

DIRECTORS AND FIRM PERFORMANCE:  
EVIDENCE FROM BRITISH SOCCER  
CORPORATIONS

by

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The candidate confirms that the work submitted is his own and that appropriate credit has been given where reference has been made to the work of others.

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## **ABSTRACT**

The purpose of this research is to analyse the importance of the interrelationship between directors and firm performance in UK soccer corporations. In doing so the analysis enriches the existing literature in corporate governance in several ways. The primary innovation contained in this thesis is that it analyses productivity performance in the field of corporate governance for the first time. My empirical analysis considers two distinctive elements of firm performance. The first element is productivity performance, which is measured by on-field football success that includes winning percentage, percentage of league points and attendance. To my knowledge, this has not been addressed elsewhere in the corporate governance research. The second element is financial performance, which is measured by off-field economic success which includes profitability and the ratio of turnover to total assets. Overall, the findings of this research suggest that productivity performance is the principle criterion used to judge corporate decision making.

The first element of the empirical analysis examines determinants of directors' remuneration under three categories, namely; board remuneration, executive remuneration and CEO remuneration. My main findings can be summarised as follows. Firstly, I find evidence that in all categories of directors' remuneration productivity performance is the chief determinant; concomitantly, there is little evidence of a link between CEO remuneration and financial performance. Secondly, I document that directors' remuneration is substantially affected by firm size and managerial ownership. Finally, I find that the proportion of non-executive directors significantly reduces board and executive compensation.

The second empirical analysis investigates the determinants of executive turnover, through using multiple theoretical approaches. My analysis compares the relative importance of productivity compared to financial performance on executive turnover decisions. My main finding is that productivity performance is more important than financial performance in driving executive turnover. Furthermore, my analysis demonstrates that executive turnover is considerably influenced by managerial ownership and industry experience. Overall, my results suggest a stronger relationship between performance and turnover in listed corporations than in FA Premier League corporations. This implies that quoted firms adhere to corporate governance directives more than FA Premier League firms.

The final empirical analysis investigates the impact of multiple directorships, ownership structure and managerial industry experience on productivity and financial performance. My main findings are as follows. First, the results reveal that directors with multiple directorships improve productivity performance by enhancing the firm's net spending, this having the effect of worsening financial performance. Second, I find that managerial ownership tends to seriously worsen productivity performance, whilst blockholder ownership enhances financial performance. Third, managerial industry experience promotes productivity performance but worsen financial performance. Overall, in the contemporary relationship football firms are characterised by a trade-off effect between financial and productivity performance measures. Finally, I document evidence that productivity performance depends on financial performance and vice-versa.

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## **LIST OF ABBREVIATIONS**

3SLS	Three-Stage Least Squares
ASB	Accounting Standard Board
ASC	Accounting Standard Council
DRC	Depreciation Replacement Cost
FA	England Football Association
FAW	Football Association of Wales
FIFA	International Federation of Association Football
FRS-10	Financial Reporting Standard 10
IFA	Irish Football Association
LSE	London Stock Exchange
OLS	Ordinary Least Squares
PFA	Professional Footballers' Association
SFA	Scottish Football Association
SPL	Scottish Premier League
SSAP 12	Statement of Standard Accounting Practice 12
UEFA	Union of European Football Associations
UK	United Kingdom
US	United States

# 1 INTRODUCTION

## 1.1 Introduction

The aim of this chapter is to discuss the objectives, motivations and contributions of this thesis. The primary objective of this thesis is to make a contribution to the understanding of the relationship between directors' features and firm performance. To achieve this objective, the thesis investigates three empirical topics. The first empirical chapter assesses factors that determine directors' remuneration. The second empirical chapter investigates factors that drive executive directors' turnover. The final empirical chapter examines the impact of multiple directorships, ownership structure and managerial industry experience on corporate performance. Overall then, the central focus of this thesis is to explore the importance of productivity performance in relation to directors' remuneration, executive directors' turnover and multiple directorships.

