Gender, Top Executive Compensation, and Risk Taking. A Mediating Model

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Bachelor of Science

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Purpose/Motivation: Women are said to be more risk-averse than men, even on the executive level. Furthermore, the compensation of executives also influences risk-aversion and there are gender differences in executive compensation structures. Since risk-aversion of top executives might benefit, but also harm firm performance, firms consider the characteristics associated with risk-taking behavior to be important.. Connecting the fields of gender and compensation, this thesis asked whether there is a mediating effect of gender differences in compensation on gender differences in risk-taking.

Theories/Hypotheses: The literature suggests that female top executives are more risk-averse than male ones (e.g., Faccio, Marchica & Mura, 2016). Additionally, research demonstrated that compensation of female top executives is less performance-sensitive than compensation of males (Kulich, Trojanowski, Ryan, Haslam & Renneboog, 2011). This paper argued that female CEOs only have limited impact on pay-setting processes and, thus, their compensation structure. Consequently, differences in risk behavior of women could be explained by differences in their compensation. Since performance-sensitive compensation is used by firms to incite certain top executive behavior, this thesis connected the two arguments and tested the following hypotheses:

> H1: Gender affects risk-taking: Female top executives are more risk-averse than their male counterparts.
>
> H2: The effect of female top executives being more risk-averse than male top executives is (partially) mediated by differences in their compensation packages.

Approach/Methodology: The paper used data mainly taken from ExecuComp and Compustat over a 14-year period (2006 – 2019), which provided observations on 2,418 firms and 4,615 CEOs, of which 4,3 percent were women. The longitudinal data were analyzed using random effects models. Risk-taking was measured by a factor analysis of R&D (Research and Development) investments, capital expenditures, and leverage. CEO compensation was measured by base salary, total compensation, current wealth, and prospective wealth, the latter

two being measures for option wealth of CEOs (Martin, Gomez-Mejia & Wiseman, 2013). The analyses controlled for several firm-level and CEO characteristics.

Findings: The effect of CEO gender on risk-taking was insignificant. Thus, no mediating effect was demonstrated either. Female CEOs tended to earn higher salaries and a higher total compensation than males, whereas they received less prospective option wealth. The effect of CEO gender on current wealth was insignificant.

Research Limitations: Only large, listed US companies were included in the analyses, thereby ignoring smaller and non-US companies. Only 4.3 percent of CEOs were female, which might account for insignificances. The influence of CEOs on their compensation structure could not be empirically assessed.

Research Implications: Gender stereotypes at the CEO level might not be as persistent as prior research estimated. More research is needed to clarify the mediation effect.

Practical Implications: Some of the constantly reported gender differences in risk-taking might have faded over the years, at least at the top executive levels. Female CEOs in the US seem to have not been financially discriminated against in recent years. The results offer important insights for pay-setting committees of firms.

Contribution: The mediation effect of executive compensation on executive risk-taking has not been addressed so far. Analyses rather focused on the question whether female CEOs receive a different compensation due to their risk-aversion (focusing on active preferences). Furthermore, the paper provides up-to-date insights on gender differences in risk-aversion and compensation on the executive level.

Paper type: empirical

Further readings:

Carter, M. E., Franco, F., & Gine, M. (2017). Executive Gender Pay Gaps: The Roles of Female Risk Aversion and Board Representation. *Contemporary Accounting Research*, *34*(2), 1232–1264. https://doi.org/10.1111/1911-3846.12286

Devers, C. E., McNamara, G., Wiseman, R. M., & Arrfelt, M. (2008). Moving Closer to the Action: Examining Compensation Design Effects on Firm Risk. *Organization Science, 19*(4), 548–566. https://doi.org/10.1287/orsc.1070.0317

Faccio, M., Marchica, M.-T., & Mura, R. (2016). CEO gender, corporate risk-taking, and the efficiency of capital allocation. *Journal of Corporate Finance, 39,* 193–209. https://doi.org/10.1016/j.jcorpfin.2016.02.008

Kulich, C., Trojanowski, G., Ryan, M. K., Haslam, S. A., & Renneboog, L. D. R. (2011). Who gets the carrot and who gets the stick? Evidence of gender disparities in executive remuneration. *Strategic Management Journal*, *32*(3), 301–321. https://doi.org/10.1002/smj.878

Martin, G. P., Gomez-Mejia, L. R., & Wiseman, R. M. (2013). Executive Stock Options as Mixed Gambles: Revisiting the Behavioral Agency Model. *Academy of Management Journal*, *56*(2), 451–472. https://doi.org/10.5465/amj.2010.0967