

The pay-performance relationship between 2009 and 2018 for CEO's in the Dutch AEX index

An insight on the past and current Dutch executive remuneration environment



The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the steward of a rich man they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

Adam Smith (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*. London: Strahan and Cadell. Book V: Chapter 1: Part III. Article 1. "Of the public Works and Institutions Which Are Necessary for Facilitating Particular branches of Commerce".

From the book of A. Pepper (2015): *The Economic Psychology of Incentives: New Design Principles for Executive Pay*

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Abstract:

Since 1990, firms have been increasingly in the spotlight of paying outrageous amounts to their top executives. Since the introduction of the Dutch Corporate Governance Code in 2003, the Dutch executive remuneration environment received a huge change. Especially, the composition of executive payment changed significantly from options to pay-for-performance. In 2018, executive compensation still increased gradually while performance still has a prominent position in the remuneration scheme.

In this research, the implications of the Dutch Corporate Governance Code are being discussed as well as the literature on recent insights of the executive remuneration environment. With this background, the pay-performance was tested between the period of 2009 and 2018 with multiple key-performance indicators and CEO remunerations. The result was a weak link between the variable pay of the CEO and the firm's performance, while total remuneration had no relationship to performance at all.

The implications of the Dutch Corporate Governance Code were analyzed where it was found that the foundation of the 'best practice' provisions and principles are based upon the old economic agent-principle theory. New theories suggest that executives are not incentivized by only extrinsic motivators. The result was that there was an unintended relationship with the compliance rate of the Code and CEO remuneration. Where the higher the rate the higher the CEO remuneration, but due to the weak compliance rate data this could be a coincidence. Thought-provokingly, the Code had a huge effect on the composition of executive pay, but partly increased the already rising executive remuneration even further unintendedly.

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1. Introduction

In a world where increasing inequality is questioning our global capitalistic economy, it is important to ask why wages have stagnated in developed countries. While stocks, bonus and dividend payments at the top have exploded (Kramer, 2018). These payments are so generous that bosses of multi-million-dollar companies generate enough cash in three/four days than the average worker will earn in a year (High Pay Centre, 2018). Executive remuneration practices at large financial institutions were even considered to be a contributing factor to the global financial crisis in 2008 (Larcker et al., 2014). The pay of chief executives throughout the years have been an increasing debate as an inequality issue. But, also an issue of poor business practice, inefficient use of shareholder funds and weak oversight (Hargreaves, 2018).

In the book of the economist Thomas Piketty (2014) inflated rates of executive pay are one of the most significant factors contributing to growing inequality in the Western World. This trend of increasing executive compensation reflects the increased power of capital compared to labour. Rising compensation is not connected with better company performance or scarcity of CEO's, but is the result of a shift in the balance of power. The capitalistic system shows signs of failure which besides rising executive compensation can also be seen in the surging power of firms since the 2000's. This can result in a gradual diminishment of trust in the capitalistic system (Díez & Duval, 2019).

Of course, if shareholders and the board want to reward the executive board so richly, one could say that it is their choice to do with the company as they see fit. But, this gaping difference of rewards between executives and the normal workforce within the firm can have a strong negative effect on the morale and motivation of the workforce (Steffens et al., 2018). High rewards can have a negative indirect effect of damaging the morale and motivations of workers and therefore impacting the whole company negatively on a far greater impact. Even a company's reputation can be harmed by not being transparent enough to the public in their corporate governance, which includes high executive pay (Coke, 2016).

The solution to Garretsen & Stoker (2019) is stabilizing or even decreasing the staggering spiralling executive compensations by giving all stakeholders a greater vote in the decision making of companies. It needs a significant re-thinking on how and why we reward CEO's, considering a much wider balanced scorecard of CEO success beyond financial

performance. Not only giving the shareholders and the board of directors voting power, but also giving employees a heavier vote in the decision-making and stimulating more long-term perspective thinking.

Many believe to restore fair compensation for CEO's is via policy changes, for example removing favourable tax positions for executives or having a maximum amount to reward an executive (Karabbel, 2018). As it is now, companies are not going to change from within so one way to resolve this problem can be done via gradual legislations (Garretsen & Stoker, 2019).

In the Netherlands and in other countries such as the UK, a corporate governance code provides guidance for effective cooperation and management. It provides and facilitates with or in relation to other laws and regulations a transparent system for Dutch listed companies and regulates relations between the management board, the supervisory board and the shareholders. The Dutch Corporate Governance Code (from now on: the Code) provides principles and provisions which are aimed at defining responsibilities for many aspects of corporate governance, including remunerations. (Dutch Corporate Governance Code, 2016).

Since the introduction of the Code in 2003 the composition of executive compensation has changed significantly (Duffhues & Kabir, 2008). The revised Code was made to cope with the original problems of the first Code. The following questions come to mind: Did the height and composition of remunerations change because of the Code? Does firm performance have a better link with executive remunerations and does the compliance of the Code have any relation with the height of executive compensation?

These questions can be formulated into one research question:

“What impact did the implementation of the Dutch Corporate Governance Code had on the executive remuneration?”

This research question can be split up into various parts:

- *“Did the remuneration policy of executive pay change because of the Code?”*
- *“Did the relationship between performance and executive remuneration become stronger with the implementation of the Dutch corporate Governance Code?”*
- *“Does the compliance of the Code have any relation with the height of executive remuneration?”*

1.2 Research method

The research will only focus on CEO's, the period of 2009 and 2018 and the Dutch listed AEX index. This will be done with a separated regression and a lagged regression of the variable and total compensation.

The research of the compliance of the Code and the height of CEO remuneration will be done from 2009 to 2017. Because the data was sometimes unreliable or missing, a comparison has been done with two graphs of the height of the remuneration the compliance rate of the Code.

Before these empirical studies, a foundation will be laid of the literature surrounding executive remuneration and the Dutch Corporate Governance Code.

1.3 Thesis outline

Firstly, a general literature review will be made of the contemporary literature surrounding executive remuneration. Here the main determinants will be explained that can have influence on this research and the executive remuneration environment.

Then, different theories will be explained, where the agent-principle theory is the most prominent. This gives the reader a view why there is need of incentivizing managers with such extensive remuneration schemes. Followed by a literature review of preceding and recent research on the pay-performance relationship of executives.

A review about the Dutch corporate Governance Code, the history of the Code, the different principles and 'best practice' guidelines and the compliance of the Code shall be put forward to give the reader the necessary knowledge about the implications of the Code.

Two hypotheses will be made based on the research question, followed by a research design, methodology, results and a conclusion.

1.4 Background

1.4.1 Dutch two-tier board

Before this thesis will discuss the ins and outs of determinants of CEO remunerations and the Code, it is important to know that the Netherlands has a different board system than most commonly used governance systems.

The Netherlands is interesting in this way, because it has a two-tier board which means that a supervisory board ('Raad van Commissarissen') exists separate from the executive board ('Raad van Bestuur'). The executive board is responsible for the daily operations of the firm

and the supervisory board monitors the executive board and can appoint, suspend and dismiss the members of the executive board as well as assess and ratify major business decisions. The general meeting of shareholders controls the supervisory and the executive board.

The executives decide the remuneration scheme of the whole company, but it would be undesirable if the executives chose their own compensation. Therefore, the supervisory board has the executing authority to decide the remuneration policy for executives. Here, a shift of authority arises where the shareholders monitor the supervisory board regarding the execution and method of compensating executives. This set of relationships has been set in the law since 2004. (Eumedion, 2019)

This is different from the Anglo-Saxon system where it is more common to have the supervisory and the executive directors in one board. The Dutch two-tier board has the advantage of being more independent than the common one-tier board. One could regard the Dutch corporate governance system as a combination of the Anglo-Saxon and Continental-European governance systems.

The differences between the Dutch corporate governance system and the Anglo-Saxon could have been affecting the remuneration developments for executives in the Netherlands (Postma & van Ees, 2000). A study about how the practices, height and composition of executive remunerations have evolved in such a landscape is therefore an interesting one.

2. Trends and Determinants of Executive Compensation

2.1 The purpose of reviewing executive remunerations

The purpose of this literature review is to collect information that could influence the Dutch executive remuneration, especially from the periods 2000 to 2018. Without this review it would be hard to know what to quantify in the empirical research and what subjects could influence the remunerations significantly. The inspiration and presentation of these chapters draws on the papers of Swagerman & Terpstra (2007) Frydman & Jenter (2010), the master thesis of Diamantopoulos (2012), Edman et al. (2017) & the research of EY (2018).

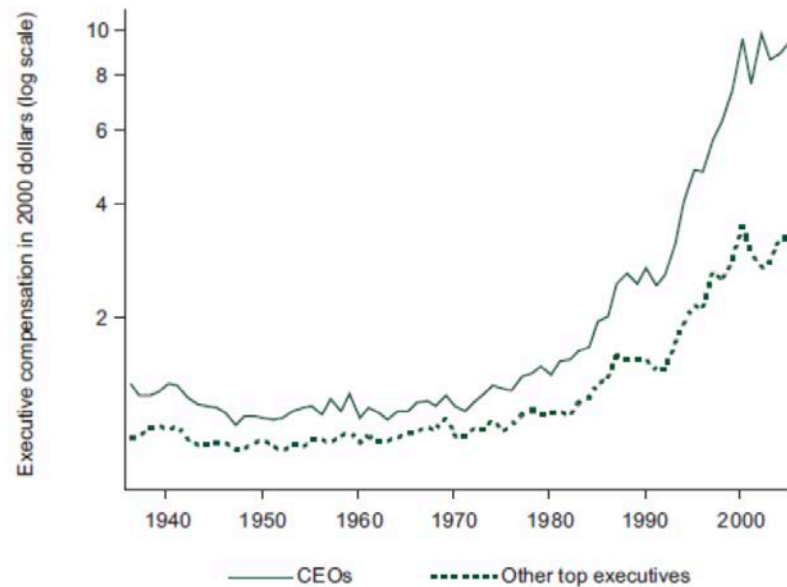
2.2 Trends in the executive environment

Since the 70's, the level of pay was rising at a much faster rate than the years recently after the second world war. According to Frydman and Saks (2010), the level of pay rose with an average rate of 10% after the "dot-com" bubble in 1997. Before, the remunerations remained fairly constant, while the governance of corporations was arguably weaker, ownership of firms was more dispersed and firms were also growing and becoming more complex during this earlier period.

Also, the market for top management was very different from now, where firms found top managerial talent from within. These talent pools were usually exposed to a single area, spent most of the time at the same corporation and rarely moved to a different firm late in their career before becoming general manager. This is quite different from the management market as it is now. Where more mobility (internationalisation) and less requirements are need for firm specific skills. Now, the norm is making decisions based on general human capital that could be applied in diverse (Frydman, 2008).

Since the 90's, the composition of compensation was also changing by paying managers mostly with employee stock options. Frydman & Jenter (2010) reported a J-shaped pattern in executive compensation from 1936 to 2005 (See figure 1) where a spiralling increase can be seen. They suggested that both managerial power and the competitive market forces are important determinants of the rise of CEO pay. According to Diamantopoulos (2012), this boost in compensation was due to the technological improvement and therefore the

Figure 1: Median Compensation of CEOs and other top officers, 1936-2005 (Source Frydman & Jenter, 2010)



productivity rose exponentially especially in the US. Huge profits were made and therefore top management had a lot of well-established reasons to ask for grander compensation schemes.