The primary innovation contained in this thesis is that it has analysed productivity performance through the theme of corporate governance for the first time. The analysis of this research considers two main metrics of firm performance. The first metric is productivity performance, which represents on-field football success, in most cases measured by winning percentage or percentage of league points accumulated. This performance metric has not been employed elsewhere in corporate governance research. The second metric is financial performance, which represents off-field economic success and is measured by profitability and the ratio of turnover to total assets. After analysing these two elements of firm performance, the main findings of this research indicate that productivity performance is the chief factor in corporate decision making.

The rest of this chapter is structured as follows. Section 1.2 discusses the motivations of this thesis. Section 1.3 describes main findings and contributions of this research. The section also explains the significance of each empirical chapter investigated. Section 1.3 outlines the structure of the whole thesis.

## **1.2 Motivation of the Study**

This section discusses main motivations behind this thesis. Other specific motivations are discussed in respective empirical chapters. The first motivation evolved from the heated debate on the determinants and quantum of directors' pay in the media and academic papers. For decades, there has been fierce debate in the literature of the determinants of directors' compensation. Studies have linked the magnitude of directors' pay with numerous factors relating to a firm in question, with the findings having always been mixed. For instance, Murphy (1985), using shareholders' realised return and sales growth as measures of firm performance finds a positive link with directors' remuneration, whilst Ozkan (2007) used stock return and shareholders' return as measures of firm performance but found no significant impact on executive compensation. This implies that the relationship depends on several factors and differs depending on which theoretic structure is used, performance measures employed and data analysed.

The second motivation comes from the theories used to describe executive turnover decisions. It appears that no single theory can fully describe the reasons for managerial changes in organisations. Most existing studies have adopted agency theory to explain performance-turnover relationships as clarified by Jensen and Meckling (1976). However, studies that have employed this theory find mixed results for the link between firm performance and CEO turnover (e.g. Warner et al., 1988). Although agency theory is the foremost establishment of turnover-performance relationship, other theories such as stakeholder theory, human capital theory and social network theory may offer other possible explanations of the relationship. This thesis has considered all the theories that offer an explanation of the divergent probability of managerial turnover in different organisations.

The third motivation relies on the resource dependency theory which to-date has been rarely examined in the corporate governance research. Recent researchers that incorporated this theory in their analysis include Fich and Shivdasani (2006), Nicholson and Kiel (2007), Sarkar and Sarkar (2009) and Ahn et al. (2010). This theory can provide a detailed explanation of the link between multiple directorships and firm performance. Principally, resource dependency theory considers the board to be an essential link between the firm and the important resources that it requires to maximise firm performance (Pfeffer and Salancik, 1978). The theory argues that directors holding multiple directorships gain experience, expertise and reputation and are in a position to establish business contacts with external organisations.

Despite the growing research on the link between multiple directorships and firm performance, the findings on this relationship are still contradictory and inconclusive. For example, Ferris et al. (2003) find no positive relationship between multiple directorships held by outside directors and firm performance. Perry and Peyer (2005) find that directors accumulating multiple board seats *does* improve firm performance, while conversely, Core et al. (1999) find that directors with multiple directorships set excessive levels of CEO pay, which ruins firm performance. Similarly, Jiraporn et al. (2008) find that multiple directorships affect the quality of managerial oversight, which leads to poor firm performance. The mounting literature on this subject has failed to confirm if multiple directorships are beneficial or disadvantageous to the firm. For this reason, this thesis extended this research by examining the benefits and drawbacks of multiple board appointments to the firm.

The final motivation relies on industry specific factors. The first factor is the availability of data recorded in a consistent and meaningful way. The sporting sector, especially the football industry has a widely available and transparent productivity-performance database. This allows an in-depth investigation into the link between directors' features and firm performance. Indeed, in soccer corporations there is a very clear distinction between productivity and financial performance thus providing the opportunity to conduct detailed analysis between corporate governance and the measures of firm performance.

