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Incentives for Top Managers in American Corporations and Privatized Polish and German Enterprises**

1. Introduction

The paper analyzes the changes in systems of economic incentives applied in relation to different employee groups of privatized state-owned enterprises in Poland and Eastern Germany. We were especially interested in changes occurring in the incentives offered for their top executives, that is persons belonging to the top management of these enterprises (which is directors in the period before privatization and next management boards in the period after privatization), and - although to a smaller extent - for members of their boards of directors (usually appointed not until the process of ownership transformations started).

While embarking upon this research project we accepted an initial assumption boiling down to a general hypothesis, in accordance with which the changes in systems of economic incentives used in privatized enterprises in Poland and Eastern Germany will be gradually bringing these systems closer to those which can be found in the countries with a well-established market economy such as the Federal Republic of Germany and the United States. Since we are primarily

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interested in the incentives offered for top executives, the analysis starts with a brief description of the systems of incentives in the U.S. corporations, and particularly large ones, which are relatively most frequently borrowed by the companies in other countries. On this basis we shall formulate some more detailed research hypotheses. They will be formulated both on the basis of trends of changes in the field of compensation and incentives observed in practice and certain theoretical concepts including the so-called alternative theories of the firm and the theory of property rights. As regards the alternative theories of the firm, we have in mind primarily the behavioural theory of the firm and the managerial theories of the firm, as well as other theories assuming, among others, the goals of firm activity being alternative in relation to the traditional profit maximization concept such as, for instance, the theories of self-governing firm. The behavioural school represented by such authors as: H.A. Simon, J.G. March and R.M. Cyert criticizes the traditional concept of optimal economic choices replacing it with the concept of satisfactory solutions (satisfactory enough) and emphasizing the impact of intra-organizational factors on the goals of activity and the policy of large companies being largely independent of the market (see Simon 1957, 1959; Cyert and March 1963). The managerial theories of the firm represented by such authors as: W.J. Baumol, O.E. Williamson, J.K. Galbraith and R. Marris are focussed primarily on the process of separating ownership from control in large corporations with dispersed ownership, in which the real power (control) more and more frequently rests with professional managers pursuing a policy oriented more at the maximization of expansion (growth) of corporations and accomplishment of their own goals (such as increasing their incomes and prestige, expenditures on the office personnel, etc.) than at increasing profits and dividends for owners (stockholders) (see Baumol 1959; Williamson 1964; Galbraith 1967; Marris 1963, 1966). In turn, the theories of self-governing (also participatory) firm, which find application today mainly in the case of firms controlled by employees emphasize a short-term orientation in firms dominated by employees, which finds expression, among others, in priority given by such firms to the growth of employee current compensation and the neglecting of innovations and investments (see Ward 1957; Vanek 1970). The theory of property rights represented by such authors as A.A. Alchian, H. Demsetz, E. Furubotn and S. Pejovich places emphasis primarily on the impact exerted by different structures of ownership on the effectiveness of management and the allocation of economic resources (see Furubotn, Pejovich 1974). The formulated research hypotheses will be next submitted to an empirical verification through analyzing the data coming from selected Polish and East German companies.The conclusions resulting from the detailed analysis of the data for the six-year period 1989-1994 coming from selected 16 Polish and 8 German enterprises (privatized in 1992) surveyed by us will be confronted with the conclusions ensuing from other empirical studies and generally available statistical data.

2. The systems of incentives for top managers in American corporations

Speaking about the incentives for top managers, and particularly about the compensation of persons being members of the management boards and the boards of directors in companies, we have in mind primarily their incomes connected with their employment itself in the company and participation on the board of directors, i.e. their compensation. Thus, we are fully omitting here their possible incomes from other sources.

The main source of information about the compensation of top executives in the U.S. corporations and members of their boards of directors (called directors in the United States after the board of directors - the supervisory board) are annual reports (the so-called proxy statements) submitted by corporations to their stockholders before the stockholders general meeting. This information is also supplied to the appropriate government agencies (and particularly the Securities and Exchange Commission); it is disseminated and analyzed by specialist journals (e.g. "Forbes") and even daily newspapers and in this way it makes its way to the general public.

2.1. Main elements of top executive compensation

According to the classification made by the Conference Board (an institution based in New York, which has been publishing reports on top executive compensation for a long time), the main elements of top executive compensation are: the salary and the so-called incentive compensation. The incentive compensation includes annual bonuses treated as short-term incentives and the long-term compensation, which is composed of: the restricted stock and bonuses for long-term effects of corporations, as well as stock options. In practice, alongside the main elements of top executive compensation listed here, the positions in corporations, particularly large ones, provide also other benefits and incomes for top executives such as e.g. profit sharing, incomes from various types of savings-investment funds supported by many corporations, old age pensions, insurance and the so-called fringe benefits or additional benefits for top executives such as a free or partly paid for use of company cars and aircraft, as well as clubs and apartments belonging to the company, free counselling in different matters, etc.

2.2. Salaries

Salaries are usually the most stable element of executive compensation. In the case of the lower and intermediate management salaries constitute a predominant part of compensation. This does not concern top executives in large corporations, whose salaries represent as a rule below 50% of their compensation. An important role played by the salaries of executives results primarily from the fact that they are a basis for fixing many other elements of compensation, e.g. certain premiums and bonuses, payments made by corporations to definite funds, etc.

The level of salaries depends mainly on: the position held, the corporation size and its field of economic activity. An important factor taken into account when fixing salaries (similarly to the entire compensation) of executives is the level of salaries in competitive corporations. The research carried out by the Conference Board shows that the median of annual gross salaries collected by the chief executives of corporations with annual sales of US$ 100 million and more reached about US$ 485,000 in the U.S. manufacturing industry in 1991, while the salaries of the next four executives in the hierarchy of a given corporation represented on average 61%, 51%, 46% and 41% of the above amount respectively (Top Executive Compensation 1992, tabl. 25 i 27, p. 21).