Another factor of increasing executive compensation can be accredited by factors such as the rise of an external job market because of the internationalisation. Internationalisation can be seen in the current executive board situation, where different nationalities are usually present within a board. This can lead to a rise of Dutch average executive remuneration, because Dutch companies do not want to lose their skilled board members to foreign companies who have higher rewards (rapport 2004). Therefore, paying their executives higher rates to retain them.

More recent research (Edmans et al., 2017) shows many developments after 2000. Four important facts have occurred that changed trends in executive compensation.

Where in 1990, the increase in mean CEO pay was larger than the increase in median pay. This was because of the relatively small number of extremely high-paid CEO's. But after 2001, this trend reversed and the outliers lessened overtime which resulted in less skewness across CEO pay for firms of all sizes. This can be seen from the research of Frydman and Jenter (2010), where in 2001 the difference between mean and median CEO pay declined from 67% to 19% in 2014. This is relevant because the decrease in skewness from 2001 to 2014 can result in more accurate results because of less outliers.

Secondly, executive compensation has not constantly risen over time. Executive pay has even been constant or declined for long periods – even decades. This means that the assumption that executive pay has always been rising every year is false. And that periods of

constant or even a decrease of executive pay should be explained alongside why executive pay increased in another period.

Thirdly, the evolution of pay levels between large-cap, mid-cap, and small-cap firms were lively from 1990. In 1994, the differences of CEO median pay of a large-cap and mid-cap was 109%. Where in 2001 this difference had risen from 186%, and decreased again to 86% in 2014. Similar results were shown between the differences of mid- and small-cap. Even more recent research of EY in the Netherlands (2018) in 2017 states that pay differences between the AEX and AMX were approximately 2.4 larger, and between the AEX and ASX this ratio was 4.2 approximately.

Lastly, the CEO compensation compared to normal executives has increased from 1992. Where the median of the within-firm ratio of CEO (large-cap) pay compared to the average pay of the other top 3 executives rose from 1.8 in 1992 to 2.4 in 2014. In the Netherlands from 2015 to 2017, the CEO and CFO compensation were also diverging. Where the ratio of CEO to CFO compensation increased 11% across the three indices.

Another interesting trend is that the overall CEO compensation decreased slightly from 2016 to 2017 in the US. While companies are increasingly trying to link performance with executive compensation all over the world (Knowlton, 2018). The question for this research is: does this also happen in the Netherlands? According to the research of the Vlerick Business School (2017), the total median CEO remunerations actually decreased from 2014 to 2016 in the Netherlands. Can this be the result of the compensation composition due the Code and a stronger link between executive remuneration and firm performance?

2.3 The main components of executive pay

The compensation structure has evolved over time, where the largest component of CEO compensation in the 70's was cash, in the 80's and 90's options and in the 00's performance-based stock. This chapter, the main components of executive pay shall be discussed where the recent studies from PWC (2018) and EY (2016) is mostly drawn upon.

The typical compensation components are comprised of:

- *Fixed salary*: This can depend on simple salary increases, changing salary levels due to replacements or the effect of different salary levels due to replacement of a company in the index.
- *Variable pay*, which is comprised of:

- *Short-term incentives (STI)*: All cash and equity-based payments that are accrued to an individual over a period shorter than 12 months. This incentive is related to the performance of a one-year period and is usually paid out in cash.
- *Long-term incentive (LTI)*: All cash and equity-based payments that are accrued to an individual over a period longer than 12 months. This compensation should align the interest of executives with those of shareholders and should link reward to performance and value created over the longer term. It is common practice that LTI's are granted conditionally and become unconditional after 3 years. Usually, this has an additional lock-up of 2 years after the 3-year conditional grant. So, the most common cycle for LTI plans from performance grant to cash is 5 years, which is in accordance to the Code.

The LTI plan is usually settled in equity based-payments and mostly linked to financial performance conditions. But it depends on factors such as the nature of the business model and industry-specific characteristics and can therefore vary significantly from one company to another. The key performance indicator (KPI) for the LTI is mostly the total shareholder return (TSR) or the earnings per share (EPS) (Bächinger et al., 2016).

Performance targets such as the EPS, earnings before interest, tax, depreciation and amortization (EBIT/EBITDA) and revenue are prevalent in both STI and LTI plans. The variable pay should be based on sustainable value creation, rather than a reward for volatility. According to the above mentioned two researches, these are the remuneration components used to compensate executives most frequently in this research time-frame. But this has not always been since the introduction of the Code of Tabaksblat in 2003.

2.4 Other non-financial executive compensation components

Usually, non-financial performance conditions are involved in the remuneration policy (around 15%). The salary of executives can be influenced by non-financial income components, such as intrinsic motivation, risks, status & power. Usually the actual compensation for the executive is larger than the target pay-out based on the remuneration policy (EY, 2018). This can have the contributing factor that executives are not paid based on performance, but on components that cannot be measured. These factors are hard to attain from an annual report and are therefore problematic to operationalize. This can lead to a less whole model in the empirical research and therefore a less accurate result.

3. Theories explaining the rise of executive pay

3.1 The Prisoners Dilemma

Although, it's in the interest of most of the companies to achieve moderate executive rewards, it has proved difficult to control. For remuneration committees, it has proved difficult to achieve a balance between offering a salary which both justifies the job and prevents executives from going elsewhere (attain & retain). This resulted in a prisoner's dilemma for the remuneration committees. Competing companies would bid higher than their rivals for the superior CEO by offering increasingly larger remuneration packages to secure talent. This generated upwards spiralling salaries which eventually becomes the market rate, which do not accurately reflect the skills and the abilities executives actually represent (Pepper, 2019). Because, if the market for CEO's would work correctly, the rewards would be a justified reflection of the worth of a CEO. The argument that the executive is a superstar in the corporate world, and therefore scarce would mean that companies would pay more for the best players (just like in the sports world) (Frydman & Jenter, 2010).

3.2 Agent-principle theory

The agent-principle theory happens in the situation when a person or organisation gives permission to make decision in their stead. This situation can create inefficiencies, because the agent (executive) can get the tendency to not only serve the interests of the principle (shareholder), but also the interest of himself. Corporate governance is made to find solutions to these inefficiencies.

This theory is grounded and applied in the executive compensation environment. According to the book of Pepper (2015), the reasons why executive pay has increased in the last 30 years lies in the continued reliance to base executive pay on the classic and outdated economic models that executives are fully rational, and only self- and financially interested. Pepper (2017) explains four key points that are not compatible this traditional approach to incentivize executives.

Firstly, executives are actually not risk-seeking than economic theory suggests. The main findings of the research of PWC (2015) about the psychology of incentives were that executives are actually risk-averse. Where 72% prefer having a fixed pay over a bonus, 50% choose a clearer package and 66% choose an internal measure they can control, such as profit as opposed to an external measure such as total shareholder return.

Thought-provoking for this research on performance pay is that deferred compensation for executives is discounted rapidly, by around 50% over three years. And even a more direct provocation to the newly incentive plans for executives is that fewer than half thinks that their long-term incentive plan is an effective incentive.

Thirdly, according to the crowding-out theory, extrinsic motivation can massively reduce the intrinsic motivation of workers. This also accounts for executives, where according to the research of Pepper (2017), they would sacrifice 30% of their income to work in more personally satisfying roles. Thus, intrinsic motivation is much more important than admitted by the traditional economic theory.

Lastly, executives care about fairness between the compensation of their workers and the compensation of themselves. In 2018, ratios were introduced by the Code between the salary of the executive and the average worker of the firm to contemplate the difference. This would maybe show executives and their bosses that their compensation has gone out of hand.

So, this brings the main question: can the agent-principle problem be resolved with any motivation schemes for executives? Well according to Pepper & Gore (2015), a modified agency-theory can be set in place based on a more realistic set of behavioural assumptions, also called the “behavioural agency theory”. The normal agency theory fundamentally focuses on monitoring costs and incentive alignment. Where the new theory places the agent’s performance at the centre of the model. The model builds on the propositions that combine monitoring and performance from Wiseman & Gomez-Meija (1998) which would enhance and extend the agency-based corporate governance literature, such as the assumption that executives are risk-averse and the other previously mentioned key points.

Other researches show the indirect effects the agent-principle problem can have on the behaviour of executives. Such as that stock options create more risky projects by managers (Raigopal & Shevlin, 2002). Or that giving stock options to managers that already have a lot of options does not have the intended result of minimalizing the agency-principle problem (Ofek & Termack, 2000). As well as, research on earnings management and misreporting due to the agency theory (Bergstresser & Phillipon, 2006). Although many negative effects, stock options can have a good effect on the successfulness of the choice to merge with other companies (Datta et al., 2001).

To solve the agent-principle problem previously mentioned with old compensation practices such as granting options to executives and expecting them to behave in the interest of

the shareholder, is quite outdated. Now, with the new remuneration environment where the remunerations are increasingly based on variable performance pay incentives. Questions arise if performance pay is the right incentive to compensate executives according to the literature of the agency theory and the behavioural agency theory. Pepper (2017) suggests that firms would be better off paying generous salaries, using annual cash bonuses to incentivize desired actions and behaviours. Requirements to invest their bonuses in the company to have sufficient incentives to be aligned with the interests of the shareholders. But, most conflicting of all with the Code's performance pay: the complex, high-powered, performance-based equity plans should be kept to a minimum.

According to Heath (2014), considerable time has been spent devising highly elaborate incentive plans while neglecting the true psychology of executives mentioned above. LTIP (long-term investment plans) are especially the culprit in the whole remuneration scheme, because executives discount time almost 50% per 3 years (Pepper, 2017). By redesigning the compensation package, the same goals can be delivered with yearly bonuses at a lower cost for the firm. The Code Van Manen (2018), has listened to one aspect of these recommendations by encouraging the Code-complying firms to make executive remunerations clearer and more transparent. So, to make the determinants of the pay for executives easier to understand. This has not led to less performance pay compensation components though.

To conclude, incentives have strengthened overtime trying to align the interest of the executive with the shareholder (Clementi & Cooley, 2009). Especially performance incentives have been prominent, trying to motivate executives to make the best long-term and value-creating decisions. Especially Pepper's research (2015) has shown that the old economic agent-principle theory – on which the remuneration environment and the Code is built – is very much outdated. The next question is: what do the results of the previous work on the pay-performance link say? Is the problem-solver of the spiralling executive pay caused by the Code even significantly effective? The next chapter will show a list of these researches that show the results of this link.

4. Literature review on the pay-performance relationship

In this chapter, several researches will be discussed that empirically study the impact of firm performance on executive pay.

In the literature review of Praag (2005), she found many problems that occurred trying to research the relation of performance related pay for board members and firm performance before 2002. According to this comprehensive literature review, information from the Netherlands before 2002 cannot be used, due to large amounts of missing information in annual reports. Therefore, Dutch research before 2002 on this subject will be left out, except for the influential research of Duffhues and Kabir (2007).