The second factor is the lack of research linking productivity performance and corporate governance topics, particularly at the board level. This thesis explores the interesting relationship between on-field football success and the theme of corporate governance. Many existing studies analyse firm performance in the context of stock market and accounting measures without a sufficient discussion on the measures of firm's productivity performance. For example, Pinnuck and Potter (2006) analysed the link between productivity performance and financial performance using the Australian Football League over the period 1993 to 2002, but did not consider corporate governance effects in their study. Such lack of coverage served to motivate me to attempt an analysis of productivity performance in the area of corporate governance.

The final factor is the increased commercial activity in the football industry which has gained pace in the last two decades. The growing financial importance of and in the industry have led to larger transactions of capital on tangible and intangible assets. These firms earn considerable revenues from broadcasting, spectator tickets, memorabilia and sponsorships. Since the 1990s, when some football companies were listed on the stock market, the industry has been treated as a business not as a sport and making it important to analyse sporting companies from business management and financial perspectives. For this reason, some scholars have been attracted to undertake finance and accounting research in the football sector (e.g. Amir and Livne, 2005, Ashton et al., 2003). To some extent, this has enhanced my motivation of doing corporate governance research using a sample of soccer firms.

### **1.3 Contributions and Significance of the Study**

This section discusses the contributions and benefits that this thesis offers to both academics and practitioners. The most important contribution of this thesis is that for the first time productivity performance is analysed in the context of corporate governance. The main findings of this thesis suggest that productivity performance is the foremost factor used in corporate decision making. In this context, the inclusion of productivity performance in the general analysis adds considerably to the corporate governance literature. In addition, empirical chapters examined in this thesis offer various contributions to the existing literatures of managerial compensation, executive turnover and multiple directorships. These contributions are discussed in the subsequent paragraphs for each empirical analysis.

The first research area investigates determinants of directors' remuneration in three categories, namely; board remuneration, executive remuneration and CEO remuneration. The findings from this analysis contribute to the literature of managerial compensation on the following grounds. Firstly, the estimates present evidence that all categories of directors' remuneration are determined by productivity performance. Conversely, the results reveal little evidence that CEO pay is determined by financial performance. Unlike previous studies, these estimates present new understanding on performance measures that are determinants of directors' remuneration. Most existing studies of managerial compensation adopted common measures of performance such as return on assets (e.g. Core et al., 1999), Tobin's Q (e.g. Mehran, 1995) and operating profits (e.g. Samuels and Piper, 1998). The use of alternative metrics of performance adds novel insights on managerial compensation studies.

Second, this analysis presents consistent evidence that directors' compensation is positively correlated to firm size. All categories of directors' remuneration investigated are substantially affected by firm size. This provides assenting evidence on the findings of previous studies on directors' remuneration, such as Benito and Conyon (1999) in the UK and Coughlan and Schmidt (1985) in the US. Third, this analysis reveals that managerial ownership significantly reduces directors' remuneration. This finding suggests that directors with substantial share ownership in the firm are happy to collect dividends and enjoy capital gains rather than receiving excessive compensation. My results here enrich previous findings by Core et al. (1999) and Cyert et al. (2002) that managerial ownership is considerably negatively linked to managerial remuneration.

Fourth, the analysis indicates that the proportion of non-executive directors is negatively related to directors' remuneration. This relationship is statistically significant on board and executive remuneration regressions but not on CEO remuneration regression. The relationship demonstrates that non-executive directors are trustworthy by providing additional monitoring value to the firm. This finding supplements previous studies by Kaplan and Minton (1994) and Basu et al. (2007) who found that non-executive directors perform vital corporate governance functions. The insignificance of the relationship for CEOs suggests that they tend to overshadow non-executive directors in deciding on their own compensation. The implication of this, then, is that outside directors are nominated and appointed by the CEOs, thus becoming less independent and effective monitors of their own bosses. This finding supports conclusions reached by Wade et al. (1990) that CEOs have the ability to increase their own compensation packages by intervening in the autonomy of outside directors. In addition, this finding enriches the literature of CEO's compensation by corroborating the findings by Hallock (1997).