2.3. Annual bonuses

Annual bonuses are bonuses linked with the corporation's profitability in a given year, which can be paid regularly each year provided the corporation achieves the planned level of profitability. Hence, they are treated as a short-term incentive and they are used primarily in order to create a material incentive for the maximization of profit. At the present time they are paid mainly in cash,while in the past they were sometimes paid in the shares of the corporation or also partly in cash and partly in shares. The plans of such bonuses are usually constructed in such way that the amount of the bonus should reflect both the corporation's profitability and the contribution made by particular executives.

The bonus fund frequently represents a share of the achieved profit, with its final amount being dependent on concrete bonus formulas worked out in most cases by special committees appointed by the supervisory board. Most formulas define: 1) a certain minimum profitability level (along with the measure of this level), with its achieving being a preliminary condition for setting up the bonus fund, and 2) the percentage of profit which can be allotted for bonuses.

The most frequently met measure of profitability is the rate of profit or also the return on equity ratio.

As regards the principles of bonuses allocation among particular employees covered by the bonus plan it is a general rule that bonuses are differentiated according to the position held, that is the higher the position held the higher the bonus. The bonus-salary ratio also increases along with the employee promotion from lower to higher managerial positions. For example, in corporations belonging to the manufacturing industry this ratio in 1991 was within the group of five best rewarded executives differentiated and it ranged on average from 40% (in the case of the fifth executive in organizational hierarchy) to 56% (in the case of the chief executive officer) (Top Executive Compensation 1992, tabl. 28 i 29, pp. 21-22). Another general rule is that both the average amount of the annual bonus annd its ratio to the salary rise along with passing from a lower to a higher corporation size class.

2.4. Restricted stock

The restricted stock means in brief the gratuitous stock carrying some restrictions such as, for example, a certain minimum length of service in the corporation (usually from 3 to 5 years) or also a prohibition of selling or transferring the stock received during this period.

The practice of passing gratuitous stock to employees by corporations, and particularly to top executives, has been known in the United States for quite a long time, with the popularity of this form of incentives remaining under the influence of changing tax regulations. From the corporation's point of view it is a solution inducing executives to pay more attention to the "market" aspects of the corporation's activity. It also increases their inclination to get more closely linked with the corporation for a longer time and identify themselves with stockholders. From executives' point of view this solution is particularly advantageous, as it creates an additional source of income for them without any risk and any financial contribution on their part.

2.5. Long-term performance plans

Long-term performance plans appeared in the United States in the early 1970s. At the present time they include principally two forms of incentives: bonuses in the form of long-term performance shares and bonuses in cash called long-term performance units. Their common characteristic is that the bonus depends upon the long-term performance of the corporation. They usually cover a relatively narrow group of executives, who can receive bonuses in the amounts dependent on the degree to which a given long-term goal assumed in advance such as e.g. the growth in earnings per share in the period of three to five years has been achieved. In such case the absolute amount of individual bonuses will be ultimately determined by two factors, that is the degree to which an assumed goal has been achieved and the prices of the corporation's stock on the capital market.

2.6. Stock options

A very important role among various incentives offered for top executives of the U.S. corporations is played by stock options. The stock option can be treated as the right to buy stock. A given employee - usually a top executive - is given the right to buy a certain (frequently very big) number of a given corporation's stock at the price fixed in advance (which is usually equal to the market price on the day the stock option is issued by the corporation). The person can make use of this right, although they do not have to, within a definite time (generally during 10 years). The specific moment at which the option will be exercised is decided upon by the person who has received the option. As a rule the option carries, however, a reservation that it can be redeemed only after a certain period of time, which usually means three to four years from the moment the option is issued.

Similarly to other forms of incentives based on the stock, stock options are an incentive inducing top executives to link themselves with their corporation for a longer period of time and pursue a policy leading to the growth of the corporation's long-term profit and dividends for its stockholders. This is due to the fact that the profit and the dividend belong to the most important factors to which the capital market responds directly (in the form of such and no other price of a given corporation's stock), while the growth of top executives' possible incomes resulting from stock options will be determined by the growing market price of the stock.

In practice, stock options are a highly discretionary incentive, which is due both to the fact that corporations restrict the number of participants of stock option plans (to a relatively narrow circle of executives, in whom a given corporation is especially interested and who are assumed in a way to have a major influence on its economic effects), and also because substantial amounts of money are required to purchase a bigger number of shares (which is more often possible in the case of persons collecting a high compensation). Corporations can also offer preferential terms in stock purchases such as e.g. a possibility of paying the amount due for the purchased stock in instalments or providing a low-interest loan for this purpose. Simultaneously, the right to acquire the stock within stock option plans is usually issued to a given executive many times, which creates a bigger possibility of raising their incomes and strengthens their ownership ties with major stockholders.

At the present time two forms of stock options can be met in the United States. These are the so-called nonqualified stock options and incentive stock options. The incentive stock options, similarly to the qualified stock options to be found in the past, must fulfil certain conditions envisaged by law (concerning, first of all, the length of time between the moment the stock option is issued by the corporation and the time it must be purchased or eventually sold). Owing to this solution the possible income from the stock received can benefit from major tax reliefs. The non-qualified stock options do not fulfil these conditions and, consequently, the possible income from the stock is subject to different tax regulations.

Both the incentive stock options and the nonqualified stock options can be accompanied by the so-called stock appreciation rights (SARs) and stock swap rights. The stock appreciation right implies the right to benefits resulting from the growth of stock market price from the time the stock option was issued. Resigning from the right to a part or a whole option, that is from the right to buy the issued stock option, a given executive can receive in cash the amounts that could be obtained when tapping the right to the stock option. The stock swap right, on the other hand, can be generally considered as the right to swap the "old" stock for the "new" stock. This solution boils down to the possibility of paying for the "new" stock issued within newly launched stock option plans not with cash but with the "old" stock held by a given executive and acquired owing to the earlier stock option plans. This procedure can be repeated many times and it allows to receive new options without the necessity of gathering considerable amounts of money for this purpose. Moreover, it also allows to postpone tax payments.