The UK is more comparable with the Netherlands due to both having a corporate governance code and comparable CEO remunerations. Where the US executive remuneration environment is different enough that it could not be compared with the Dutch environment, and is therefore left out.

Surprisingly, little recent and formal research has been done on the pay-performance link. Although, there is more informal research done on this subject. This research cannot be used due to the unreliability of the research. The relatively recent and formal research is in the following table:

Table 1: Summary of previous pay-performance literature

Author	Country	Period	Main findings
Duffhues and Kabir (2007)	NL	1998-2001	<ul style="list-style-type: none"> - Due to no corporate governance Code, firms were reluctant to disclose specific remuneration data. Ordinary shareholders had no influence over the compensation of executives. - Leverage has a significant positive relationship influence on executive pay. - Negative pay-performance relationship.
McKnight and Tomkins (2007)	UK	1992-1995	<ul style="list-style-type: none"> - A significant link was detected between the pay-performance link for both the short and longer term.
Cornelisse et al. (2005)	NL	2002-2003	<ul style="list-style-type: none"> - No relationship between cash compensation and company performance
Mertens et al. (2007)	NL	2002-2006	<ul style="list-style-type: none"> - Incentive pay increased considerably. - No significant pay-performance relationship. - The ratio of the compensation for CEO's for AEX, AMX & AScX was 100-60-40.
Van der Laan et al. (2010)	NL	2002-2006	<ul style="list-style-type: none"> - CEO compensation is only weakly related to company performance, at best. - Profit positively related with bonus.

			<ul style="list-style-type: none">- rTSR positively related with option grants and option value changes.- Earnings per share positively related with option grants and negatively with share grants.
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5. The Dutch Corporate Governance Code

5.1 The purpose of reviewing and explaining the Code

The purpose of this review is the same as the literature review previously mentioned. To collect information about the Code related to remunerations in the period of 2000 to 2018. Without this review, it would be hard to know when and which legislations could have influenced the rewards for Dutch executives.

To give a sound structural view on how this research will inform the reader about the Code that influences this research, the following subjects are explained:

1. How the Code works for Dutch listed companies and where it stands in the remuneration environment.
2. The history of the Code where the full Codes from 2004, 2009 and 2018 will be considered.
3. The Code throughout the years with an explanation of the two parts of the Code related to remunerations. Namely, the height and composition, and the determination and disclosure of remunerations.

5.2 How does the Code work?

Corporate governance is about how a company should be governed by the executive, supervisory board and the general meeting of shareholders and how responsibility of these boards are managed. Well governed businesses are of great concern to a well-functioning and competing economy, and therefore important for the welfare of people.

In 2003, an initiative was created to develop a corporate Governance Code for the improvement of the corporate governance structure (The Code, 2004). The compliance of the Code is mandatory for all Dutch listed companies from the 1st of January 2004 by law, if these firms chose to implement the Code. These firms had to abide to the “comply or explain” principle and the general ‘spirit’ of the implications of the Code. Which means that the firm has to disclose several ‘best practice’ provisions in their annual report, and if they deviated from it explain why they deviated from the guidelines. So, full compliance can be avoided with an explanation, but non-disclosure of a ‘best practice’ rule is not complying to the Code and therefore against the law. The Code is principle-based and not rule-based: it is the spirit and not the letter of the Code which is important.

5.3 History of the Code

5.3.1 Commission of Tabaksblat (1997-2004)

On the 10th of March 2003, the commission of Tabaksblat was made to develop and create a code of conduct for Dutch listed companies and their shareholders. Here, the 40 recommendations of the Peters Commission (June, 1997) were used to start off the initiative. The goal of this initiative was to achieve a sound and transparent system of “checks and balances” for Dutch listed companies. And, to regulate the relations between the executive directors, the supervisory board and the shareholders.

On the 9th of December 2003, the commission of Tabaksblat published their first code of conduct of corporate governance, which was effective at the 1st 2004. The Code consisted of more than 100 guidelines about the working methods, independence, the roles of the chairman of a board and of course the remuneration height and structure for the executive- and the supervisory board and more. Also, the strength and position of the shareholders and their general meeting of shareholders was improved to incorporate a more influential role for shareholders in their firm. The general meeting of shareholders got control over the remuneration policy via the supervisory board which was chosen by the shareholders.

On December 2004, the Monitoring Commission of the Corporate Governance Code was installed with the main goal to mentor the compliance of the Code. But also, to encourage the use of the Code and to look at events that could influence Dutch corporate governance and make recommendations for a possible improved Code. The Monitoring Commission posts a report on their site every year to explain their findings.

In the first report (2005), compliance of the overall Code was high, but the committee observed a lack of uniformity and transparency in the field of remuneration policy. The companies that were examined changed their remuneration policy to a degree that it was followed to the letter, but they decided not to motivate and account for the actual management and remuneration policy (Monitoring Commissie Corporate Governance Code, 2005). According to the monitoring commission, the compliance and application rates were very good from 2004 to 2008 (90 to 95% and 85 to 90%). But, according to the Dutch Association of Owners and Securities this should be taken with a grain of salt, because they established an actual compliance rate of 63%. The same problems were found previously mentioned, but also the complying firms were only complying to the Code partially. Where the monitoring commission considered these firms were complying. This was not the inaccuracy of the monitoring commission, but the way the Code was composed.

5.3.2 Commission of Frijns (2004-2008)

At the time of the Commission of Frijns in the Netherlands, social outrage was present about various excessive CEO remuneration scandals. The Frijns committee took a middle road position in this stating that the remunerations were indeed excessive, but it was also in line with the whole remuneration environment in Europe. On the 10th of December 2008, the Monitoring Commission presented a revised Code, with Jean Frijns as the chairman, that was better suited for the current corporate governance climate. The revised Code was effective for Dutch listed companies on the 1st of January 2009 and anchored in the law on the 1st of January 2010. The changes made to the original code can be seen in the appendix.

Also, the powers of the supervisory board were strengthened and gave the board more responsibility and say over the remuneration of its management. This substantiated in the provisions mentioned in the appendix under chapter 10.1.2.

On the 2nd of July 2009, the second Monitoring Commission of the Corporate Governance Code was appointed in which the new chairman was Jos Streppel. At the request of the Dutch Cabinet, this commission was appointed to research the current Dutch corporate governance situation. Unfortunately, this commission came to no new recommendations for a new Code which was caused by the financial crisis in 2008.

5.3.3 Commission of Van Manen (2013-now)

On the 11th of December 2013, the third Monitoring Commission of the Corporate Governance Code was appointed in which the new chairman was Jaap van Manen. They presented a new revised Code named the Code Van Manen on the 8th of December 2016. The biggest changes were on the aspect of long-term value creation and the introduction of culture as a part of good corporate governance. And on the 1st of January 2018, this code was anchored in the law and was effective for companies on the same date.

Provision changes were not made related to executive remuneration, but the principle in which the remunerations should be made was changed. There was more emphasize that remuneration policies should be clear and understandable, focus on long-term value creation for the company and consider the internal pay ratios within the enterprise. The policy should not incentivize managers to act in their own interest, nor take risks that are not in keeping with the strategy formulated and the risk appetite that has been established (Dutch Corporate Governance Code 2018).

5.4 Earlier research on the Code

Before the Code existed, there was hardly any market for corporate control where the Annual Meeting of Shareholders only had a limited amount of influence. The large influence of the executive board to appoint supervisory board members had led to a high degree of managerial entrenchment (Van Ees & Postma, 2014). This phenomenon was referred as the ‘old boys’ network’ by the popular media, in which the business community would divide all the jobs among one another. In this context, the spiralling increase in executive pay have also been considered as a favour among friends (Swagerman & Terpstra, 2007).

But about two decades ago, the Dutch corporate Governance environment was profoundly changed where the prime exponent of this change was the implementation of the Dutch Corporate Governance Code in 2003 (Tabaksblat Code). Although not legally binding, companies that do not conform to the majority of the principles are signalled out by the press, investors or shareholder associations and can count on heavy criticism in publications or at annual shareholder meetings. The power of the general meeting of shareholders in 2004 changed greatly regarding executive remuneration by mandatorily approving the proposed remuneration policy (‘say on pay’). The influence of shareholders quite considerably changed, stimulated dialogue and increased the pressure on boards regarding remuneration matters (van der Elst & Lafarre, 2017).

Thus, at the first years of the Code, this influence had led most companies to review and reconstruct their incentive plans which were in line with the Code’s provisions. This can be seen in the shift from traditional stock option plans to other forms of equity-based pay (performance shares). In the empirical research of Swagerman & Tersptra (2009), they found that in 2002 only 9,9% used performance shares which had risen in 2005 to 57,8%. The Code of Tabaksblat had a serious consequence on the composition of remuneration packages for the management board. But this also had downsides, because total compensation for executives increased to 28,6% between 2002 and 2004. This was in particular triggered by the value increases from equity-based pay packages. The equity-based pay packages of CEO’s even rose to an astonishing 70,8% in the same period (Swagerman & Terpstra, 2009).

In the book of Cools “Controle is goed, vertrouwen nog beter” (2005), he asserts that because of the rising legislation related to corporate governance such as the Code. It could have major and unforeseen consequences on pay developments for both the executives and the supervisory board. One of these unforeseen effects are that transparency can extend the comparability of remunerations between companies which can be used by remuneration

committees for determining executive pay. When the current compensation is beneath the average compensation, the commission will increase the pay to correct for this. Especially when Dutch companies are compared to foreign companies such as in the US or UK, where executives were paid much, much more.

So, the Code could create two effects that have a positive, but also a negative effect. The positive effect is more transparency which could result in a better relationship between performance and compensation. But on the other hand, this could also have the effect that companies will compare their target remuneration more often which could end up in a loop of spiraling rewards. So in the end, the composition of remunerations changed, but the height will presumably increase even more due to the changes made in the composition by the Code.

5.6 Other factors that could have influenced the Dutch remuneration environment

In 2007, not only the Code had an aim to stimulate the business community with more transparency for the remuneration policy. The Act of Harrewijn in 2007 implemented by the government for the labor unions was aimed to prevent management from receiving compensation that would be out of proportion in comparison to the pay of all the other employees involved in the company (Burgers, 2008). Obligations were implemented in the law which overlap the Code of Tabaksblat and Frijns, but unfortunately not add obligations for Dutch listed companies.

The government also has an influential role in the remuneration environment and the behavior of the public and companies. Tax law and regulations have been used to encourage and discourage approved or disapproved behavior related to remunerations.

5.7 The height and composition of remunerations

The provisions and principles discussed in this chapter and the next will be within the framework of this thesis and will be restricted to the alterations connected with the remuneration policy. That is, the provisions directly related to the remuneration of executives as well as the provisions indirectly influencing the pay of management by strengthening the powers of the supervisory board to control the management board remuneration. Because the Code changed substantially in the Code of Frijns and is within the framework of 2009 and 2018, this chapter will include the Code of Tabaksblat and the revised Code of Frijns. The revised Code of Manen did change, but only in principle and is not within this time-span.

