The relationship between executive remuneration at financial institutions and economic value added

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Abstract:
The research will compare the alignment of the remuneration between United States and South African banks with respect to the Economic Value Added, a measure of a firm's economic profit that adjusts profit by subtracting the cost of capital. South African banks have been widely recognised for their high standard of corporate governance and stability during the financial crisis. Executive remuneration based on short-term equity has been recognised by both academic literature as well as bank regulators as one of the causes of the financial crisis. The research seeks to understand the differences in remuneration alignment between the failed and surviving banks. Misaligned incentives within the United States banks are accepted by both academics and regulators as one of the causes of the 2008 financial crisis and subsequent economic downturn. This research puts this theory to the test by comparing the alignment of executive remuneration between South African banks that were internationally recognised for successfully navigating the financial crisis, and the largest United States banks, of which three failed catastrophically over the same time period. The remuneration for the largest United States and South African banks is tested for correlation against Economic Value Added (EVA®), share price and return on equity. Correlation between executive remuneration and the constructs is tested between the two countries before as well as after the financial crisis. South African bank executive remuneration correlated strongly with EVA® and this correlation strengthened after the financial crisis. In comparison, the United States sample banks exhibited strong correlation between share price and remuneration before the financial crisis. The failed United States banks had no correlations between executive remuneration any of the constructs, a pattern that has been repeated in the United States Banks that have survived the financial crisis. Practically, the research demonstrated the vast differences in executive remuneration alignment between the United States and South Africa. In South African banks, executive remuneration is far more closely aligned to EVA®, whereas the United States banks only correlated with share price before the financial crisis, raising the question of whether managers are able to exert excessive power. The research demonstrates the magnitude of the gap between the recommendations of regulators and remuneration policies, with South African banks far more closely aligned than their United States counterparts. The research findings concur with theory presented in literature that misaligned incentives based on equity contributed towards the financial crisis. Of particular concern is the change in remuneration correlation after the financial crisis, where South African banks increased correlation with EVA® while United States banks no longer correlated with EVA®, ROE or share price.

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As the economic and competitive environments change, attention to profit and, more than ever, risk become increasingly important. This book offers a unique analysis of the risks faced by investors and savers interacting through both financial institutions and financial markets, as well as strategies that can be adopted for controlling and better managing these risks. Special emphasis is also put on new areas of operations in financial markets and institutions such as asset securitization, off-balance-sheet activities, and globalization of financial services. Financial institutions play a pivotal role in every economy. They are regulated by a central government organization for banking and non-banking financial institutions. These institutions help in bridging the gap between idle savings and investment and its borrowers, i.e., from net savers to net borrowers. Following are the list of roles performed by Financial Institutions –

1. Regulation of Monetary Supply
2. Banking Services
3. Company value performance: Remuneration return relative to company return
4. Economic value add
5. Consolidated position
6. Contrast by sector

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