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Surrey research: independent directors help rein in bossy bosses

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Surrey research: independent directors help rein in risky CEO pay

New research from the University of Surrey suggests that independent company directors may be more effective at scrutinising executive pay than critics often assume.

The study found that companies with a higher proportion of independent board members were quicker to correct CEO pay arrangements that could expose shareholders to unnecessary risk.

The research, published in *European Financial Management*, focused on “inside debt” — a term used to describe executive rewards such as pensions and deferred compensation. Unlike bonuses or shares, these forms of pay can encourage chief executives to take a more cautious approach, because part of their personal wealth is tied to the company’s longer-term financial health.

Researchers examined 6,357 firm-year observations across 942 US companies between 2006 and 2019. They looked at executive pay, company accounts and governance data to assess how quickly firms adjusted CEO compensation towards what the researchers calculated to be a healthier balance.

The study found that companies with more independent directors adjusted CEO pay structures more quickly. This effect was particularly strong in high-growth companies, financially secure firms and businesses led by overconfident chief executives, where poor incentives may create greater risks for shareholders.

The findings challenge the view that company boards simply approve executive pay packages shaped by powerful CEOs. Instead, the research suggests that independent directors do intervene when pay structures move too far away from what may be financially appropriate for the business.

The study also found that boards did not simply cut or increase compensation automatically. Where the risks linked to CEO inside debt were lower, independent boards moved more slowly, suggesting that directors weigh the costs and benefits before changing pay structures.

Bonnie Buchanan, co-author of the study and Associate Dean International for the Faculty of Arts, Business and Social Sciences at the University of Surrey, said: “There is a common perception that boards are often powerless when it comes to executive pay, particularly when dealing with influential CEOs. What we found is much more nuanced. Independent directors appear willing to step in and adjust compensation structures when they believe shareholders could be exposed to unnecessary risk.”

Shuhui Wang, co-author of the study and Senior Lecturer in Finance at the University of Surrey, said: “Executive compensation has become incredibly complex over the last two decades. Our findings suggest independent directors are not simply approving pay packages without scrutiny. They are making detailed decisions about when faster intervention is needed and when a slower approach makes more sense.”

The researchers argue that inside debt receives far less public attention than share-based rewards, even though it can have a significant influence on corporate decision-making. Used carefully, it may help boards balance risk-taking with long-term stability.

The study also suggests that board independence mattered more than pressure from institutional investors or major shareholders when it came to adjusting executive compensation structures.

Professor Buchanan added: “This matters because executive pay shapes how companies behave. If boards get those incentives wrong, it can affect investment decisions, growth and ultimately shareholder value. Strong independent oversight appears to play an important role in keeping those incentives balanced.”

The study was written by Bonnie Buchanan and Shuhui Wang of the University of Surrey, in collaboration with Tina Yang, Associate Professor of Finance at the Kate Tiedemann School of Business and Finance, University of South Florida.

Sam Jones – Reporter



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