

1. Introduction

Higher levels of compensation are expected to be paid to executives in larger firms (Gaver & Gaver, 1995) because the larger the scope of operations, the greater the demands on top executive. Moreover, since executives who manage larger and more complex firms require greater knowledge and ability than do executives of smaller and less complex firms, they require a higher level of compensation on the external labor market (Becker, 1964; Rosen, 1982).

Firm size affects managerial compensation (Jensen & Murphy, 1990; Sanders & Carpenter, 1998). Firm size is the key determinant of CEO pay (Singh, Agarwal, 2003). Moreover, firm size affects firm diversification (Kim, Kim & Pantzalis, 2001). If firm size is positively associated with a firm's international diversification, then it should have similar implications for CEOs compensation. CEOs who work in large firms with a high international diversification should also be compensated for the increased work burden they carry.

The higher International diversification is associated with work that is more complex for CEOs than for domestic CEO's in domestic environments. In contrast, CEOs who work in firms with a high International diversification and large firm size should also be compensated for the increased work burden they carry. Therefore, firm size may influence and moderate the relationship between international diversification and industrial diversification and total compensation such that the larger firm size, the higher International and industrial diversification may be related to a higher total compensation pay.

Taking into account the research results suggesting that firm size may be the primary reason for CEO compensation, firm size may affect other relationships to CEO compensation. Specifically, the relationship between international diversification, industrial diversification and total compensation may change as firm size increases. The influence of international

diversification, industrial diversification and total compensation may increase as firm size increases.

This study seeks to expand existing research by using firm size, as moderating variables international diversification and industrial diversification and for influencing CEO compensation. This distinction is important for understanding the interaction effects of firm size, on international diversification, industrial diversification, and the CEO compensation.

Sales volume (Baker, Jensen & Murphy, 1988; Newman & Banister, 1998) and total assets (Baumol, 1959; Marris, 1963; Sridharan, 1996; Useng et al., 2000) are two generally used measures of firm size. Firm size is generally measured by assets, but sales can also be used to determine firm size. Sale volume is also considered a measure of firm size because CEOs earn profit for the company through the volume of sales; the higher the sale volume sold, the higher the firm profit. Since firm size is generally measured by assets, this study will use total assets to measure the firm size.

This study found new evidence that firm size positively influences and moderates the relationship between both international diversification and industrial diversification and CEO compensation.

The rest of the paper is organized as follows: Section 2-literature review and hypotheses development, section3-outline the research design, data and Methodology, section 4-Analysis and presentation of finding, section 5-reports and discussion the empirical results, and Section 6-conclusions from our findings.

2. Literature Review and Hypotheses Development

Duru and Reeb (2002) divides executive compensation into total compensation, short-term compensation and long-term compensation. Short-term compensation includes salary and cash

bonus. Long-term compensation includes stock options, restricted stocks and other long-term compensation. References from previous study: ‘Executives Compensation Structure and Definition,’ in this study are shown on Table 1.

Corporate diversification has been divided into international diversification and industrial diversification (Duru & Reeb, 2002; Kim, Kim, & Pantzalis, 2001).

International diversification is positively associated with CEO compensation (Duru & Reeb, 2002); while industry diversification is negatively associated with CEO compensation (Duru & Reeb, 2002). Moreover, corporate diversification is on average associated with increases in firm value (shareholder wealth).

Firm size effects managerial compensation (Jensen & Murphy, 1990; Sanders & Carpenter, 1998). Firm size is the key determinant of CEO pay (Singh, Agarwal, 2003). Moreover, firm size effects firm diversification (Kim, Kim & Pantzalis, 2001). If firm size is positively associated with a firm’s international diversification, then it should have similar implications for CEOs compensation. CEOs who work in large firms with a high international diversification should also be compensated for the increased work burden they carry.