According to numerous surveys, the highest incomes due to stock options are usually achieved by chief executive officers and particularly in large corporations. These incomes are, of course, quite differentiated in particular years due to the fluctuations in stock prices on the Stock Exchange. The reports written by about 800 chief executive officers and analyzed by the "Forbes" magazine clearly show that the incomes of CEOs in large corporations due to stock options frequently exceed several times their incomes from all the remaining elements of the executive compensation (e.g. salaries and bonuses).

2.7. Compensation (fees) of the board of directors members

It is a general rule followed by the U.S. corporations that the board of directors members, who are simultaneously full-time employees of corporations usually referred to as inside directors in the United States, do not receive any additional compensation for their participation in board meetings. In turn, the board members, who are not full time employees of corporations and who are usually called outside directors or non-employee directors, do not have the right to typical incentive plans built with full time corporate directors in mind.

The compensation of "outside" directors (most often called „annual retainer fee" recently) usually comprises several elements and their composition can be differentiated in particular corporations. Practically all corporations offer a stable annual compensation to their "outside" directors. A big part of corporations gives them additionally stable fees for their participation in particular committees of the board, with their level being quite often differentiated according to the committee on which they work. The best rewarded are such committees as: the Audit Committee, the Executive Committee, and the Executive Compensation Committee. Quite common practice are also additional fees for the chairmen of particular committees, whose level is also quite often differentiated depending on the committee. Almost all corporations provide their "outside" directors with additional fees for participation in particular meetings of the board and committees, or for each day on which such metings are held (if the meetings last more than one day). Corporations also usually cover the costs of directors' travel and stay connected with their participation in these meetings ("per diem"). Moreover, the so-called "teleconferences" of boards of directors, which have become quite popular recently, are also paid for.

Another quite common practice is covering by corporations the insurance premiums against accidents, life assurance and insurance against financial liability for their "outside" directors. Increasingly more corporations guarantee old age pensions for their "outside" directors, which are usually equal to their stable annual fees for participation in the board of directors and which can be received once a given director reaches a definite age (differentiated among corporations) during a period equal to their length of service on the board, and sometimes till the end of their lives. More and more corporations issue to their "outside" directors also the restricted stock and stock options.

The total compensation of "outside" directors received for their participation in the board of directors is obviously quite differentiated depending on the corporation's size, field of its economic activity and other factors (e.g. in 1993 it ranged in the manufacturing sector from US$ 1,250 to US$ 75,000) and, moreover, it is several times lower than the top executive compensation.

For example, according to relatively comparable data of the Conference Board concerning the U.S. manufacturing industry the median of "outside" directors' compensation reached ca. US$ 29,000 in 1993, while the median of full current compensation (i.e. salaries and annual bonuses) of CEOs amounted to ca. US$ 585,000 over the same time (see Corporate Directors' Compensation 1994, tabl. 1 i 2, s. 12; Top Executive Compensation 1995, s. 13-14).

2.8. Conclusions

The systems of incentives offered for top executives by the U.S. corporations comprise many different solutions, which could be relatively easily tapped in other countries, and especially in corporations (joint stock companies). However, they also contain some specific characteristics, which do not allow to transfer automatically certain solutions to other countries.

Moreover, the systems of top executive compensation and incentives have a number of significant advantages. As a rule they are characterized by great elasticity and simultaneously simplicity, as well as by their pragmatic character. A very important role in the systems of incentives for top executives is played by the so-called mobile elements of compensation and long-term incentives linked with the capital market.

Despite a big number of corporations being independent of one another and competing with one another, there should be noted a high degree of uniformity of solutions used in practice. It is due, among others, to their long experience in this field, to the openness of particular corporations and their big susceptibility to various types of innovations (including organizational innovations), a big mobility of top executives and numerous links among corporations (including the so-called "interlocking directorates"[1]), as well as generally standardized tax regulations and certain federal regulations.

As regards different types of federal regulations, a special attention should be paid to the regulations concerning an obligation to disclose by corporations to their stockholders, definite federal agencies and public opinion a relatively comprehensive and also standardized information about the incomes of particular members of the management board and the board of directors, about the stock held by them and their functions on the other boards. It is quite a specific characteristic of the American economic and social system, which distinguishes it positively from many other systems including e.g. the British system.

[1] For more information on this susbject see, for example: Interlocking Directorates Among the Major U.S. Corporations (1978)

Another characteristic feature of the systems of incentives in U.S. corporations, which also arouses numerous controversies (also in the United States) is the fact that they permit for a huge differentiation of incomes among particular persons in a given corporation and among corporations. It would be certainly difficult to accept this solution in many other countries, and particularly in the post-communist countries.

3. Major research hypotheses

The major research hypotheses could be formulated as follows:

1. Privatization of enterprises should lead to a greater differentiation of compensation between particular company positions and professional groups.
2. There can be expected a growing importance of premiums and bonuses connected with improved financial effects of the company and productivity of employees receiving performance - related pay.
3. Privatization of enterprises should lead to major changes in the structure of incentives addressed to top executives. There can be expected in particular:
   - a higher ratio of the top executive compensation to the average pay in the company;
   - a bigger differentiation of the top executive compensation (e.g. higher ratio of the chief executive's compensation to the compensation of other top executives);
   - a higher ratio of premiums, bonuses and other "mobile" elements of total compensation in relation to the salary;
   - a gradually growing role of long-term incentives (such as company long-term performance shares) in comparison with short-term incentives (such as annual bonuses).
4. The tendencies listed in point 3) can be expected, first of all, in companies controlled by strategic investors (particularly from abroad) or managers, and to the smallest extent in companies controlled by employees.

