supposed to benefit the company as well as the CEO, through guiding the allocation of company resources by making clear to the CEO the objectives to work on; thus inducing him or her to identify the set of actions that generate the efficient RG goal and allocate the company resources definitely to these actions. If the CEO succeeds in fulfilling his or her challenge undertakings; then, he or she acquires the right to be rewarded. Any

resources allocation or CEO's efforts out of the identified set of actions will benefit neither the company performance nor CEO compensation, because of lack of relationship between the actions and the desirable outcomes. "Our named executive officers may earn shares under the annual LTI PSU awards based on achievement of the specified performance goals [...] because ... revenue helps focus our executives on sustainable long-term corporate growth." (Western Digital Corporation 2018 Proxy Statement, p.60).

Incentive Power: Compensation committees rely on RG incentive power to continually supply the CEO by motivation energy to keep the driving capability machine running. Therefore they believe that the metric has a potential incentive power that comes from rewarding. The compensation committees suppose that the reward a CEO can earn, if he or she meets the RG goal levels, will induce him or her by the means of desire to earn, and by the pain of losing potential reward, as ending up with an "O" instead of his or her efforts regarding that goal all over the year. Moreover, what is considered as underperforming may endanger the CEO's reputation in managerial market. Seeing that the aim of any CEO incentive compensation program is to attract, develop, and retain talented leaders; as this compensation committee announced "We design our executive compensation programs to achieve our goals of attracting, developing, and retaining global business leaders who can drive financial and strategic growth objectives and build long-term shareholder value."(Johnson and Johnson 2019 Proxy Statement p. 57) Thus, failing not merely mean losing the current reward, but could also cause the CEO to no longer be viewed as a talented leader by shareholders.

The compensation committees count on these two forces to impact on CEOs behavior to take the actions in best of RG achievements. The first force (desire to earn) starts impact on CEO behavior from the minimum threshold up to maximum threshold. The second force (pain of losing), the compensation committee expects that the more CEO approaches the goal, the more feeling pain mitigates and vice versa.

*Rewarding:*the contemporary dictum that companies embrace, when they announce their executive compensation philosophies is: "pay for performance". Although fair pay is the rationale behind pay for performance philosophy, the incentive effect is the ultimate aim. Wherefore, the compensation committees count upon reward to fuel the

incentive power. Reward takes many forms that have to be in line with balancing considerations. In general, cash is used to reward the achievements of short term objectives; the equity based compensation is used to reward the long term achievements “The Compensation Committee structured the 2020 LTI awards to provide strong alignment between the executives’ incentives and the key drivers underlying our long-term growth strategy, including our three-year Organic Revenue Growth metric.” (PepsiCo 2019 Proxy Statement, p.55).

Balancing:selecting R.G. metric, as a CEO incentive compensation metric to induce the CEO to behave in accordance with what was visualized as a desirable behavior to achieve efficient RG as a strategic goal, may involve inducing the CEO to take over risky decisions; like increasing sales with effect from augmenting prices or reducing profitability and engaging in inefficient capital investment.

To mitigate the risk of inducing excessive risk behavior or seeking to enhance one performance measure on the detriment of the other performance measures, the compensation committees rely on balancing as a tool to keep the incentive power within the borders of its target zone. The performance measures that compensation committees aim to get balanced are: revenue growth, profitability, cash generating and efficient capital use. These measures constitute the performance key drivers of long term stockholders value creation. On the other hand, the balancing has to cover the time frame too (short and long term).

Assigning weight to CEO compensation based on R.G. metric or using it as a modifier to adjust bonuses are the ways to achieve balancing. This company announced how to achieve balancing:

The C&LD¹Committee also noted that the design of the PSP²reduces the likelihood that an executive will focus too much on a single performance measure by including four different performance categories with weightings of 20% or 30% each to provide a balanced risk profile. The categories are: organic sales growth relative to competitive peers, constant currency core before-tax operating profit growth, core earnings per share growth, and free cash flow productivity.(Procter & Gamble, 2019 Proxy Statement, p24).

The balancing often also needs to be reinforced by the payment instruments (cash and equity) and restrictions on vesting period “Under

¹C&LD:Compensation & Leadership Development

²PSP: Performance Stock Program

our shareholder-approved LTI Plan, stock options, RSUs, PSUs and LTC Awards generally require a three-year minimum vesting period.” (PepsiCo2019 Proxy Statement, p.57).