In a small firm, because of the small number of units sold, even a big increment in managerial efficiency does not yield a large increase in total profits. In contrast, in a large firm, even a small increase in profits per unit and result in a large increase in total profits. Thus, large firms with high sales volume are able to compensate CEOs with higher based salary. Large firms are also often more operationally complex than small firms; CEOs of large firms, consequently, have the more difficult task of managing them. International diversification and industrial diversification firms generally have a larger scope of operations with complex work environments requiring higher compensation for their CEOs.

Table 1.
Executives Compensation Structure and Definition in this study

Components	Definition
Total compensation structure: short-term compensation, long-term compensation and all Other compensation	
I. Short-term compensation: Current compensation and other annual compensation	
1. Current Compensation: salary and bonus	
A. Salary is defined as the dollar value of the base salary (cash and non-cash) earned by the named executive officer during the fiscal year.	
B. Bonus is defined as the dollar value of a bonus (cash and non-cash) earned by the named executive officer during the fiscal year.	
2. Other annual compensation is defined as the dollar value of other annual compensation not properly categorized as salary or bonus	
II. Long-term compensation: Incentive compensation plans and all other Compensation.	
Incentive compensation plans: stock options, restricted stocks and long-term incentive plan.	
A. Stock options: Stock options are defined as the aggregate value of all options granted to the executive during the year as valued by the company.	
B. Restricted stocks: Restricted stocks are defined as the value of restricted stocks granted during the year (determined as of the date granted).	
C. Long-term incentive plans are defined as the amount paid out to the executive under the company's long-term incentive plan.	
All other compensation	
All other compensation is compensation that does not belong under other columns of compensation.	

Sources: Extracted from Duru and Reeb (2002); Gaver and Gaver (2003); Sanders and Carpenter (1998) and Standard and Poors Research Insight (2004).

Larger firms increase the shareholders' and board of directors' difficulty of monitoring CEOs, thereby better aligning CEOs' interests with stockholders' interests, and increasing the compensation package pay. The CEO is more likely to behave in the best interest of principals, thereby raising agency costs to pay higher levels of compensation to their CEOs.

Taking into account the research results suggesting that firm size may be the primary reason for CEO compensation, firm size may affect other relationships to CEO compensation. Specifically, the relationship between international diversification, industrial diversification and total compensation may change as firm size increases. The influence of international diversification, industrial diversification and total compensation may increase as firm size increases.

The higher International diversification is associated with work that is more complex for CEOs than for domestic CEO's in domestic environments. In contrast, CEOs who work in firms with a high International diversification and large firm size should also be compensated for the increased work burden they carry. Therefore, firm size may influence and moderate the relationship between international diversification and industrial diversification and total compensation such that the larger firm size, the higher International and industrial diversification may be related to a higher total compensation pay. This influence and interaction effect will be tested as follows:

Hypothesis H_{1aN} (null): Firm size will not moderate the relationship between international diversification and total compensation.

Hypothesis H_{1aA} (alternative): Firm size will moderate the relationship between international diversification and total compensation.

Hypothesis H_{1bN} (null): Firm size will not moderate the relationship between industrial diversification and total compensation.

Hypothesis H_{1bA} (alternative): Firm size will moderate the relationship between industrial diversification and total compensation.

3. Data and Methodology

This study identified two hypotheses associated as moderator to explore their influence on the relationship between international diversification and industrial diversification and total compensation. This interaction effect will be tested as follows.

Hypothesis H_{1aN} (null): Firm size will not moderate the relationship between international diversification and total compensation.

Hypothesis H_{1aA} (alternative): Firm size will moderate the relationship between international diversification and total compensation.

Hypothesis H_{1bN} (null): Firm size will not moderate the relationship between industrial diversification and total compensation.

Hypothesis H_{1bA} (alternative): Firm size will moderate the relationship between industrial diversification and total compensation.

To test hypotheses 1 through 2, hierarchical regression was employed. The regression model to test CEO compensation structure is shown below.