The remunerations part of the Code (part II.2) describes which ‘best practice’ guidelines and principles firms should comply to when they adopted the Code. The remunerations part consists of two parts which is divided with a principle and a ‘best practice’ part. The first part is about the amount and composition of executive remuneration and the second about the determination and disclosure of executive remuneration.

The basis of these principles and provision lies with the first Code of Tabaksblat, where this Code was substantially amended in the revised version of Frijns (2008). Some provisions are held the same in the sense of the ‘spirit’ of the provision, while the phrasing of the provision is made differently. This was done to counter the problem of the unclear guidelines of the provisions of Tabaksblat.

The principle in terms of the ‘spirit’ when using the Code and related to the composition and height of the remuneration of Tabaksblat and Frijns are:

1. *Attract & retain:* the composition of executive compensation had to be enough so that qualified and skilled executives had to be attracted and retained.
2. *Performance criteria:* The pay had to consist of a fixed and variable component where the variable part had to be connected to a predetermined, measurable and controllable goal that could be achieved in the short- and predominantly the long-run.
3. *Simplicity and transparency (Since 2008):* The remuneration structure shall be simple and transparent.
4. *Correct incentives:* The composition of the salary had to incentivize the interests of the company in the middle- and long-run and not incite behaviour that is in the executives’ own interest that could harm the interest of the whole company.
5. *Reward for failure:* Companies should not compensate executives who had failed to serve the company with high rewards.
6. *Performance-based pay:* When determining the height and the structure of the pay, the developments of the results, the share price performance and non-financial indicators that are relevant to the company’s long-term value creation should be considered.
7. *Termination of employment:* The shares held by a board member is a long-term investment and upon termination of employment cannot exceed one year’s salary, unless it would seem unreasonably dependant on circumstances.

Alongside these principles of remunerations are the ‘best practice’ determinations which are divided into various parts. Again, the principles of the Code imply the ‘spirit’ in which the Code should be used, where the ‘best practice’ determinations should be followed

alongside the principles. The ‘best practice’ provisions are fully mentioned in the appendix. Below is a summary of what each provision consists of related to the height and composition of executive remuneration (Tabaksblat, 2003) (Frijns, 2009):

Table 2: Summary of the ‘best practice’ guidelines related to height and composition

<i>II.2.1, II.2.2 & II.2.3</i>	<i>Performance criteria & performance-based pay</i>
<i>II.2.4, II.2.5 & II.2.6</i>	<i>Regulations of options and securities</i>
<i>II.2.7</i>	<i>Termination of employment</i>
<i>II.2.8</i>	<i>Preferential treatments</i>

5.7.1 Linking the height and composition provisions to performance pay

In this and the next chapter, the provisions will be chosen which can have significant influence on the change on the height of compensation to executives related to performance pay.

Best practice provision II.2.1, II.2.2 and II.2.3 are much alike, because they implicate that without any performance criteria targets, options or shares cannot be awarded. The provisions guarantee this by forcing executives to retain the options or shares for at least the performance criteria demands (LTI: 3 to 5 years & STI: 1 year). In which options and shares are only granted when the predetermined quantifiable performance criteria target is fulfilled. So, if these ‘best practice’ provisions are being complied to, the options and shares are tied to the performance criteria targets. This can result in more meaningful incentive-based pay, but is still dependent on how the remuneration schemes are made by the remuneration committee.

Although, provisions II.2.4-6 are very important to regulate option and share violations, it will not have an effect on the transition and the use of more performance criteria. It will however, create a lot more transparency on the practices of granted options and shares which can influence the height.

Provision II.2.7 & II.2.8 would also be effective against the use of executive compensation without any criteria, such as the golden handshake or preferential usage of credit to the executive. Just like provisions II.2.4-6, provision II.2.7 & II.2.8 are critical for a remuneration environment that is consciously thought about. Companies could bypass this though by just not complying to this rule, but it would be harmful for the reputation of the company when shareholders would be informally paid.

To conclude, provisions II.2.1, II.2.2 and II.2.3 will be used in to analyze the compliance of the Code. In the next chapter the other provisions will be added to the previous which are related to performance criteria.

5.8 Determination and disclosure of remuneration

The second part of II.2 is about the determination and disclosure of executive remuneration. This part is the same as the previous part where a principle and ‘best practice’ part exists to supplement and augment each other.

The principle of the second part of II.2 are according to Tabaksblat and Frijns:

1. *The supervisory board determines the remuneration for the individual managers which is within the scope of the remuneration policy and which is approved and adopted by the general meeting of shareholders.*

2. *The principal points of the remuneration report in relation with the remuneration policy of the firm shall be disclosed. The policy (with an overview) should be described in clear, transparent and understandable terms, as well as the components of the compensation for individual managers.*

Below are the ‘best practice’ provisions of Tabaksblat and Frijns related to the determination and disclosure remunerations that could have an impact on this research:

Table 3: Summary of 'best practice' guidelines related to the determination and disclosure

II.2.10	<i>Target versus actual compensation based on performance</i>
II.2.11	<i>Clawback when management fraud appears</i>
II.2.12	<i>Disclosure of remuneration policy</i>
II.2.13. a & b	<i>Disclosure of the executive compensation components</i>
II.2.13. c	<i>Maximum and minimum executive shares granted when performance criteria are met</i>
II.2.13. d	<i>Guidelines on equity-based remuneration components</i>
II.2.13. d. i)	<i>Total value of equity-based remuneration components when granted</i>
II.2.13. d. ii)	<i>Present status of total equity-based remuneration components</i>

II.2.13. d. iii)	<i>Value of equity-based remuneration components at the end of vesting period</i>
II.2.13. d. iv)	<i>Value of equity-based remuneration components at the time the executive obtains unrestricted control</i>
II.2.14	<i>Disclosure of the main elements of the executive's contract</i>
II.2.15	<i>Disclosure of special executive remuneration</i>

5.8.1 Linking the determination and disclosure of remuneration provisions to performance pay

Likewise to the previous chapter, provisions and principles will only be chosen if it influences the performance pay. Because the provisions of Frijns are significantly different from the provisions of Tabaksblat and the timeframe fits better with the provisions of Frijns. Only the 'best practice' provisions of Frijns will be elaborated:

Firstly, provision II.2.10 ensures that when the executive would get an unfair compensation due to extraordinary circumstances, the supervisory board would have the power to adjust the value downwards or upwards. This can have the effect that firms would not uphold to their performance criteria targets and that actual remuneration would be much higher than the target. This can be seen in the report of EY (2018), where they show the difference between the target and actual compensation for STI's. Although, the supervisory board can adjust the short-term variable pay to a maximum of 10% of the base salary. It would be quite undesirable if every target would be met and that the actual payment would be more than the target. This can have the result that performance is actually not linked executive compensation. Therefore, it would be a compelling provision to analyse.

The clawback provision (II.2.11) explains when the variable pay for managers could be recovered after a scandal when incorrect financial or other data has been used to base the executive's performance. Some research has been done on the effects of clawback adoption, but the results are ambiguous concerning the height of executive compensation (Prescott & Vann, 2018).

Although, research has shown that when clawbacks were adopted, management techniques shifted to improve short-term performance instead of long-term value. (Chen et al., 2015). CEO's are performance sensitive, especially in recent times where variable pay is

increasingly a larger portion of the composition of pay for executives. Clawback adoption by firms can therefore lead to more short-term insights by CEO's. This would lead to more short-term compensation and less long-term compensation. It would therefore be interesting if this phenomenon would also happen in the current remuneration environment by looking at the adoption rates of clawbacks by the firms and the actual executive remuneration.

The disclosure of the remuneration policy (provision II.2.12) is almost wholly implemented into the remuneration environment. The remuneration policy however must include how the long-term objectives will be achieved through the chosen remunerations policy. If companies do not comply to this provision, it could be that their policy is not trying to incentivize executives to make long-term decisions, instead of short-term.

Provision II.2.13 consists of many sub provisions, in which II.2.13. c) would be the minimum and maximum number of shares granted when performance criteria are met. If companies do not comply to this provision, it would say a lot about how the promise of the performance target is being uphold.

Provision II.2.13 d) is how the supervisory board copes with granting shares to executives, without any relation to performance criteria. This could well have an effect on the height of the executive compensation if firms are tampering with the value, vesting-period or the granting date. If the compliance these provisions will be low, it could say something about that there is an informal scheme to compensate managers that is not disclosed. However, it is hard to know if this influences the performance pay, because informal payments cannot be measured.

To conclude, provisions II.2.10, II.2.11, II.2.13 c & d will be considered.

5.9 Compliance of the Code

The compliance research was done initially every year by the Rijksuniversiteit Groningen but changed numerous times between 2009 and 2018. But, around 2010 the Dutch Monitoring Commission switched to Nyenrode Business University and afterwards to the SEO (Dutch Economic research centre). This had quite the effect fluctuational effect on the compliance rate that resulted from switching from researcher.

Every year the remuneration part of the Code had the second lowest compliance rate since the introduction. The Code created insufficient clarity for firms to formulate what the Code really implied due to the inaccurate phrasing of the provision. The optional phrasing is suggesting firms what they should do, instead of giving clear guidelines on the information they must disclose to comply to the provision. Due to the fact that the researchers of the compliance were confronted with the same degrees of freedom as the complying firms. It had the result that when an explanation was present related to a provision, it would be reported that the firm complied to the provision without actually complying to the ‘spirit’ of the provision. The firm usually only had an explanation that was partly sufficient so the results could be inaccurate. Though, the accurateness was not made by the researchers, but by the Code itself due to the suggesting character of the provisions. In 2008, the Code was amended to make the provisions clearer to firms, so they had better guidelines on which criteria to comply to.

6. Hypothesis

In the literature review, various components were discussed that had a significant influence on the remuneration environment, such as the trends, the structure of remunerations, non-financial components, theories that explain the rising executive pay phenomenon, a literature review on the relation between CEO remunerations and performance and a review of the Dutch Corporate Governance Code related to executive remuneration.

According to trends and research, the composition of executive remuneration has significantly changed. This can be seen in the transition from paying executives only in options in the 90's, where now executives are mostly paid via performance criteria such as LTI's and STI's ((Duffhues & Kabir, 2008). It is therefore interesting to discover if this change in compensation structure also changed the way CEO's earn their salary.

The literature review about the impact of the pay-performance relation showed that beyond 2008 there was little formal research on this relation. While the implementation of the revised Code of Frijns, which was effective in 2009, could have changed this relationship. Therefore, this study will analyse this relation in the time-span of 2009 and 2018.

Given this information, this thesis will test the following hypothesis:

“The pay-performance relationship is significant and strong for CEO's of Dutch AEX companies between the period of 2009 and 2018.”

Here, the underlying test question can be: Do CEO's get more compensation when they achieve the performance targets, or are the performance criteria just a disguised way to pay CEO's unjustifiable sums?

Previously mentioned, the Code was revised in 2008 and effective for every firm that used the Code on the 1st of January 2009. In 2008, the Tabaksblat Code still had a lot of issues with the compliance rate of the Code regarding remuneration. Although, the compliance rate was rising, the Code had unclear provisions which resulted in firms complying to the letter, instead of complying to the principle of the provisions (Monitoring Report, 2008). The Code was revised so that the remuneration report of firms consisted of specific criteria, which were clearer for firms to comply with. It would therefore be interesting to see what the developments of the relationship of performance and CEO remuneration would be alongside the compliance of the revised Code.