3.1.3.Responsibilizing: after consenting and generating desirable behavior, contracting needs to be completed with responsabilizing to provide CEO by the necessary control over the company’s resources and hold him or her accountable for the outcomes resulting from exerting control over those resources. Responsibilizing seeks to eliminate the performance factors beyond the CEO’s hand; thus avoiding undeserved reward or penalty. Compensation committees announce as a CEO compensation philosophy principle what they called: pay for performance, called also: linking pay to performance. Responsibilizing is a feature of substantiating this principle. The way to achieve responsabilizing based on two mechanisms: accountability and controllability, which are mutually impacted.

*Accountability:*accountability is a company governance feature; therefore, companies tend to responsabilize their CEO for performance. One way to support CEO accountability is to set goals that CEO has the most control over. In other words: enhancing controllability. Growing revenue is considered as under the control of the CEO; thereby, rewarding him or her upon R.G. metric is a way to hold the CEO accountable for company performance, as can be deduced by this excerpt:

Verizon views accountability to shareholders as both a mark of good governance and a critical component of our success. In 2018, management and our Directors met with our shareholders and engaged in discussions on a variety of issues, including ...; and the relationship between our compensation program and our long-term strategy.(Verizon 2019 Proxy Statement, p. 23).

*Controllability:*controllability is a condition to legitimate accountability. The R.G. metric is viewed as being under the control of CEO, unlike the market measures that are impacted, in part, by factors beyond management hand. Compensation committees consider R.G. metric as controllable performance measure that is impacted directly by CEO’s decisions, and in order to maintain the controllability at a high level, the R.G formula excludes factors that may affect controllability level, like foreign exchange rate fluctuation, revenue from non-continuing operations, and accounting standard changes. “These performance metrics ... can be impacted by our executives...[They]

can have a direct impact on our sales, operating income, and ROI. Furthermore, ... sales, operating income, and ROI are not materially impacted by our share repurchase program.” (Walmart 2019 Proxy Statement, p. 52)

Ensuring controllability aims to responsabilize CEO through keeping him or her accountable for his or her managerial decisions. Though, R.G cannot be totally shielded from micro-economic factors, assessing the metric relatively to benchmarking peer group will support the controllability by contextualizing the outcomes.

3.2. Responding: Selecting R.G as a metric in CEO incentive compensation program is not merely an internal issue; it is also strongly affected by external environment factors which are: investors need for information, and investors’ beliefs. These factors cannot be looked over; because they impact directly the investors’ perception of the company’s market value. The compensation committees respond to these factors by: first, defining the investors and third parties who are viewed as company’s evaluators, and their needs for information, in order to be matched. Second, being congruent to the evaluators’ beliefs; these beliefs are about industry conventions and stock price correlation to RG values.

3.2.1. Informing Investors: compensation committees recognize that investors analyze growth trends relying on what is called: top line performance, as a metaphor to indicate the top line of income statement, which represents the company’s revenue in a given period, quarter or year, to understand what underlies the growth and how its momentum is “...We believe this measure [R.G] is useful to investors and management in understanding our ongoing operations and in analysis of ongoing operating trends.” (Honeywell 2018Proxy Statement, p. 104), “Net operating revenue aligns with the Company’s growth focus, by reflecting how we are sustainably growing top-line performance.” (Coca-Cola 2019 Proxy Statement, p. 53).

Retaining customers and acquiring new ones are the primary source of long term value creation, and this source manifests financially as revenue. Although high amount or growth in revenue doesn’t necessarily mean that a company makes earnings; nevertheless, it remains the primary source from which the earnings can be made real. Investors observe and assess trends of earning relatively to revenue and other factors; for example “To Warren [Buffet], the source of

earnings is always more important than earnings themselves” (Buffett & Clark, 2008, p. 27)

Investors view a company that shows consistent R.G. as having a great potential to sustainably create shareholders value; therefore, the company is required to manage all its efforts towards achieving its RG target to meet its current and potential investors’ expectations, as this company stated:

Sensata currently grants two forms of PBUs; PRSUs and GPUs. PRSUs are tied to adjusted EPS and ROIC. GPUs are tied to organic revenue. The Adjusted EPS, ROIC and organic revenue growth targets are set by the Committee at the start of the performance period, taking into account the Company's short- and long-term financial operating plans and shareholder expectations regarding the Company's earnings performance and growth. (Sensata2019 Proxy Statement, Appendix B-6).