4. Economic incentives in the privatized Polish and German companies in the light of empirical data

We are proceeding now to the analysis of the compensation and incentives in the privatized Polish and German state-owned enterprises based on the empirical data gathered by us in the analyzed enterprises. The main goal of research was not to supply the information about compensation and other forms of economic incentives used by the enterprises that would be representative for all privatized enterprises. The main goal was to recommend possibly correct methods of analyzing the changes in systems of economic incentives and, in particular, the incentives offered for top executives, which are, to some extent, an effect of privatization. Thus, we were interested in the methods which would allow to verify definite hypotheses especially if they are used in more comprehensive surveys guaranteeing the representativeness of their findings.

As it could be expected the main problem which emerged when carrying out the research project in the field of problems analyzed here was the unwillingness of companies, particularly German ones, to disclose many items of information being of great significance for us. In fact, the greatest secrecy surrounds this information which is the most interesting for us, that is the information concerning compensation and other elements of incentive systems offered by companies to their top executives, that is the persons sitting on the management boards of companies and their boards of directors. It was for this reason that the list of analyzed companies had to be changed several times. A few companies, despite earlier assurances and an informal approval, refused finally to disclose a great deal of important information, although incidently they are virtually obliged to pass this information to the general public even for this simple reason that some of them are companies whose stock is traded on the Warsaw Stock Exchange. No assurances about a full anonymity of the surveyed companies given by us were of any help either. Consequently, it became necessary "at the last moment" to look for other firms, which would be willing to disclose certain information indispensable for our surveys. Ultimately, even though the situation in this respect was highly differentiated both in the group of Polish and German companies, the surveyed Polish firms provided incomparably more information important for us than the German companies.

4.1. Differentiation of compensation between employees

Tables 1, 2 and 3 illustrate the differentiation of compensation between different employee groups in the analyzed companies, and also - to some extent - between particular positions within a given group, e.g. among executives.

Table 1 contains the data gathered in 13 Polish companies and characterizing the real growth or drop in the highest and the lowest compensation, as well as the ratio of the highest compensation to the lowest compensation. These data shed some light, among others, on the pay differentiation between executives and rank-and-file administrative-office employees and workers, as these are usually persons holding the highest positions in the company who receive the highest compensation, while the average and the lowest pay is collected by persons belonging to the two remaining employee groups. The full information concerning these issues (covering the entire period under survey) was provided by 9 companies and incomplete by 4 companies. Three analyzed Polish companies and all the German companies refused to disclose the relevant data.

Table 1. Real growth of the highest and the lowest compensation in the analyzed Polish companies in 1989-1994 (in %) and ratio of the highest compensation to the average and the lowest compensation in the years 1989, 1992 and 1994

Companies	Average compensation growth between 1989 and 1994:		Average for a given group of companies ratio of the highest compensation to:					
	highest pay	lowest pay	average pay			lowest pay		
			1989	1992	1994	1989	1992	1994
total	37,7	- 20,9	3,96	5,13	5,73	6,06	8,18	9,12
- controlled by strategic investors	- 18,5	- 25,1	3,35	4,77	3,39	4,89	6,70	4,85
- controlled by managers	71,1	- 22,4	3,94	5,63	8,41	6,43	10,34	13,01
- controlled by employees	105,0	67,3	4,61	4,99	5,47	6,86	7,50	9,41

As it can be seen from Table 1, the real growth of the highest compensation accompanied by a drop in the lowest compensation took place in the Polish companies as a whole in the period 1989-1994. The most pronounced growth of the highest compensation was recorded in the companies controlled by employees during that period, with the compensation drop occurring only in the companies controlled by strategic investors. The latter similarly to the companies controlled by managers recorded also a real drop in the lowest compensation. From this point of view also the companies controlled by employees looked best, because only these companies recorded a real growth of the lowest compensation. These conclusions correspond, in principle, with the hypotheses which could be formulated referring to the contemporary theory of the firm, but they rather depart from the statistical data concerning all companies privatized in Poland and the findings of some other empirical studies (e.g. those conducted by the Institute of Market Economy Studies, which point at a generally relatively advantageous pay situation in the companies controlled by strategic investors). In turn, the survey of companies controlled by employees carried out by a research team headed by M. Jarosz revealed that their main goal in the period 1992-1994 was to preserve the company even at the cost of lay-offs, and consequently the "model" type of behaviour for the companies of this type that is the maximization of pay was not discovered (see Jarosz et al., 1993, 1994; Report on Ownership Transformations in 1994 1995, pp.104-108).

As regards the ratio of the highest compensation to the average compensation and also that of the highest to the lowest compensation, the data gathered by us lead to the conclusions similar to those ensuing from other surveys (Dąbrowski, Federowicz, Levitas 1993, p.42; Dąbrowski, Szomburg, Kamiński 1995, pp.26-27). Namely, in both cases we were dealing in the analyzed period with quite a marked upward trend in all three groups of the Polish companies under analysis.The ratio of the highest compensation to the average compensation rose most significantly in the group of companies controlled by managers, while the ratio of the highest compensation to the lowest one increased most significantly in the group of companies controlled by strategic investors. A comparison of our findings with the results of other surveys and the available statistical data (showing the situation in all Polish companies) leads to the conclusion that pay differentials between the highest, average and the lowest pay increased more significantly in the privatized companies than in the state-owned enterprises (Dąbrowski, Federowicz, Levitas 1993, p. 42; Dąbrowski, Szomburg, Kamiński 1995, pp.26-27). That rapid growth of pay differentials in the privatized companies can be considered to be an effect of privatization and deliberate pay policy pursued by these companies. There is also confirmed a hypothesis ensuing from the alternative theories of the firm, in accordance with which the relatively fastest growth of pay differentials can be expected in the companies dominated or also controlled by managers. On the other hand, it is rather surprising that pay differentials tend to increase more in the companies controlled by employees than in those controlled by strategic investors.

The data about pay differentiation of various employee groups, which allow to make some comparisons between the Polish companies and the German companies can be found in Table 2. Four Polish companies and one German company did not supply any data on this subject. Moreover, six analyzed Polish companies and all the German companies refused to disclose data that would give an insight into the differentiation of pay within the company's top management.