CEO compensation structure $i = f$ (INTD, INDD, SIZE, INTD*SIZE, INDD*SIZE, Tenure, Age, Duality, Gender)

When i =a CEO compensation structure = total compensation

INTD International Diversification

INDD Industrial Diversification

SIZE firm size

INTD*SIZE international diversification*firm size.

INDD*SIZE industrial diversification*firm size.

Tenure CEO tenure position

Age CEO age

Duality CEO duality

Gender CEO gender

The dependent variable in this model is the level and structure of CEO compensation, including Total Compensation designated as (TC). ExecuComp database was the source for the data. The independent variables in the study are as follows: International Diversification (INTD),

Industrial Diversification (INDD), Firm Size (SIZE), international diversification*firm size ($INTD * SIZE$), and industrial diversification*firm size ($INDD * SIZE$).

Table 2 Frequency statistics for CEOs (N=2,448)

	SIC codes	Number of observations	%
Panel A: Filing Year			
1997		335	14
1998		414	17
1999		828	33
2000		438	18
2001		433	15
2002		71	3
Total		2,448	100.0
Panel B: Type of Industry (SIC)			
0 = aerospace and shipbuilding	3720-3829	96	3.9
1= agriculture and metal	0000-1099, 1400-1499	34	1.4
2= cars	3711-3716	42	1.7
3= chemical, tire, and leather	2800-2821, 3011-3199	73	3.0
4= commodity	4812-4899	47	1.9
5= computer and software	3570-3579, 7370-7389	299	12.2
6= construction, wood, furniture and house	1500-1799, 2400-2599, 2840-2844, 3200-3299	86	3.5
7= electric	3661-3699	161	6.6
8= entertainment	7000-7369, 7400-7999	93	3.8
9= finance	6000-6799	190	7.8
10= food and tobacco	2000-2199	69	2.8
11= health, education and law	8000-9999	93	3.8
12= machinery	3510-3569, 3580-3652	138	5.6
13= medical, photo and other	3841-3999	81	3.3
14= paper and publish	2600-2673, 2711-2780	81	3.3
15= petroleum and refinery	1220-1389, 2911-2999	87	3.6
16= retail and wholesale	5000-5999	306	12.5
17= steel	3300-3496	102	4.2
18= textile	2200-2399	34	1.4
19= transportation	4011-4799	61	2.5
20= utility	4911-4991	160	6.5
21=others	2833-2836, 2851-2891	115	4.7
Total CEOs		2,448	100.0

Note. Data are comprised of 2,448 CEOs observations with the mean for each CEO over the six-year period from 1997-2002. This table shows the Frequency statistics for CEOs.

COMPUSTAT's Geographic Segment File, COMPUSTAT's Industry Segment File, COMPUSTAT's database, and the CRSP database obtained the data for the independent variables. The Control variables are CEO position, tenure, age, duality, and gender.

The sample consisted of secondary data selected from three databases and supplemented with additional data from the Security and Exchange Commission (SEC). Company stock-return data from the Center for Research in Security Prices (CRSP) along with financial statement data made available from Standard & Poor's Research Insight was included. The ExecuComp database, based on the S&P 400, S&P 500, and S&P 600 indexes that comprise large, mid, and small-cap firms was selected for use because it reduces the time investment required to extract data from proxy statements and alleviates the difficulty of extracting specific information from individual company reports. However, there is often missing data, particularly relating to age and employment starting dates. Thus, it was necessary to supplement information in the ExecuComp database with information contained in Lexis/Nexis.

CEO compensation data selected from Standard & Poor's COMPUSTAT ExecuComp (1997-2002) covers total compensation and current compensation, such as salary and bonuses. The data also contains long-term compensation, such as long-term incentive plans, restricted stocks, stock appreciation rights, and stock options granted. Most studies of CEO compensation rely upon secondary data from filings with the Securities and Exchange Commission (Miller, 1995). International diversification data obtained from COMPUSTAT's Geographic Segment File classified firms as multinational, if firms report any foreign sales on COMPUSTAT's Geographic Segment File; otherwise, they are domestic firms. COMPUSTAT limits the number of global segments to five. Industrial diversification data obtained from COMPUSTAT's Industry Segment

File classified firms as multi-segment if they report more than one business segment; otherwise, they are single-segment firms. COMPUSTAT limits the number of industrial segments to ten.