Selecting R.G as a metric in CEO incentive compensation program carries out a straightforward message to investors that the company has fostered the growth strategy and has put it into action. The compensation committees expect that this message will Impact investors’ forecasts positively, especially if the company shows a consistent R.G. trend, this trend is supposed to be perceived by investors as having the ability to create sustainable long term shareholders value. If the company succeeded in convincing investors about its potential, then the likelihood of increasing its market value will increase; as a result of leveling up investors’ expectations about its ability to create sustainable long term stockholder value.

3.2.2. Being Congruent:compensation committees respond also to the external factors, when deciding on selecting R.G metric, by being congruent with the evaluators’ beliefs about industry conventions and the stock price correlation to the historical RG values.

Some industries have developed conventions over time. Such kind of conventions frames the assessment of companies’ success by investors and third parties, this tenet comes from the assumption that the human perception of events is shaped by beliefs. The compensation committees, that recognize that their companies operate under such circumstances, take into consideration these conventions and acknowledge that the selection of RG metric is, in part, imposed by industry convention. The intent is to be congruent with evaluators’ beliefs. Thus; being congruent is a sort of conformity which supposed

to support the ability to convince the company evaluators about its potential to generate future value and impact on their investment decisions; because their decisions are the source of the company's market value creation. "The Compensation Committee also included revenues as a quantitative criterion because revenues are commonly used as a selection criterion by our peer companies, third-party compensation survey providers and proxy advisory services."(Qualcomm 2019Proxy Statement, p. 48)

The stock price correlation to RG historical values, on the other hand, is another factor that influences the attitude of compensation committees toward the beliefs of company evaluators and compel them to be congruent with those beliefs; they argue that the historical trend shows correlation between R.G metric amounts and share prices; this observation makes companies suppose the existence of a cause and effect relationship between motivating CEO (by compensating him or her according to R.G. metric achievements) and company's stock price; thus reaching R.G. targets will result in stock price enhancements, as clearly stated in this excerpt:

As we continue our strategic transformation, we believe it is important to drive strong performance with respect to traditional measures of success in the retail industry. Our incentive metrics of sales, operating income, and ROI are traditional measures of retail success and are commonly used by retailers in their incentive plans. Moreover, they are broadly correlated with share price in the retail industry and aligned with our historical stock performance. (Walmart 2019 Proxy Statement p. 46)

4. Conclusion:

The theory of presence of RG metric in CEOs incentive compensation programs explains how compensation committees resolve their main concern of how to appropriately motivate the company's CEO to best achieve an efficient RG as a strategic goal, in such a way that current and potential investors, as well as third parties, would perceive it as in line with their expectations. To resolve the main concern, selecting emerges as the core category. Selecting accounts for the decision made by the contracting parties (compensation committee and CEO), which based on the process leading to qualifying RG metric to be included in CEO incentive compensation program to motivate the company's CEO in order to best achieve the efficient RG as a strategic goal. Selecting is based on two sub-categories: (1) contracting, which

performs with the help of three sub-sub-categories: consenting, generating desirable behavior, and responsabilizing; (2) responding, which is influenced by two sub-sub-categories: informing investors, and being congruent. While compensation committees and CEOs engage in contracting to activate selecting, responding is a consideration of external factors that represent investors and third parties' needs for information that have to be satisfied, and their beliefs about industry conventions and the relationship between RG and share prices.

The theory adds to the literature by offering new approach to study the presence of different kind of metrics in the CEOs incentive compensation programs to get a deep understanding of the concerns relating to each metric or metrics group, and to explore the processes in order to resolve those concerns in a substantial area. The importance of studying the metrics and the processes to set them was mentioned by Mejia (1997) as described the failure in prior research on CEOs pay that may be attributed in part to the failure "to distinguish the process used to reward or punish the executive, the indicators [metrics or measures] used to pay the executive, ... [and] external context ..." (Mejia, 1997, p 292). The theory will contribute to get insights on these dimensions that often overlooked by researchers.

The theory, also, offers a plain depiction of the process of selecting RG metric to be included in CEO incentive compensation program, which may help professionals to get a deep insight when designing CEOs compensation programs. Researchers noticed that there was a need for a deep understanding of the CEO compensation design to avoid defects in plans. They reported that: "Remuneration committees ..., lack both the time and expertise to be involved in the minutia of performance evaluation and pay design." (Jensen, Murphy and Wruck, 2004, p.51). The theory may assist compensation committees' members and other professionals to support building their expertise and bridge this gap, which, in my view, due to the lake of theories that explain the use of each metric or group of metrics in CEOs incentive compensation programs.