Therefore, the formulation of the hypothesis will be:

“There is a relationship between the height of CEO pay for AEX companies and the compliance of the revised Dutch Corporate Governance Code between 2009 and 2017.”

Here, the underlying test question can be: Does the compliance of the Code have any influence on the implementation of performance-pay, or does it merely serve as an indication that companies follow the Code to letter instead of complying to the principles of the Code.

The revised Code of 2008 was only effective between 2009 and 2017, where the Code ‘van Manen’ was effective at the 1st of January 2018. So, the only Code that was used in this research would be the Code of Tabaksblat which was revised by the committee of Frijns in 2008. Because there was no information of the year 2018, the time-frame was amended to 2009-2017.

7. Research Design

In this chapter, the determinants of the hypotheses that was discussed previously shall be examined. Such as the determinants of the performance of firms, the remunerations of CEO's, the compliance of the Code and other factors.

7.1 Sample

This research will focus on the Dutch listed companies from the Euronext Amsterdam stock exchange, in which the research will only use companies from the AEX large cap index. These companies have the largest market capitalization on the Amsterdam Stock Exchange.

Sometimes, these companies are merged with foreign companies and can therefore lose their place in the Euronext Amsterdam stock exchange. If this happens between 2009 and 2018, this company will not be included in the research. However, when a firm enters or leaves the AEX index within 2009 and 2018 the company will still be used for the sample. The firm size control variable will regulate for this switch.

When companies grow rapidly and entered the AEX index late in this time-span, some data can be missing at the beginning of this interval. Therefore, these companies will be left out of the research. The company sample which has been used is in the appendix under table 9.

7.2 Sources of data supply

The database that will be used to collect the remuneration details is from www.bestuursvoorzitter.nl. This site has remuneration data for every CEO since 2002 (since the introduction of the Code) from companies which are listed in the Euronext Amsterdam (AEX, AMX, AScX). The source uses fixed pay (mentioned as salary), bonus, pensions, options, shares and other compensation fees as compensation parts. All these together is the total remuneration for the CEO.

The variable pay for the CEO that will be used is the bonus, options and shares that is dependent on the performance of the company. Because the source only has information until 2017, the CEO remuneration information of 2018 is collected from public annual reports.

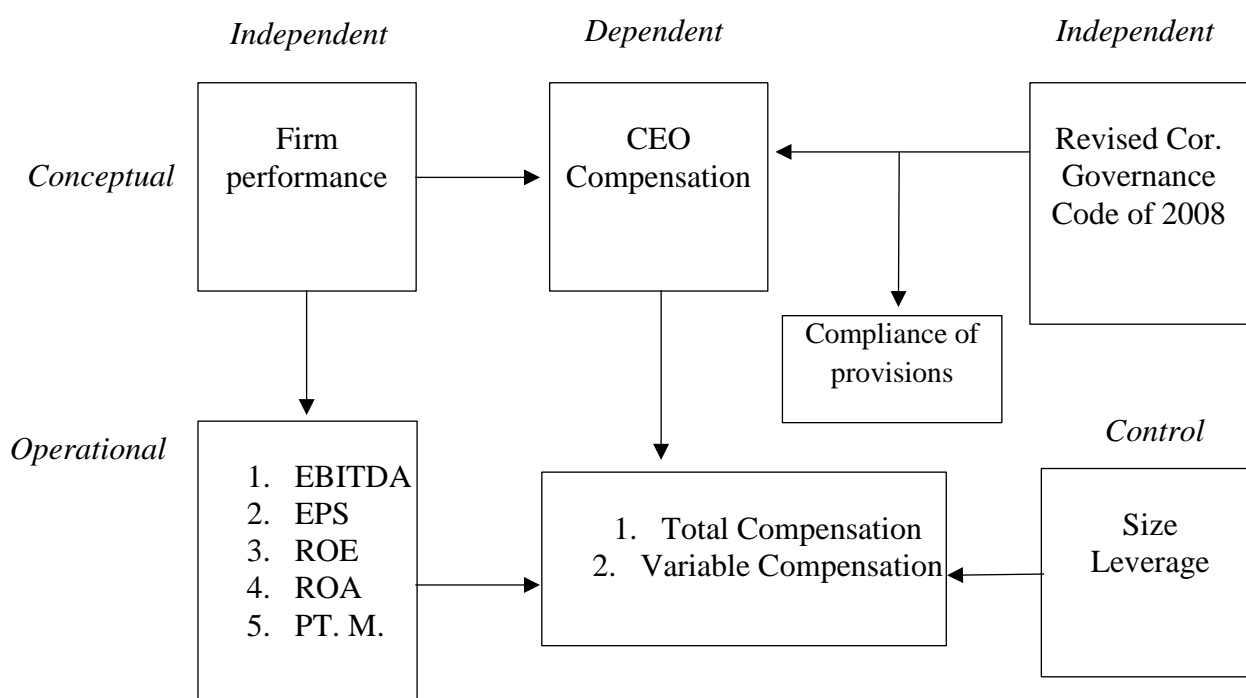
The other database that will be used to collect the key performance indicator data is from ThomsonOne (T1). This database has an accurate and comprehensive list of annual report data from Dutch listed companies since 1987.

The compliance rates will be collected from the yearly monitor reports published by the Monitoring Commission of the Dutch Corporate Governance Code on their site. The information regarding the rate is in the appendix in table 10.

7.3 Variables

In this part of the empirical research the operationalized variables of the pay-performance relationship model will be explained. A visualization has been made below with the help of Libby’s predictive validity framework (2002, p.795). Furthermore, the operationalization of these variables is explained in this chapter.

Table 4: Predictive validity framework (Libby et al., 2002, p.795)



7.3.1 KPI’s

The most commonly used key performance indicator (KPI) for establishing the variable pay of executives in the short run, which is also known as STI’s, are: Free Cash Flow, EBITDA/EBITA, Revenue, EVA and Net Sales Growth. The most commonly used long-term KPI, which is also known as the LTI, are: rTSR (Relative Total Share Return), EPS and FCF.

These KPI's were based on the research of Bächinger et al. (2016) and the research of the Monitoring Commission (2005 & 2007).

Some KPI's could not be used due to lack of data and therefore other KPI's have been used that could estimate the pay-performance link in the same way. Therefore, the chosen performance-based STI's are EBITDA and pre-tax margin, where pre-tax margin is comparable with net sales growth. The chosen performance-based LTI's are EPS, ROE and ROA, where ROE and ROA measure management efficiency. If executive compensation is predicted to be higher in companies with higher performance, then the estimated coefficient (β_1) should be positive. In table 5 below, the KPI's and the control variables are explained in more detail.

Table 5: Key performance metrics used in pay-performance model

Management Performance ratio's	
ROE (financial & management performance measurement)	Return on equity: net income / shareholders equity. Measurement of management effectiveness to create profits.
ROA (financial & management performance measurement)	Return on assets: the amount of profit the company is generating from its assets. Net income / average total assets.
Firm performance ratio's	
EPS (profitability measure)	Earnings per share: net income / outstanding shares common stock
EBITDA (financial performance measure)	Earnings before Interest, Taxes, Depreciation and Amortization. Alternative to net income.
Pre-tax Margin (operating efficiency measure)	Percentage of sales that has turned into profits.
Market Capital (proxy firm size)	Total value of company's outstanding shares.
Leverage (total debt / total equity)	Amount of debt a firm uses to finance assets

7.3.2 Remunerations

CEO remunerations can be made operational with several variables used by the dataset from www.bestuursvoorzitter.nl. The variable reward for CEO's in the data source is measured

as the bonus, shares and options. Usually, the bonus is linked to specific short-term performance achievements to be delivered by the CEO. Shares and options are usually used to incentivize CEO's in the long-run to align them with the Shareholders, but is also used to reward CEO's when specific performance achievements are realized. So, the variable compensation – which is paid out in cash (bonus), shares and options – is formally and partly dependent on the achievement of the performance criteria by the CEO in the short- and long-run. Then, total compensation can be used as the second dependant variable which is the sum of all compensation components. This is the variable pay plus the fixed pay with the other compensation fees such as pensions.

The measurement of options was done with the Black & Scholes option-model. According to the source of the data, this model gives a reasonable estimate of the real value of the options on the basis of the current rate, the exercise price, the duration of the term, dividend return, the interest rate and the volatility. The stock price is corrected for share-splits or other share related mutations. To measure the stock price, the average yearly rate was taken at the yearly term of the CEO.

Conditional options and shares are often used as a payment factor to CEO's in return for performance. Because the time-span of this study is between 2009 and 2018, CEO performance before 2009 and the granting of conditional options after 5 years can cause problems for this research. As well as, the CEO performance in the time-span and the compensation of this performance after 2018. Therefore, when the LTI equity-based compensation component is granted upon the year of the CEO's performance, the equity component will be valued and vested. This way the allocation of the compensation and performance will happen in the same year. Although, equity can increase or decrease in this 5-year time-span until it is actually granted, which is a limitation to this study.

7.3.3 Control & dummy variables: Size, Leverage & Years

To prevent this research from misrepresenting the relationship of performance on pay, three control variables are setup: size, leverage & time.

There has been some old (Mertens et al., 2007) and recent (EY, 2018) research done on the relationship of size and CEO compensation, which has a strong and significant link. Firm size, defined as the natural logarithm of the market value of equity, is used as the first control variable. The natural logarithm was used here to get rid of the outliers.

The other control variable is leverage, which is defined as the ratio of total debt to total equity. The influence of high debts on the compensation of the executive can be positive as well as negative. The creditor will monitor the firm more closely if there is a high debt owed by the company, which can lead compensation being less. On the other hand, this high debt can lead a higher risk for the CEO, which could justify a higher pay.

The year dummy variables will be used to isolate the other variables into a specific year.

7.3.4 The pay-performance link and Code

The compliance rate will be collected from yearly monitoring reports from 2009 to 2017 and will be linked to the height of CEO compensation. Where the CEO compensation will be divided into variable and total pay.

The compliance was done by multiple universities and institutions which partly caused the compliance rate to fluctuate a lot over the years. The research can therefore be deeply affected. Because the data is very vulnerable, Stata graph will be used and converted into excel for readability purposes. 2 graphs will be compared to link the two variables. Namely, CEO compensation and the compliance of the ‘best-practice’ provisions.

The provisions that will be used are: II.2.1, II.2.2, II.2.3, II.2.10, II.2.11, II.2.13 c & d. But, because of the unverifiability of provisions II.2.1 and II.2.3 these provisions will not be considered. Also, information was missing between 2013 and 2015, which can make the limited data even more vulnerable.

7.4 Missing data

The data from Thompson One lacked the preferable KPI’s such as the rTSR and the FCF. Therefore, other KPI’s were used which measured the management effectiveness (ROA & ROE) and the firm performance (pre-tax margin).