Table 2 shows that the pay differentiation between different employee groups was as a rule much bigger among the analyzed Polish companies than the German companies in the period 1989-1994, and it was best visible in the case of the ratio of pay of a typical worker and that of the managing director (chief executive). Moreover, as it could be supposed the pay differentiation was bigger after privatization than before it. Both the Polish companies and German companies witnessed a pronounced trend of growing differences in the pay between the compensation of workers, foremen, department managers and managing directors (chief executives) - of course, in favour of those holding higher positions in the hierarchy. The relatively greatest pay differentiation could be observed in the companies controlled by strategic investors (both the Polish and the German companies). As for the Polish companies (from which more complete data were available), the differentiation of pay between different employee groups - as it could be expected - was relatively the smallest in the group of companies controlled by employees. These conclusions confirm the research hypothesis formulated above, in accordance with which the processes of transformation and privatization should lead to growing pay differentials between executives and rank-and-file administrative-office employees and shop floor workers.

More data about the pay differentiation of different employee groups in the analyzed Polish companies can be found in Table 3. It also contains some information concerning the fees received by members of the boards of directors (supervisory boards) in these companies. However, the data about fees of board members come from only a few companies and as such they cannot be a basis for any generalizations. It is only worth pointing out that the data in Table 3 include only a part of real benefits derived by the board members from their participation in board meetings. It is connencted, among others, with not very precise legal regulations in this field. Indeed, the companies supply only the data about constant, in a way "routine" payments to persons sitting on their boards of directors. As a rule these are insignificant amounts. However, it is known from practice that many companies allot from time to time a part of their profit for the fees of their board members and these are quite big amounts.

Table 2. Differentiation of average compensation of different employee groups in the analyzed companies in the years: 1989, 1992 and 1994

Companies	Average percentage share of compensation for a given group of companies:											
	typical worker in pay of:									first vice-managing director in pay of his/her boss		
	typical foreman			typical department manager			managing director (chief executive officer - CEO)					
	1989	1992	1994	1989	1992	1994	1989	1992	1994	1989	1992	1994
Polish:	83,9	75,7	71,4	73,5	62,8	57,7	25,6	19,4	18,2	84,8	76,4	80,6
- controlled by strategic investors	81,5	75,2	71,5	69,0	59,5	52,7	20,7	12,5	15,7	84,0	81,5	84,0
- controlled by managers	86,7	86,3	79,3	78,3	78,2	69,0	21,0	19,0	15,0	63,3	63.3	61.3
- controlled by employees	84,1	87,2	83,3	74,5	70,4	68,6	34,6	23,2	22,5	85,2	69,6	76,6
German:	88,8	77,3	72,6	80,6	68,0	62,7	67,0	41,7	36,9	-	-	-
- controlled by strategic investors	88,4	72,1	70,2	79,1	63,8	59,9	63,2	25,0	19,7	-	-	-
- controlled by managers	89,1	81,2	74,4	82,2	71,1	64,9	80,1	66,7	62,7	-	-	-

Moreover, a part of companies create a possibility of purchasing their shares along preferential conditions for their top executives and sometimes also for their board of directors members.

As regards the pay differentiation among the top management of the analyzed companies, some data on this subject were received only in the Polish companies (see: the last three columns in Table 2). The biggest differentiation of compensation between the managing director (chief executive officer) - and the first vice managing director was revealed in the group of companies controlled by managers, with the differentiation being a little bigger after privatization than before it.

Table 3. Ratio of average compensation in the company to average top executive compensation in the analyzed Polish companies in the last year before privatization (a) and in 1994 (b) (in %)

Companies	Ratio of average compensation in company to compensation of:									
	managing director (CEO)		first vice-managing director		chairman of board of directors		vice-chairman of board of directors		member of board of directors	
	a	b	a	b	a	b	a	b	a	b
total	31,7	18,5	37,9	20,8	160,8	91,5	193,2	114,6	221,9	121,7
- controlled by strategic investors	56,0	20,9	71,0	20,0	-	-	-	-	-	-
- controlled by managers	21,0	14,3	23,3	16,0	-	-	-	-	-	-
- controlled by employees	27,6	19,7	32,2	24,8	-	-	-	-	-	-

4.2. Factors determining the level of top executive compensation

As regards the factors determining the level of top executive compensation in the analyzed companies, it can be seen in Table 4 that before privatization the most important role was played by: high qualifications of a given person and company size, while in the period after privatization such factors were: entrepreneurship displayed by a given person, high professional qualifications, and leadership abilities. There should be noted a sgnificant convergence of evaluations given by the top executives in the Polish and German companies, and particularly in relation to the period after privatization.

Table 4. Main (most frequently mentioned) factors (besides the position held) determining the level of top executive compensation in the analyzed companies in the periods: before privatization (a) and after privatization (b)

Companies	Number of companies with indications at:									
	entrepre-neurship		high qualifica-tions		leadership abilities		compensation offered by competitors		company size	
	a	b	a	b	a	b	a	b	a	b
Polish:	1	9	2	8	1	7	2	1	3	0
- controlled by strategic investors	0	4	0	3	0	2	1	1	2	0
-controlled by managers	1	2	2	2	1	2	1	0	1	0
-controlled by employees	0	3	0	3	0	3	0	0	0	0
German:	0	5	2	4	1	3	0	2	1	2
- controlled by strategic investors	0	2	1	1	1	2	0	0	0	0
-controlled by managers	0	3	1	3	0	1	0	2	1	2
all companies	1	14	4	12	2	10	2	3	4	2

An attempt was also made to identify the most important factors determining the compensation (fees) of board of directors members in the analyzed companies. The information received from these companies shows that in as many as 16 of them (from among 21 companies, which supplied such information) the only factor taken into consideration was the position held on the board - the chairman or sometimes the vice-chairman, or the board member. In the remaining companies (4 Polish companies and 1 German company) the attendance of board meetings most frequently had an influence on the compensation collected by board members. Apart from these factors, there were quite sporadically (one case in each group of companies, i.e. Polish and German ones) taken into account the professional qualifications of a given person and the company size. Unlike in the U.S. corporations, permanent committees of the board of directors could not be found in any of the companies under analysis (at least till the end of 1995).