This study classified each firm's primary Standard Industrial Classification (SIC) Code according to the 10-K product breakdown (SIC), and classified each firm according to the industry classification scheme suggested by Lippert and Moore (1995) and further modified in this study. Table 2 provides a list of the 1,622 firms, industry classes, and the SIC codes used in this study.

The multiple regression analyses was employed to examine firm size, in turn, as moderator variables to moderate the relationship between international diversification and industrial diversification and total compensation.

The regression moderating effect tests whether firm size influences and moderates the relationship between international diversification and industrial diversification and total compensation plan. The regression equation is as follows:

$$TC_{t,i} = \beta_0 + \beta_1 INTD + \beta_2 INDD + \beta_3 SIZE + \beta_4 INTD * SIZE + \beta_5 INDD * SIZE + \beta_6 Tenure + \beta_7 Age + \beta_8 Duality + \beta_9 Gender + \varepsilon_{t,i} \dots(1)$$

Where, β_0 = the constant of regression equation $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8, \beta_9$ = coefficient of *INTD, INDD, SIZE, INTD * SIZE, INDD * SIZE, Tenure, Age, Duality, Gender*

TC denotes total compensation for firm *i* at time period *t*; it is a dependent variable in equation 1.

INTD denotes international diversification.

INDD denotes industrial diversification.

SIZE denotes firm size and is measured by total assets.

*INTD * SIZE* denotes international diversification*firm size.

*INDD * SIZE* denotes industrial diversification*firm size.

Tenure denotes CEO tenure and is the number of years that the CEO had held his/her current position at the end of the fiscal year.

Age denotes CEO's age and is the age of the CEO at the end of the fiscal year.

Duality denotes CEO's duality and refers to the situation in which a CEO holds both the CEO and chairperson of the board position.

Gender denotes CEO's gender and is the proxy gender of the CEO, dummy variables, 1= male; 0= female

$\varepsilon_{t,i}$ is the error term (all measured for firm i at time period t).

4. Empirical Results

This study extracts each firm's primary SIC code according to a 10-K product breakdown (SIC). Each firm is classified according to the industry classification scheme suggested by Lippert and Moore (1995), which was modified for this study. Table 3 present descriptive statistics for the CEOs sample.

Panel A presents the mean, median, standard deviation, and minimum and maximum for dependent and independent variables, as well as information on total CEO compensation. Mean and median total compensations during the period (1997-2002) are \$5,198,947.00 and \$2,354,788.00, respectively.

Panel B presents the mean, median, standard deviation, and minimum and maximum for the control variables, which included tenure, age, duality, and gender. Tenure is the number of days that a CEO has held his or her current position at the end of the fiscal year. The mean and median of tenure during the period 1997-2002 are 2,947.66 and 2,192 days, respectively. Age is the age of the CEO at the end of the fiscal year. The mean and median of age during the period

1997-2002 is 56.91 years and 57 years. Duality is considered 1 if the CEO is the Chairman, otherwise it is 0. Mean and median of duality during the period 1997-2002 is 0.56 and 0.67, respectively. Gender is considered 1 if the CEO is male and 0 if CEO is female. The mean and median of gender during the period 1997-2002 is 0.96 and 1.00 respectively.