Initially, 30 companies were going to be used in this thesis, but due to missing data only 20 were used. These 20 AEX companies are mentioned in the appendix (table 9), where the information is quite complete except for ING where some KPI’s and remunerations were missing. The missing data was replenished from the company’s public annual reports. The remuneration source lacked the 2018 data and was also extracted from public annual reports.

7.5 Methodology

In the literature review, other researches of the same subject were analysed which used several econometric models to run an Ordinary Least Squares (OLS) regression (Duffhues & Kabir, 2007). Both the variable and total compensation has been set into a natural logarithm due to the large outliers in the data.

The first model will predict the influence of performance on variable CEO remuneration.

Model 1: dependent variable: variable compensation

$$\Delta \ln(\text{Varrem})_{it} = \beta_0 + \beta_1 \Delta (\text{Perf})_{it} + \ln \beta_2 \Delta (\text{Markcap})_{it} + \beta_3 \Delta (\text{Leverage})_{it} + \beta_4 \Delta (\text{Year})_{it} + \Omega_{it}$$

The second model will predict the influence of performance on total CEO remuneration.

Model 2: dependent variable: Variable compensation

$$\Delta \ln(\text{Totrem})_{it} = \beta_0 + \beta_1 \Delta (\text{Perf})_{it} + \ln \beta_2 \Delta (\text{Markcap})_{it} + \beta_3 \Delta (\text{Leverage})_{it} + \beta_4 \Delta (\text{Year})_{it} + \Omega_{it}$$

Because the remuneration of the current year might be affected by former year's performance such as STI's, the research can observe simultaneous effects, but also effects that can be observed in subsequent years. Therefore, with each model a one-year lagged version will be included to account for this problem. Due to large outliers in the market capital which serves as a proxy for firm size, mark capital has been set into a logarithm.

7.6 Limitations

A combination of the previously mentioned KPI's can be used to base the performance of CEO's, instead of just one KPI. So different performance criteria can exist in one pay-package, which can be a limitation for this study.

Also, non-financial based compensation – which can reach around 15% of the total remuneration – is not considered for this research and can therefore give a less accurate result (EY, 2018).

According to the research of Knop & Mertens (2010), the ownership and board composition have considerable impact on CEO remuneration at Dutch listed Companies. Certain ownership structures have a dampening effect on CEO remuneration when:

- there are shareholders who have a large proportion of the company's shares (>5%), especially larger companies;
- at least 1% of the shares is owned by management of supervisory board members;

- companies have anti-takeover defences;
- there are non-independent supervisory board members present who have a business interest in the company.

Also, when supervisory boards have an above-average number of members, CEO remuneration are substantially higher. These multiple factors of firm structure and board composition that influence CEO remuneration is not incorporated into the research, due to the difficulty to operationalize these many factors.

The first hypothesis only answers the question if performance has influence on the CEO remunerations. The backward relationship – the influence of remunerations on performance – cannot be answered with this research.

This research can give an answer to the pay-performance relationship of the CEO, but a conclusion for other executives cannot be drawn for this research. Nor can this research give an answer for the other indices but the AEX-index.

Some KPI's used in this study are unfortunately not the most used KPI's to measure performance to indicate CEO performance. Mentioned before, the most used KPI's used by listed companies are: Free Cash Flow, Revenue, EVA, Net Sales Growth and rTSR (Bächinger et al., 2016). The revenue, EVA and net sales growth could be accurately measured with the substitutes: EBITDA, Pre-tax Margin, ROE and ROA. rTSR can be substituted with EPS, but a substitute for cashflow was not used. This could be a limitation to this research.

According to the article of Edmans et al. (2017), many conflicting forces are influencing executive pay that not one perspective can explain all of the evidence. The shareholders' desire to maximize firm value, the executives desire to maximize their rents, the influence of legislation, taxation, accounting policies and social pressures. All these narrow perspectives will distort rather than inform the view of executive pay. Also, identifying the causal effect of compensation contracts on any interesting outcome variable is extremely difficult. Because these contracts are usually based on unobservable firm, industry and executive characteristics. As a result, the executive contracts are correlated with these unobservable characteristics which in turn can affect the behaviour, performance and value of the executive. Because many determinants influence executive pay, the reliable causality of this research is still questionable.

8. Results

8.1 First hypothesis

Here, the following hypothesis will be answered: “*The pay-performance relationship is significant and strong for CEO’s of Dutch AEX companies between the period of 2009 and 2018.*”

According to Alin (2010), the different variables to explain CEO compensation with firm performance should be tested for multicollinearity. The VIF function was used to look for large degrees of correlation between the performance metric variables, and if these were higher than 10 the variable had to be separated from each other. Because these variables showed quite some multicollinearity, each performance criteria were separated from each other. Therefore, in each regression only one performance metric will only be used.

8.1.1 Results of the variable pay on firm performance.

Table 6: Regression results for Variable Compensation

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
ROE	0.577*** 2.29				
ROA		1.36 1.65			
EPS			0.018* 1.82		
EBITDA				(-0.000*) (-1.76)	
Pre-tax Margin					0.245* 1.76
Constant	9.495***	9.480***	9.500***	8.866***	9.477***
	25.63	25.22	25.56	21.35	25.69
LnMARKCAP	0.511***	0.512***	0.514***	0.593***	0.517***
	12.57	12.07	12.72	12.85	12.96
LEVERAGE	(-0.001***) (-2.92)	(-0.001***) (-2.98)	(-0.001***) (-2.99)	(-0.001***) (-2.86)	(-0.000***) (-3.01)
Year dummies	Yes	Yes	Yes	Yes	Yes
Industry dummies	No	No	No	No	No
White (1984) Robustness	Yes	Yes	Yes	Yes	Yes
Adjusted R ²	0.503	0.500	0.498	0.514	0.498
Observations	187	187	187	186	185

This table shows the regression results where the dependent variable is the natural logarithm of variable CEO compensation. Firm performance is measured with ROE, ROA, EPS, EBITDA and Pre-tax Margin. Firm size (LnMARKCAP) and leverage operate as control variables. The absolute t-statistics are reported in parentheses. ***, **, * indicate significance at the 1%, 5% and 10% level, respectively.

Table 6 presents the results from the 5 different performance indicators where the dependent variable is variable compensation. The overall adjusted R^2 is generally moving between 0.498 and 0.630. Showing that about 56% of the variance of the natural logarithm of variable compensation is explained by performance, having controlled for firm size and leverage. This model could be an accurate representation of the intended pay-performance relationship and can show a high degree of reliability. Other factors influencing CEO compensation such as non-financial indicators and factors that are not mentioned in an annual report could show a more complete picture of the model.

The results of the regression show a somewhat positive relationship between firm performance and the variable CEO compensation. Especially ROE is very significant (1%) with EPS, EBITDA and pre-tax margin having a lesser significance factor (10%). The results, holding all other constant, can be interpreted as when a one percent increase in return of equity (ROE) would result in a 0.577% increase/decrease in variable compensation (as a result of the natural logarithmic form of variable compensation). The other performance metrics which are less significant (EPS, EBITDA and Pre-tax Margin) cannot be reliably concluded that they have any influence on the variable performance.

Concerning the control variables, the proxy for firm size (market capitalization) is always heavily positive and significant which was expected. Whilst leverage has the same significance but is slightly negative. Which can mean that more leverage can result in less CEO compensation. Maybe due to the risk of more leverage firms cannot afford to pay CEO's more. This cannot be said with certainty though due to only a slightly negative relation.

Because the remuneration of the current year might be affected by a former year's performance. A second regression has been done with the only difference in having a one-year lag. In the second part of the table, the lagged regression results are less significant than the previous regression. Here only the performance metrics EPS and pre-tax margin have a 5% significance result.

To conclude, the CEO variable compensation is only partly significant and does not have a significant positive factor (only 0.577% for ROE). The other performance indicators are not significant enough and only has a suggestive meaning.

Table 7: Regression results for the lagged variable compensation

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
ROE	(-0.007)				
	0.02				
ROA		0.361			
		0.50			
EPS			0.015**		
			2.24		
EBITDA				0.000	
				0.44	
Pre-tax Margin					0.201**
					2.05
Constant	9.411***	9.348***	9.360***	9.418***	9.383***
	25.79	25.38	25.51	25.25	25.64
Ln MARKCAP	0.528***	0.537***	0.530***	0.529***	0.527***
	13.20	13.38	13.56	13.39	13.56
LEVERAGE	(-0,001***)	(-0,001***)	(-0.000***)	(-0,001***)	(-0,000***)
	2.79	-3.00	-2.79	-1.96	-2.84
Year dummies	Yes	Yes	Yes	Yes	Yes
Industry dummies	No	No	No	No	No
White (1984)					
Robustness	Yes	Yes	Yes	Yes	Yes
Adjusted	0.494	0.542	0.502	0.527	0.497
Observations	180	180	180	180	180

8.1.2 Results of the total pay on firm performance.

Table 8 shows the results of the logarithm of total CEO compensation on firm performance. The same has been done with the previous model, only the dependent variable has changed.

The results are far less significant than the previous model of variable compensation. This can have a logical explanation, because the total compensation variable consists of many more factors that cannot be attributed to firm performance. Such as fixed pay, pensions, severance pay and other remuneration components. An outrageous example is in 2014 when Ben van Beurden was granted a 18,600,000 million pension fee at the beginning of his career as CEO at Shell. These factors are not aligned with firm performance at all and can therefore have significant influence on this model. The lagged version showed very similar results and is therefore not included. It also suggests that the variable compensation component of the total

compensation is only related to performance. The rest of the compensation components is still rewarded upon factors that is not disclosed publicly.

Table 8: Regression results for total compensation

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
ROE	0.236				
	1.24				
ROA		-0.025			
		0.05			
EPS			0.003		
			0.44		
EBITDA				(-0.000)	
				1.14	
Pre-tax Margin					(-0.000)
					1.14
Constant	11.159***	10.984***	11.165***	10.864***	11.145***
	48.24	48.25	47.61	42.89	47.80
Ln MARKCAP	0.404***	0.427***	0.407***	0.442***	0.409***
	15.44	16.27	15.56	15.28	15.80
LEVERAGE	(-0,000***)	(-0,000***)	(-0,000***)	(-0,000***)	(-0,000***)
	2.29	-1.60	-2.33	-2.00	-2.32
Year dummies	Yes	Yes	Yes	Yes	Yes
Industry dummies	No	No	No	No	No
White (1984) Robustness	Yes	Yes	Yes	Yes	Yes
Adjusted R ²	0.583	0.630	0.579	0.601	0.580
Observations	195	190	194	191	195

This table shows the regression results where the dependent variable is the natural logarithm of total CEO compensation. Firm performance is measured with ROE, ROA, EPS, EBITDA and Pre-tax Margin. Firm size (LnMARKCAP) and leverage operate as control variables. The absolute t-statistics are reported in parentheses. ***, **, * indicate significance at the 1%, 5% and 10% level, respectively.

The answer to the research question if there truly is a pay-performance relationship for Dutch listed companies between 2009 and 2018 has a two-sided meaning. There is definitely a weak relationship at best between the variable CEO compensation and firm performance. But, the total remuneration granted to the CEO is not based upon the performance, although there is a significant variable part within the total pay. Therefore, the hypothesis should overall be refused.