4.3. Structure of compensation

Speaking about the structure of compensation (or also more broadly - the structure of economic incentives), we have in mind, first of all, the share of relatively stable elements in the total compensation, and especially salaries and variable elements, that is different types of premiums and bonuses. A little data on this subject gathered in the analyzed companies can be found in Tables 5, 6 and 7.

Table 5 contains data concerning the share of premiums and bonuses from profit in the total expenditures on employee compensation in the Polish companies. Such rewards paid from profit could be found in 12 companies from among 14 companies, which provided the relevant data. The share of these rewards in the total expenditures on employee compensation displayed a rather downward trend in the analyzed period. It should be noted that it was the highest in companies controlled by strategic investors at the beginning of the analyzed period (in 1989). Although the profit index did not play at that time the same role as it did after privatization, the quoted data seem to be confirming some conclusions ensuing from other empirical studies (particularly those of the Institute of Market Economy Studies). Two such conclusions are most important here. First of all, large investors were interested primarily in Polish companies with quite good economic situation, which is confirmed indirectly by premiums from profit paid to employees by this group of companies. Secondly, in the period after privatization many companies introduced some changes in the system of economic incentives. They consisted primarily in a considerable simplification of the entire system and in a gradual departure from solutions characteristic for the previous economic system.

Table 5. Share of premiums and bonuses from profit in total expenditures on employee compensation in the analyzed Polish companies (in %)

Companies	Average share of premiums and bonuses from profit for a given group of companies in the years:		
	1989	1992	1994
total	8,2	7,9	5,8
- controlled by strategic investors	10,5	5,1	1,7
- controlled by managers	5,8	5,3	6,6
- controlled by employees	7,5	10,5	7,1

Table 6 shows the percentage shares of premiums and bonuses in the total compensation of different employee groups in the analyzed companies in the years 1989, 1992 and 1994. There were distingusihed three groups of employees and namely: workers, rank-and-file administrative-office employees and top executives, and four intervals of the percentage shares: below 10%, from 10% to 25%, from 25% to 40%, and above 40%. In the Polish companies the share of premiums and bonuses in the total compensation could be most frequently found in the three years under analysis in the interval from 10% to 25% in the case of workers and rank-and-file employees and in the interval from 25% to 40% in the case of top executives. In the German companies the situation was more differentiated. In the case of workers the corresponding share was under 10% in all the companies and in all three analyzed years, in the case of rank-and-file administrative-office employees it was most frequently under 10% in 1989 and 1992, and in the interval from 10% to 25% in 1994, while in the case of top executives it was most frequently under 10% in 1989, from 10% to 25% in 1992, and above 40% in 1994. Thus, the greatest changes in the expected direction took place in the case of top executives of the analyzed companies, and particularly the German companies controlled by managers.

Table 6. Share of premiums and bonuses in total compensation of different employee groups in the analyzed companies in 1989, 1992 and 1994.

Companies	Number of companies with the share in a given interval (a, b, c or d) in year:	Workers				Rank-and-file administrative-office employees				Top executives			
		a	b	c	d	a	b	c	d	a	b	c	d
Polish:	1989	1	12	0	0	1	11	0	0	2	4	6	0
	1992	3	8	2	1	4	7	3	0	4	3	4	1
	1994	4	7	2	1	5	6	2	1	3	3	5	1
- controlled by strategic investors	1989	1	5	0	0	1	5	0	0	3	3	2	0
	1992	2	3	1	0	3	2	1	0	0	3	0	1
	1994	2	3	1	0	3	2	1	0	0	2	1	1
- controlled by managers	1989	0	3	0	0	0	3	0	0	1	0	2	0
	1992	0	3	0	0	0	3	0	0	1	0	2	0
	1994	1	2	0	0	1	2	0	0	1	0	2	0
- controlled by employees	1989	0	4	0	0	0	3	0	0	1	1	2	0
	1992	1	2	1	1	1	2	2	0	3	0	2	0
	1994	1	2	1	1	1	2	1	1	2	1	2	0
German:	1989	6	0	0	0	4	1	0	0	3	1	0	0
	1992	6	1	0	0	5	2	1	0	1	5	0	0
	1994	5	3	0	0	3	4	1	1	1	3	0	2
- controlled by strategic investors	1989	3	0	0	0	2	1	0	0	2	0	0	0
	1992	3	0	0	0	2	1	0	0	0	3	0	0
	1994	4	0	0	0	2	1	0	1	0	3	0	0
- controlled by managers	1989	3	0	0	0	2	0	0	0	1	1	0	0
	1992	3	1	0	0	3	1	1	0	1	2	0	0
	1994	1	3	0	0	1	3	1	0	1	0	0	2

a - under 10%; b - from 10 to 25%; c - from 25 to 40%; d - above 40%

Table 7 shows (on the basis of data coming from almost all the analyzed companies) the relationship between top executive premiums and bonuses in these companies and the profit recorded by them. Theoretically speaking, the process of privatization should pave the way for a stronger correlation between top executive premiums and bonuses and the profit. The data gathered from the companies show what it looked like in practice according to the top executives of these companies. In the period before privatization such correlation was declared by 11 Polish companies (from among 16, which supplied relevant data) and by 3 German companies (from among 7, which supplied the data). On the other hand, in the period after privatization almost all (with the exception of one) analyzed Polish and German companies declared that their top executive premiums and bonuses were dependent partly or fully on the profit made. Simultaneously, one of the surveyed firms declared that its top executive premiums and bonuses were dependent not only on the profit but also on another (not specified explicitly) index of the company's economic effects. In accordance with the traditional theory of the firm these findings should be considered to correspond to the expectations. Moreover, the above conclusions confirm one of the research hypotheses formulated by us above.