Table 3. Descriptive Statistic--dependent and independent variables

Panel A: Variables	Number of Observations ^a	Mean	Median	Std. Deviation	Minimum	Maximum
Total Compensation	2,434	5,198.95	2,354.79	11,795.97	0	273,415.47
International Diversification	2,448	3.29	3	1.11	0	5
Industrial Diversification	2,448	2.55	2.33	1.57	1	10
Firm size(Assets)	2448	7994.00	1199.97	35813.94	8.66	692789.00
Panel B: Control Variable						
Tenure ^b (day)	1,069	2,947.66	2,192	2,774.43	13	19,935
Age	1,288	56.91	57	7.75	36	89
Duality ^c	2,448	0.56	0.67	0.45	0	1
Gender ^d	2,448	0.96	1	0.18	0	1
Panel C: Firm Characteristic (000s)						
Assets	2,448	7,994	1,199.97	35,813.94	8.66	692,789
Sales	2,448	4,346.94	1,102.44	11,799.42	0	180,041.33
Capital Exp	2,426	312.11	51.39	1,270.14	0	31,672.5
EBIT/Sales	2,445	89.7	0.51	796.75	-10,537	30,877
R&D/Sales	1,464	0.22	0.03	2.7	0	96.1
Capital Exp/ Sales	2,423	0.13	0.05	1.75	0	85.68
Market Value/ Capital Exp	2,364	64.27	24.1	264.19	0.05	10996.64

Note. ^a n=the mean for each CEO over the six-years period (1997-2002) ^b days ^c recoded as 1=CEO and chairperson, 0= otherwise. ^d recoded as 0=female, 1=male. This table shows the descriptive statistics for the CEOs sample.

Panel C presents the mean, median, standard deviation, and minimum and maximum for the firm characteristic variables, which include total assets, sales, capital expense, EBIT/sales, R&D/sales, capital expense/sales, and market value/capital expense. The mean and median of assets during the period 1997-2002 is \$7,994,000.00 and \$1,199,900.00, respectively. The mean and median of sales during the period 1997-2002 is \$4,346,940.00 and \$1,102,440.00 respectively. The mean and median of capital expense during the period 1997-2002 is \$312,110.00 and

\$59,390.00 respectively. The mean and median of EBIT/Sales during the period 1997-2002 is \$89,700.00 and \$510.00 respectively. The mean and median of R&D expense/sales during the period (1997-2002) is \$200 and \$3, respectively. The mean and median of capital expense/Sales during the period (1997-2002) is \$13 and \$5, respectively.

Table 4 Pearson Correlation Coefficient Matrix

Variables ^a	1	2	3	4	5	6	7	8
1.Total Compensation	1							
2.International Diversification	.144**	1						
3.Industry Diversification	.073**	.146**	1					
4.Firm size	.751**	-.138**	-.254**	1				
5.Gender ^b	-.008	-.017	.056**	-.025	1			
6.Age	.125**	-.007	.169**	.119**	.108**	1		
7.Duality	.251**	-.003	.105**	.267**	.023	.271**	1	
8.Tenure	.195**	-.120**	.341**	.089**	.127**	.369**	.297**	1

Note. values^a of n ranged from 1,069 to 2,448^b *p<0.01; **P<.05.

This table shows the correlations between variables by using Pearson Correlation Coefficients.

Since multicollinearity between independent variables causes large variances and covariances for the estimators of the regression coefficients, it becomes difficult to distinguish their relative influences. This problem addressed by deriving the correlation coefficient matrix shown in Table 4. The correlations between variables were computed by using Pearson Correlation Coefficients.

The correlation matrix in Table 4 shows that the strongest correlation coefficient among the independent variables was 0.751 between firm size and total compensation. The second highest correlation coefficient was 0.369 between tenure and age. Gujarati (1988) suggests that simple

correlations between independent variables should not be considered “harmful” unless they exceed 0.80 or 0.90. The Pearson correlations coefficient suggests that multicollinearity is not severe for the independent variables in this study.