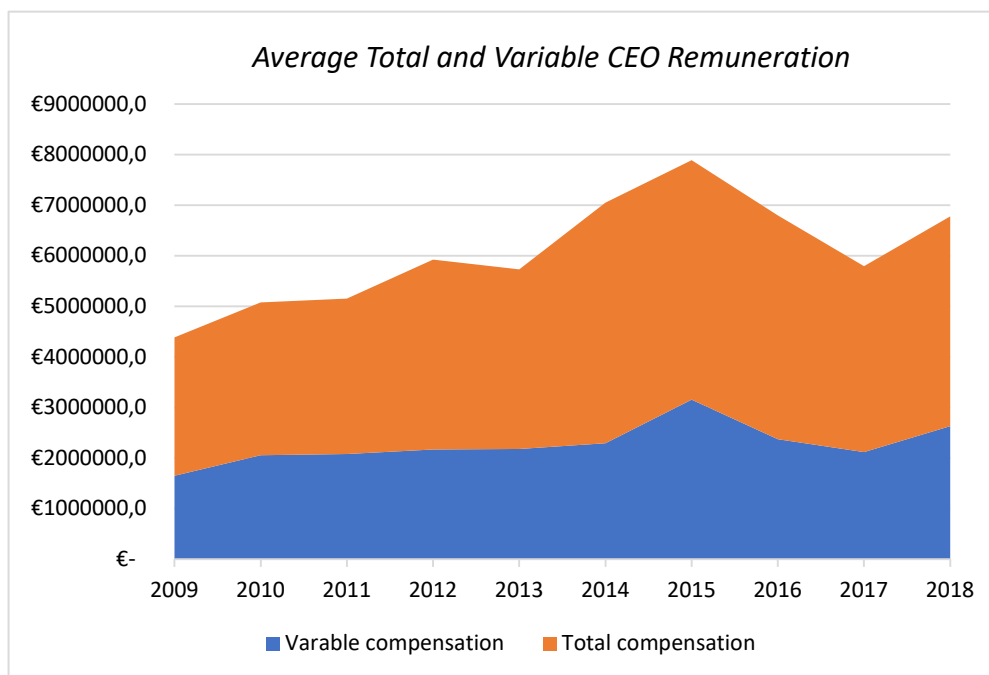
8.2 Second hypothesis

Here, the following hypothesis will be answered: *“There is a relationship between the height of CEO pay for AEX companies and the compliance of the revised Dutch Corporate Governance Code between 2009 and 2017.”*

The question arises if the Dutch Code had any influence on the height of executive remuneration, if not only increase it even more? Since the introduction, the height of remunerations has only been rising (Duffhues & Kabir, 2008). Does the Code improve what it is trying to prevent or does it actually unintentionally inhibit the remuneration environment to stabilize their spiraling executive rewards?

Simple excel tools were used to graph the average height of total remunerations and the compliance of the Codes below.

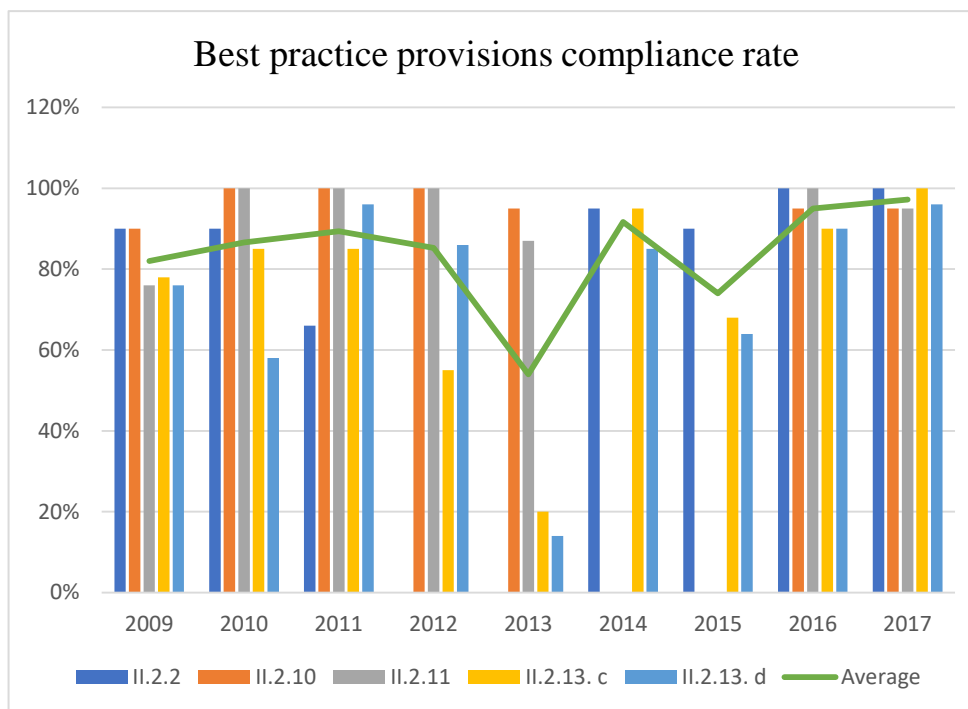
Figure 2: Graph of average executive compensation between 2009 and 2018



In this graph, the steady increase can be seen of the variable and total CEO compensation. Interestingly the variable compensation has a steadier horizontal line than the total compensation. Where, the variable pay rises less fast than the total compensation. This can be attributed to the Code, because it provides limits to how high variable pay can go. This does not however count for other compensation parts, such as severance pay, pensions and other forms of compensation.

Thought provokingly in 2015 there was a spike in CEO compensation where it dropped considerably again to its normal level, where variable pay showed this trend as well. Then after 2017, both began to rise again. To compare this with the ‘best practice’ compliance, the graph is set out below.

Figure 3: Graph of compliance between 2009 and 2017



As can be seen, the two graphs show some similarities, especially between 2013 and 2016 there seems to be a causality. When the Code increased in compliance, the CEO compensation seems to be increasing as well. This is odd, because one would think when the Code increases in compliance, the CEO compensation would be set into a state where it is stable. The reverse happens, which can be deduced from the reasoning that when firms comply they have the know-how to raise the CEO compensation within the scope of the guidelines of the Code. When before, they did not comply and were restrained from raising the compensation due to lack of performance measures. When not complying to the Code, the firm could count on serious criticism from the shareholders, the press, investors (van der Elst & lafarre, 2017). Therefore, preventing from even raising the compensation even further. When these firms did comply to the Code with their remuneration policy, they could raise the CEO compensation in the pay-performance game of the Code. This is only suggestive due to the missing information in 2013, 2014 and 2015, and could very likely be a coincidence.

To conclude for this hypothesis, a big problem is that firms do increasingly comply to the Code, but the aforementioned principles are badly considered (EY, 2018). This can have the effect that companies still increase their CEO compensation, while complying to the Code. Therefore, to analyse the compliance of the Code is maybe not a good method to measure the influence of the Code on executive remuneration.

Annual compliance research can be useful in the way it monitors and deters companies which results in complying. Although, it has a lot of influence on the transition of different executive compensation structures. However, It does not grant the desired effect to limit the spiralling executive compensation.

Therefore, the answer to the hypothesis that there is a relation between the height of CEO remuneration and the compliance of the revised Code between 2009 and 2018, is that there is a relation. But, it has not the desired effect of limiting the rising executive compensation. Instead, the Code still has the paradigm that executive compensation is grounded in the old agency-theory (Pepper, 2015), which translates into the idea that CEO's are only interested in extrinsic motivation. This has caused the executive to be riddled with complicated performance guidelines in which he/she almost has too much or too few influences on. The agency-theory is one of the main causes why CEO's are still overpaid (Pepper, 2017). The given problem solver was performance-pay, in which it actually had the adverse result.

9. Conclusion

In the first part, different theories were highlighted which explains the different views on why executive compensation sky-rocketed in the 90's (Frydman & Jenter, 2010). Such as the rising influence of internationalization which gave the prisoner's dilemma theory a bigger grip on getting the best executive for the firm. As a result of this, the agent-principle theory became a more prominent problem to solve, because managers were not as before recruited from the company after many years of loyal service. The expectation that these managers were only incentivized by extrinsic motivators was based upon an old economic theory that should have been amended to more realistic expectations of managers.

In 2002, the Dutch Code was introduced to give guidelines for the disclosure of executive remuneration with the debut of performance criteria on which executives should be rewarded upon. This was a solution for the unjustified grants of options and shares to executives which gave more clarity how executives will be paid. Unfortunately, the guidelines were too vague, complicated and incomplete for firms to comply to (Monitoring report, 2005). Until now, this still gave the guidelines, but most importantly the principle of the Code a hard time to follow (EY, 2018). Although, the revised Code of Frijns in 2008 partly these problems.

The transition from options to performance pay was supposable the solution to control the height of executive remuneration. But, the foundation on how executives were paid however did not change. And according the behavioral-agency theory from Pepper (2015), complicated performance compensation criteria are the culprit of motivating executives. However, the Code tried to amend this problem by making the guidelines less complicated and easier for firms to follow with a focus on making the remuneration policy as transparent and clear as possible (Commission of Frijns, 2008).

In the period of the introduction of the revised Code of Frijns (2008), these guidelines were made clearer. The revised Code of Van Manen (2018) elaborated this, with a bigger emphasize on making remuneration policies more transparent and clearer. Between this period, the pay-performance relationship was tested (2009-2018). The results were that the variable pay was somewhat positively significant with the performance metric, especially the ROE. But, the performance metrics did not have a huge positive effect on the increase of CEO

remuneration. Therefore, the variable pay is only weakly and positively significant with the performance of the AEX firms.

Also, the total executive compensation was not significant with any performance metrics, which is in line with comparable research in the literature review. This is logical, because the variable pay is only between 25% and 33% of the total remuneration (EY, 2018). Where the total remuneration consists of many parts that are not related with any performance metrics.

The relationship with the compliance rate of the Code and the height of executive remuneration was hard to predict, due to the lack of accurate research and missing data. The result was an unintended causality, where the higher the rate of compliance the higher the rate of remuneration was found. This can be rationalized due to the conforming nature of the Code. Where non-complying firms could not raise executive remuneration due to already been pressured to conform to the Code by shareholders, investors and the press (van der Elst & Lafarre, 2017). But, if these companies did conform, they would focus on raising the remunerations with the Code's own guidelines. Because the Code only gives many guidelines on the composition and less to specific height rules, firms could still bypass the intended principle of the Code by raising executive remuneration with other means, but performance pay (severance pay, pensions, fixed pay etc.).

The impact of the Code on executive remuneration has been numerous on the composition, the height and other responsibility shifts in the Dutch two-tier board. Although it had great influence and intentions to change the remuneration environment for good, it had the unexpected effect of allowing firms to justifiably pay CEO's higher and higher pay checks. Now, companies are complying to best practice guidelines that only costs the shareholders, stakeholders and even the executives more money (and motivation).

Therefore, the Code should base their foundation on a realistic model that puts the executive's performance at the centre of the model that thinks from within the executive instead of outwards (Pepper, 2017).