Table 7. Relationship between premiums and bonuses for top executives of the company and its profit in the period: before privatization (a) and after privatization (b)

Companies	Number of firms, in which premiums and bonuses			
	were dependent on profit		were not dependent on profit	
	a	b	a	b
Polish:	11	14	5	1
- controlled by strategic investors	5	5	1	0
- controlled by managers	3	3	1	1
- controlled by employees	3	6	3	0
German:	3	6	4	1
- controlled by strategic investors	3	3	0	0
- controlled by managers	0	3	4	1

An important role in the structure of top executive compensation in the U.S. corporations, which is treated here as the model structure in some sense, is played by long-term incentives (e.g. bonuses dependent on the profit growth during a period of two or more years) and incentives linked with the capital market (particularly the so-called stock options). What does it look like in the firms studied by us?

As far as long-term incentives are concerned, only one analyzed company (Polish) mentioned using them in the period before privatization. Namely, a big part of the future top executive compensation was dependent on the successful implementation of the company's restructuring programme facilitating its privatization. In the period after privatization three companies (German) admitted they used such incentives, while three further companies (one Polish and two German) declared that they intended to introduce them within the next three years (1997-1999). At the same time, however, none of these companies disclosed any closer details concerning the substantive reasons for these solutions. Only one of the companies, which used long-term incentives, considered the role of such incentives in the total top executive compensation to be quite significant.

As for the incentives linked with the capital market (and particularly with the securities market), only two companies admitted using them, of course, in the period after privatization. One of the Polish companies used the incentives of stock option type and one of the German companies offered the owner shares for its top executives. It was only from one of these companies, i.e. Polish company, that information was received about the benefits for employees resulting from this solution. They were considered significant only in the case of the management board members. Moreover, it is quite surprising that only two of the surveyed companies - both Polish ones - planned to offer their top executives the incentives linked with the capital market within the next three years, i.e. in the period 1997-1999.

All in all, the changes in structure of economic incentives initiated in the analyzed companies go in the right direction, although they were not very big in the period under survey. However, this conclusion should be accompanied by an additional commentary. It should be noted, among others, that the object of our analysis was a period not too long, and particularly after privatization. Consequently, the analysis aimed at grasping relatively direct effects of privatization. Moreover, in the case of incentives linked with the capital market, we practically excluded from our analysis special incentives created for employees (including the management) of privatized enterprises by the State in order to win their support for the privatization concept itself. Such an incentive was, in particular, a possibility of buying the shares of privatized enterprises by their employees on advantageous (preferential) conditions. In the Polish companies such purchases of shares could be made during a relatively long period of time (which made it easier for employees to gather the necessary funds) and they were connected as a rule with significant advantages for the interested persons, and especially for the top executives of privatized enterprises. It is quite understandable that such solution meant a greater involvement in the company of its rank-and-file employees and executives. Moreover, in this situation it was possible to postopne a thorough reform of the system of economic incentives until some indefinite time in the future.

4.4. Influence of top executive compensation on economic effects of companies[2]

Finally, we would like to make an attempt to determine the relationship between the top executive compensation and the economic effects of the analyzed companies using more formalized tools of analysis. Due to the shortage of data from the German companies our analysis was limited to the Polish companies. As a measure of the top executive compensation we accepted the average highest real compensation for a given group of companies, and as a measure of the company's economic effects - the average net return on equity ratio for a given group of companies, that is the ratio of net profit adjusted for net losses to the equity in each of the groups of companies, which gives information how much profit is yielded by each unit (e.g. the zloty or the mark) of the equity invested by shareholders.

A simple econometric model allowed us to use the data contained in Tables 8 and 9 to determine the impact of profit recorded by companies (measured by the net return on equity - in Table 9) on the top executive compensation (measured by the highest real gross compensation - in Table 8).

Table 8. The highest real (in prices of 1989) compensation in the analyzed Polish companies (in old zloty million)

Companies	Average highest compensation for a given group of companies in the years:					
	1989	1990	1991	1992	1993	1994
total	8,790	6,331	8,154	10,294	11,621	12,831
- controlled by strategic investors	7,736	5,130	6,692	6,902	5,560	5,683
- controlled by managers	10,401	7,373	7,863	11,065	13,801	16,237
- controlled by employees	8,232	6,492	9,907	12,915	15, 500	16,572

[2] Dr Jacek Sztaudynger is a co-author of this part of the paper

Table 9. Net return on equity in the analyzed Polish companies (ROE)* (in %)

Companies	1989	1990	1991	1992	1993	1994
total	6	4	2	0	- 5	14
- controlled by strategic investors	3	5	0	- 2	- 8	13
- controlled by managers	63	2	9	4	0	9
- controlled by employees	62	69	45	128	141	54

ROE = return on equity; the ratio of net profit adjusted by net losses to the equity in each group of companies.

The model was estimated by means of the least squares method on the pooled time series 1989-1994, cross section sample including 18 observations in three types of the Polish companies: the companies controlled by strategic investors, by managers and by employees. The result of estimation is the following equation:

$$\begin{array}{l} WAGES = 6362 + 33\ PROFNET + 49\ PROFNET_{-1}\ PRIV + 1695\ MEN\ T \\ \qquad\qquad\quad 11.8 \qquad 3.2 \qquad\qquad\qquad 4.8 \qquad\qquad\qquad 6.9 \end{array}$$

$$R2 = 0.87$$

where:

WAGES - the highest real gross compensation, the average in the distinguished types of companies, in thousand zloty, in 1989 prices

PROFNET - net return on equity ratio

PRIV - dummy variable taking the value:
0 - in the years 1989-1991, before privatization
1/2 - in 1992. i.e. in the privatization year, and
1 - in the years 1993-1994 after privatization,

MEN - dummy variable taking the value:
1 - for companies controlled by managers in the years 1990-1994,
O - for the remaining observations,

T - time variable.