Table 5
Results of Regression Equations Model 1 Analysis for Testing Moderating Effect of Firm Performance on the Relationship between Corporate Diversification and Total Compensation

Variable	Model 1	Model 2	Model 3
β_1 International Diversification(<i>INTD</i>)		.105*** (6.358)	.129*** (7.206)
β_2 Industry Diversification (<i>INDD</i>)		-.074*** (-4.135)	-.124*** (-4.392)
β_3 Firm Size (<i>SIZE</i>)		.591*** (31.961)	.723*** (13.277)
β_4 International Diversification * Firm size (<i>INTD</i> * <i>SIZE</i>)			.077* (2.176)
β_5 Industry Diversification * Firm size (<i>INDD</i> * <i>SIZE</i>)			-.178** (-3.322)
β_6 Tenure	.064** (3.124)	.058** (3.447)	.129*** (7.206)
β_7 Age	-.040† (-1.957)	-.057** (-3.410)	-.057** (-3.427)
β_8 Duality	.174*** (8.442)	.058** (3.447)	-.061** (3.626)
β_9 Gender	-.065** (-3.246)	-.052** (-3.173)	-.054** (-3.336)
Adjusted R^2	.039	.357	.360
Change in adjusted R^2	.041***	.318***	.004**

Note. ^a $n = 2438$ ^b Beta weights and t -values reflect results for the full model † $p < .10$; * $p < .05$; ** $p < .01$; *** $p < .001$ When the predicted sign is either (+) or (-), then the P value is a one-tailed test; when the predicted sign is (?), then the P value is a two-tailed test.

To test hypotheses 1 through 2, the moderator variable -firm size moderating effects on the relationship between international diversification, industrial diversification and CEO

compensation, this study employs hierarchical regression. First, all of the cross products of the moderator variables were entered together into the regression model to examine how they moderate the full regression model of both international diversification and industrial diversification on CEO compensation as a whole. Three steps were performed to enter the variables in to the regression equation model. In step 1, the control variables - tenure, age, duality and gender - were entered with the measure of corporate diversification and total compensation. In step 2, the predictor variables in the moderating equation model were entered together to measure corporate diversification and total compensation. In step 3, cross products of the interaction terms in that moderating equation model were entered together to test the full model corporate diversification and total compensation.

Table 5 provides the results of the regression analyses that test hypotheses H_{1aA} and H_{1bA} . Using the results, an analysis was performed of how the cross products of the moderator variables together moderate the full regression model of both international diversification and industrial diversification on CEO compensation.

For the hypothesis H_{1aA} : Firm size will moderate the relationship between international diversification and total compensation.

The results of the interaction term, involving both firm size and international diversification ($\beta = .077$, $t = 2.176$, $p < .05$), were found to be positively significant. Thus, the results support hypothesis H_{1aA} that firm size positively moderates the relationship between international diversification and total compensation.

For the hypothesis H_{1bA} : Firm size will moderate the relationship between industrial diversification and total compensation.

The results of the interaction term involving both firm size and industrial diversification ($\beta = -.178$, $t = -3.322$, $p < .01$), were found to be negatively significant. Thus, the results support hypothesis H_{1aA} that firm size negatively moderates the relationship between industrial diversification and total compensation. This is the first study to examine if firm size moderates the relationship between industrial diversification and total compensation. To test the moderating effect of firm size on the relationship between corporate diversification and total compensation, hierarchical regression was used. The significance of interaction terms relating to hypotheses H_{1aA} ($p < .01$) and H_{1bA} ($p < .10$) shows an interaction between firm size and both corporate diversification and total compensation, respectively. Therefore, the results support both hypotheses H_{1aA} and H_{1bA} , which indicate that firm size moderates international diversification and total compensation, and industrial diversification and total compensation, respectively.

6. Conclusions

This study uses firm size as the moderator to test whether firm size influences the relationship between international diversification, industrial diversification, and CEO compensation. The result shows that firm size significantly influences the relationship between international diversification and CEO compensation. Additionally, the finding also shows that firm size significantly influences the relationship between industrial diversification and CEO compensation.

7. References

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