9.1 Recommendations

Recommendations for future research can be discovering new insights on the different mechanisms and motivations of executives. In the book of Pepper (2015) this has been

carefully set out in his new model “the behavioral agency theory”. Interesting research could be done how executives will react and will be affected by this new model. Differences between the old and the new and the implications thereof on the height and composition would be an interesting topic.

According to Pepper (2017), thinking from within the executive going outwards rather than outwards to within is the key of stabilizing and heavily decreasing the excessive executive compensation schemes. Building remuneration policies from this perspective instead of assuming that every executive is motivated by extrinsic factors, is a good start to compensate executives in a fair and effective way.

10. Appendix

Table 9: AEX Companies in sample (20)

Aalberts	BAM	Philips	Shell
Aegon	Boskalis	PostNL	TomTom
Ahold Delhaize	Heineken	Randstad	Unibail
Akzo Nobel	ING	Royal DSM	Unilever
ASML	KPN	Royal Vopak	Wolters Kluwer

Table 10: Compliance rate of the chosen 'best practice' guidelines

Year	II.2.2	II.2.10	II.2.11	II.2.13. c	II.2.13. c	Average
2009	90%	90%	76%	78%	76%	82%
2010	90%	100%	100%	85%	58%	87%
2011	66%	100%	100%	85%	96%	89%
2012	#	100%	100%	55%	86%	85%
2013	#	95%	67%	20%	14%	54%
2014	95%	#	#	95%	85%	92%
2015	90%	#	#	68%	64%	74%
2016	100%	95%	100%	90%	90%	95%
2017	100%	95%	95%	100%	96%	97%

10.1 Full 'best practice' provisions of the Code throughout the years

10.1.1 Code of Tabaksblad regarding the height and composition of remunerations:

II.2.1 – Options to acquire shares are a conditional remuneration component, and become unconditional only when the management board members have fulfilled predetermined performance criteria after a period of at least three years from the grant date.

II.2.2 – If the company, notwithstanding best practice provision II.2.1, grants unconditional options to management board members, it shall apply performance criteria when doing so and the options should, in any event, not be exercised in the first three years after they have been granted.

Attract and retain & performance-based pay: from 2008: II.2.5

II.2.3 – Shares granted to management board members without financial consideration shall be retained for a period of at least five years or until at least the end of the employment, if this period is shorter. The number of shares to be granted shall be dependent on the achievement of clearly quantifiable and challenging targets specified beforehand.

Provision II.2.3 was changed to (2008) II.2.5

Regulations of options and securities: from 2008: start from II.2.6

II.2.4 – The option exercise price shall not be fixed at a level lower than a verifiable price or a verifiable price average in accordance with the official listing on one or more predetermined days during a period of not more than five trading days prior to and including the day on which the option is granted.

II.2.5 – Neither the exercise price nor the other conditions regarding the granted options shall be modified during the term of the options, except in so far as prompted by structural changes relating to the shares or the company in accordance with established market practice.

II.2.6 – The supervisory board shall draw up regulations concerning ownership of and transactions in securities by management board members, other than securities issued by their ‘own’ company. (...)

Termination of employment

II.2.7 – The maximum remuneration in the event of dismissal is one year’s salary (the ‘fixed’ remuneration component). If the maximum of one year’s salary would be manifestly unreasonable for a management board member who is dismissed during his first term of office, such board member shall be eligible for a severance pay not exceeding twice the annual salary.

Preferential treatments

II.2.8 – The company shall not grant its management board members any personal loans, guarantees or the like unless in the normal course of business and on terms applicable to the personnel as a whole, and after approval of the supervisory board. No remission of loans shall be granted.

10.1.2 Provisions that strengthened the influence of the supervisory board over executive remuneration.

II.2 – The supervisory board shall analyze the possible outcomes of the variable remuneration components and how they may affect the remuneration of the management board members before they decide over it (Principle II.2.1). Contrary to suggestions in earlier reports (2006, 2007), however, the Frijns Committee did not propose a remuneration ceiling.

II.2.10-11 – The supervisory board can adjust a variable component of the remuneration awarded in a previous year if it is, in their opinion, an unfair result due to extraordinary circumstances. More important, in the light of the public outrage over excessive pays, is the power of the supervisory board to recover from the management board members any variable remuneration awarded on the basis of incorrect or other data (Clawback).

10.1.3 Code of Frijns regarding the height and composition of remunerations:

The following provisions are added or changed to the Code of Tabaksblat, while other provisions have a different order which is seen in the previous provisions:

II.2.1 – Before drawing up the remuneration policy and determining the remuneration of individual management board members, the supervisory board shall analyze the possible outcomes of the variable remuneration components and how they may affect the remuneration of the management board members.

II.2.2 – The supervisory board shall determine the level and structure of the remuneration of the management board members by reference to the scenario analyses carried out and with due regard for the pay differentials within the enterprise.

II.2.3 – In determining the level and structure of the remuneration of management board members, the supervisory board shall consider, among other things, the results, the share price performance and non-financial indicators relevant to the long- 15 term objectives of the company, with due regard for the risks to which variable remuneration may expose the enterprise.

10.1.4 Code of Tabaksblat regarding the determination and disclosure of remuneration:

Disclosure of the remuneration report

II.2.9 – The remuneration report of the supervisory board shall contain an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years.

Disclosure of the fixed and variable remuneration components

II.2.10 – The overview referred to in II.2.9 shall, in any event, contain the following information:

- a) a statement of the relative importance of the variable and non-variable remuneration components and an explanation of this ratio;
- b) an explanation of any absolute change in the non-variable remuneration component;

Disclosure of the use of peer companies for remuneration comparison

- c) if applicable, the composition of the group of companies (peer group) whose remuneration policy determines in part the level and composition of the remuneration of the management board members;

Disclosure of the term of employment and the endorsement of provision

- d) a summary and explanation of the company's policy with regard to the term of the contracts with management board members, the applicable periods of notice and redundancy schemes and an explanation of the extent to which best practice provision II.2.7 is endorsed;

Disclosure of the chosen performance criteria

- e) a description of the performance criteria on which any right of the management board members to options, shares or other variable remuneration components is dependent;
- f) an explanation of the chosen performance criteria;
- g) a summary of the methods that will be applied in order to determine whether the performance criteria have been fulfilled and an explanation of the choice of these methods;
- h) if performance criteria are based on a comparison with external factors, a summary should be given of the factors that will be used to make the comparison; if one of the factors relates to the performance of one or more companies (peer group) or of an index, it should be stated which companies or which index has been chosen as the yardstick for comparison;

Disclosure to the rights of variable remuneration

- i) a description and explanation of each proposed change to the conditions on which a management board member can acquire rights to options, shares or other variable remuneration components;
- j) if any right of a management board member to options, shares or other variable remuneration components is not performance-related, an explanation of why this is the case;

Disclosure of pensions and retirement

- k) current pension schemes and the related financing costs;
- l) agreed arrangements for the early retirement of management board members

Disclosure of an executive's contract

II.2.11 – The main elements of the contract of a management board member with the company shall be made public immediately after it is concluded. These elements shall in any event include the amount of the fixed salary, the structure and amount of the variable remuneration component, any redundancy scheme, pension arrangements and performance criteria.

Disclosure of special remunerations

II.2.12 – If a management board member or former management board member is paid special remuneration during a given financial year, an explanation of this remuneration shall be included in the remuneration report. The remuneration report shall in any event account for and explain remuneration paid or promised in the year under review to a management board member by way of severance pay.

Disclosure of remuneration report to the public domain

II.2.13 – The remuneration report of the supervisory board shall, in any event, be posted on the company's website.

Disclosure of the granted and determined value of options for executives

II.2.14 – The company shall state in the notes to the annual accounts, in addition to the information to be included pursuant to article 2:383d of the Civil Code, the value of any options granted to the management board and the personnel and shall indicate how this value is determined.

10.1.5 Code of Frijns regarding the Disclosure of the remuneration report:

The following provisions are substantially different from the Code of Tabaksblat and few are alike. The whole Code of Frijns is therefore listed below:

Target versus actual compensation based on performance

II.2.10) – If a variable remuneration component conditionally awarded in a previous financial year would, in the opinion of the supervisory board, produce an unfair result due to extraordinary circumstances during the period in which the predetermined performance criteria have been or should have been achieved, the supervisory board has the power to adjust the value downwards or upwards.

Clawback when management fraud appears

II.2.11 – The supervisory board may recover from the management board members any variable remuneration awarded on the basis of incorrect financial or other data (clawback clause).

Disclosure of remuneration policy

II.2.12 – The remuneration report of the supervisory board shall contain an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the remuneration policy planned by the supervisory board for the next financial year and subsequent years. The report shall explain how the chosen remuneration policy contributes to the achievement of the long-term objectives of the company and its affiliated enterprise in keeping with the risk profile. The report shall be posted on the company's website.

II.2.13 – The overview referred to in best practice provision II.2.12 shall in any event contain the following information:

Disclosure of the components of executive compensation components

- a) an overview of the costs incurred by the company in the financial year in relation to management board remuneration; this overview shall provide a breakdown showing fixed salary, annual cash bonus, shares, options and pension rights that have been awarded and other emoluments; shares, options and pension rights must be recognized in accordance with the accounting standards.
- b) a statement that the scenario analyses referred to in best practice provision II.2.1 have been carried out.

Provisions surrounding executive shares (II.2.13. c-d)

Maximum and minimum executive shares granted when performance criteria are met

c) for each management board member, the maximum and minimum numbers of shares conditionally granted in the financial year or other share-based remuneration components that the management board member may acquire if the specified performance criteria are achieved.

Total amount of outstanding restricted executive share-based remuneration components

d) a table showing the following information for incumbent management board members at year-end for each year in which shares, options and/or other share-based remuneration components have been awarded over which the management board member did not yet have unrestricted control at the start of the financial year.

Total value of executive share-based remuneration components when granted

i) the value and number of shares, options and/or other share-based remuneration components on the date of granting.

Present status of total share-based remuneration components

ii) the present status of shares, options and/or other share-based remuneration components awarded: whether they are conditional or unconditional and the year in which vesting period and/or lock-up period ends.

Value of share-based remuneration components at the end of vesting period

iii) the value and number of shares, options and/or other share-based remuneration components conditionally awarded under i) at the time when the management board member obtains ownership of them (end of vesting period), and

Value of share-based remuneration components at the time the executive obtains unrestricted control

iv) the value and number of shares, options and/or other share-based remuneration components awarded under i) at the time when the management board member obtains unrestricted control over them (end of lock-up period).

Disclosure of the main elements of the executive's contract

II.2.14 – The main elements of the contract of a management board member with the company shall be made public after it has been concluded, and in any event no later than the date of the notice calling the general meeting where the appointment of the management board member will be proposed. These elements shall in any event include the amount of the fixed salary, the structure and amount of the variable remuneration component, any agreed redundancy scheme and/or severance pay, any conditions of a change-of-control clause in the contract with a management board member and any other remuneration components promised to the management board member, pension arrangements and performance criteria to be applied.

Disclosure of special executive remuneration

II.2.15 – If a management board member or former management board member is paid severance pay or other special remuneration during a given financial year, an account and an explanation of this remuneration shall be included in the remuneration report.

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