The values of t-Student statistics are given under the estimates of structural parametres.

The real values of the highest real compensation and the values resulting from the model are shown on Figure 1.

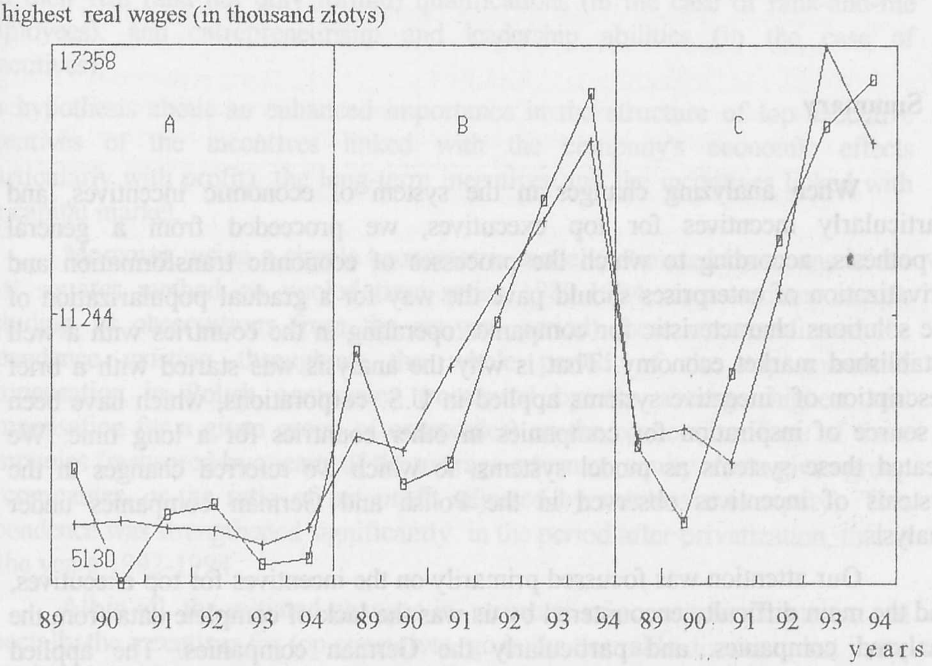

Figure 1. + values generated by the model, 0 actual values,

A - companies controlled by strategic investors, B - companies controlled by managers, C - companies controlled by employees.

There was confirmed the influence exerted by the return on equity ratio on the highest real gross compensation throughout the entire analyzed period 1989-1994. The influence increased considerably after privatization in the years 1992-1994. 87% of variables in the highest real gross compensations were explained in the model.

During the entire analyzed period 1989-1994 the growth of return on equity ratio by 1 percentage point led, with a high probability (0.95), to the growth of the highest compensations in real categories by about 33,000 zloty, while in the period after privatization the estimate of this parametre reached the level of 82,000 zloty. It can, thus, be said that privatization led to a significant - reaching about two and a half times - strengthening of the dependence of the highest compensations on the return on equity ratio.

Moreover, in the companies controlled by managers there appeared a trend towards a gradual growth of the highest compensations not finding any justification in the growth of return on equity ratio. Over the years 1990-1994 the highest compensations in these companies were rising additionally by about 1,695,000 zloty annually.

5. Summary

When analyzing changes in the system of economic incentives, and particularly incentives for top executives, we proceeded from a general hypothesis, according to which the processes of economic transformation and privatization of enterprises should pave the way for a gradual popularization of the solutions characteristic for companies operating in the countries with a well established market economy. That is why the analysis was started with a brief description of incentive systems applied in U.S. corporations, which have been a source of inspiration for companies in other countries for a long time. We treated these systems as model systems, to which we referred changes in the systems of incentives observed in the Polish and German companies under analysis.

Our attention was focussed primarily on the incentives for top executives, and the main difficulty encountered by us was the lack of complete data from the analyzed companies, and particularly the German companies. The applied research methods allow, in our conviction, to verify correctly more important theoretical hypotheses concerning the impact of privatization in this field. The value of our research findings would have obviously increased greatly if our surveys had covered a bigger number of companies, and also if we had had a more complete information from these companies. Since these conditions were not fulfilled, our research findings and conclusions resulting from them cannot be treated as representative ones. It is worth underlining, however, that these conclusions are generally convergent with the conclusions ensuing from broader programmes of empirical studies (such as, for instance, the surveys made in Poland by the Institute of Market Economy Research) and with the analysis of available statistical data.

As regards the preliminary research hypotheses formulated by us, among others the following found confirmation:

- a hypothesis about growing pay differentials between different employee groups (e.g. between executives and rank-and-file employees) and between different jobs/posts within particular professional groups being a result of privatization and, in particular, in the companies controlled by managers;

- a hypothesis about a significant growth of importance - as a result of privatization - of such criteria of pay differentiation as: employees' productivity and their real (and not only formal) qualifications (in the case of rank-and-file employees), and entrepreneurship and leadership abilities (in the case of executives);

- a hypothesis about an enhanced importance in the structure of top executive incentives of the incentives linked with the company's economic effects (particularly with profit), the long-term incentives and the incentives linked with the capital market.

Moreover, using a simple econometric model (estimated by means of the least squares method on pooled time series 1989-1994, cross-section sample including 18 observations from the six-year period) there was confirmed the dependence existing throughout the whole period of the top executive compensation in Polish companies (measured by the average highest real compensation for a given group of companies) on the economic effects of these companies (measured by means of the average return on equity for a given group of companies, or the ratio of net profit adjusted by net losses to equity). This dependence was strengthened significantly in the period after privatization, that is in the years 1992-1994.

All in all, the initiated changes in structure of economic incentives, and especially the incentives for top executives, go in the desirable direction, but in the period analyzed by us they were not significant in the surveyed companies.

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