The theory has limitations regarding the data it is built on, for it is built only on "official stories" that are told in companies' proxy statements; and focuses only on one CEO compensation metric, which

is RG, whereas CEOs incentive compensation programs involve several metrics that remain behind theory scoop.

References

1. *Bebchuk, L. A., & Fried, J. M. (2004). Pay without Performance: The Unfulfilled Promise of Executive Compensation. Cambridge, MA.: Harvard University Press.*
2. *Buffett, M., & Davide, A. C. (2008). Warren Buffett and the interpretation of Financial Statements, The Search for the Company with a Durable Competitive Advantage. New York: Scribner.*
3. *De Angelis, D., & Grinstein, Y. (2015). Performance terms in CEO compensation contracts. Review of Finance, 19 , 619–651.*
4. *De Angelis, D., & Grinstein, Y. (2019). Relative performance evaluation in CEO compensation: A talent-retention explanation. ECGI finance working paper n 615/2019 .*
5. *Fama, E. F., & Jensen, M. C. (1980). Separation of ownership and control. Journal of Law and Economics, 26 , 301–325.*
6. *Glaser, B. G. (2007). All is data. The Grounded Theory Review, volume 6, issue 2 , 1-22.*
7. *Glaser, B. G. (1998). Doing grounded theory: Issues and discussions. Mill Valley, CA: Sociology Press.*
8. *Glaser, B. G. (2016). Grounded Description: No No. The Grounded Theory Review, Volume 15, Issue 2 , 3-7.*
9. *Glaser, B. G. (2001). The Grounded Theory Perspective: Conceptualization Contrasted with Description. Mill Valley, Ca: Sociology Press.*
10. *Glaser, B. G. (1978). Theoretical sensitivity. Mill Valley, CA: Sociology Press.*
11. *Glaser, B. G., & Strauss, A. L. (1967). The discovery of grounded theory: Strategies for qualitative research. Chicago: IL: Aldine Publishing.*
12. *Gomez-Mejia, L. R., & Wiseman, R. M. (1997). Reframing executive compensation: An assessment and outlook. Journal of Management, 23(3) , 291-374.*
13. *Holmstrom, B. (1979). Moral Hazard and observability. The Bell Journal of Economics 10 (1) , 74-91.*
14. *Holmström, B. (1982). Moral hazard in teams. Bell Journal of Economics, 324-340.*

15. Huang, Y., Li, N., & Ng, J. (2013). *Performance Measures in CEO Annual Bonus Contracts*. working paper, university of texas at Ausin .
16. Jensen, M. C., & Meckling, W. H. (1976). *Theory of the firm, managerial behavior, agency costs and ownership structure*. *Journal of Financial Economics*, 3 , 305–360.
17. Jensen, M. C., & Murphy, K. J. (1990). *Performance Pay and Top-Management Incentives*. *Journal of Political Economy*, 98 , 225-264.
18. Jensen, M. C., Murphy, K. J., & Wruck, E. (2012). *CEO Pay and What To Do About It: Restoring Integrity to Both Executive Compensation and Capital-Market Relations*. Cambridge, MA: Harvard Business School Press.
19. Jensen, M., Murphy, K., & Wruck, E. G. (2004). *Remuneration: Where we've been, how we got to here, what are the problems, and how to fix them*. Working Paper, Harvard Business School .
20. Kaplan, R. S., & Norton, D. P. (2000). *Having Trouble with Your Strategy? Then Map It*. *harvard business review*, September–October , 1-13.
21. Lambert, R. A. (2001). *Contracting theory and accounting*. *Journal of Accounting and Economics* 32 (1-3) , 3-87.
22. Lambert, R., & Larcker, D. (1987). *An analysis of the use of accounting and market measures of performance in executive compensation contracts*. *Jornal of Accounting Research*, 25 , 85-125.
23. Murphy, K. J., & Sandino, T. (2019). *Compensation Consultants and the Level, Composition and Complexity of CEO Pay*. Working Paper 18-027 at Harvard Business School .
24. Murphy, K., & Jensen, M. (2011). *CEO bonus plans: And how to fix them*. Working Paper, Harvard Business School .
25. Sloan, R. (1993). *Accounting earnings and top executive compensation*. *J.Account. Econ.* 16 (1-3) , 55-100.