Finally, this analysis contributes to managerial compensation research by considering multiple theories to examine the determinants of directors' remuneration. My analysis used agency theory along with stakeholder theory and stewardship theory to explore determinants of directors' remuneration in three categories. Most previous studies, however, used only agency theory to examine one or two categories of directors' remuneration. For instance, Brick et al. (2006) used agency theory to analyse CEO compensation, director compensation and firm performance, while Lin (2005) used agency theory and stewardship theory to analyse CEO compensation and other corporate governance attributes. For this reason, my analysis provides

more comprehensive evidence of the determinants of managerial compensation than other existing compensation studies.

Overall, the study on directors' remuneration is important because this is one of the main mechanisms used to resolve conflicts of interest between managers and shareholders. The application of agency theory reveals that separation of ownership and control in corporations is the main source of agency problems (Jensen and Meckling, 1976). Therefore, extension of directors' compensation research assists scholars and practitioners to understand the way the agency problems of a firm can be minimised. Most importantly, this research offers new insights to the public that companies may reward their executive directors using productivity performance standards rather than financial performance criteria.

The second research area considers the real factors that drive executive turnover. The findings from this analysis contribute to executive turnover research in the following ways. First, this analysis offers new evidence on the negative relationship between productivity performance and probability of executive turnover. My analysis has compared the different importance between productivity and financial performance on influencing executive turnover. The findings suggest that productivity performance is more important than financial performance in determining executive turnover. To my knowledge, this has not been addressed elsewhere in other performance-turnover studies. To date, the majority of existing studies in executive turnover research have commonly adopted stock market returns measures (e.g. Kaplan, 1994b), and accounting measures (e.g. Conyon and Florou, 2002). The consideration of productivity performance in performance-turnover analysis is an important contribution in executive turnover research.

Second, this analysis contributes to the debate on the effectiveness of boardroom governance, particularly by considering the impact of board and ownership structures on executive turnover. The results indicate an inverse relationship between managerial ownership and probability of executive turnover. This finding suggests that director ownership leads to managerial entrenchment within the firm. Through this finding, my analysis provides confirmatory evidence on the previous findings by Denis et al. (1997) and Goyal and Park (2002). Further evidence shows that in a sample of FA Premier League firms, managerial ownership hampers the role of productivity performance on executive turnover decisions. For listed firms, managerial ownership does not intervene in the role of productivity performance in executive

turnover decisions. This suggests that listed firms adhere to corporate governance prescriptions more than FA Premier League firms.

Third, the results from this analysis demonstrate that managerial industry experience is a considerable factor in executive turnover decisions. There is consistent evidence that directors with large industry experience tend to be entrenched in their firms. This finding confirms the earlier finding by Goyal and Park (2002) who found that CEO tenure is negative and significant related to CEO turnover. Although the empirical findings of prior research are consistent with my results, I demonstrated that without considering the productivity performance of the firm, any insights gained from existing research will be flawed.

Lastly, this analysis uses several theories, including agency theory, stakeholder theory, human capital theory and social network theory to examine factors that determine executive turnover. Existing research studies on this have primarily been based on principal-agent theory (e.g. Dahya et al., 2002, Conyon and Florou, 2002). This analysis extends managerial turnover research by integrating other corporate governance theories that offer potential explanations of turnover decisions. The findings of this analysis confirm that stakeholder theory, agency theory and human capital theory all offer insightful explanations of executive turnover decisions. Further evidence suggests, however, that stakeholder theory seems to be more relevant than agency theory in explaining how performance affects the probability of executive turnover.

Generally, the extension of executive turnover research is important because it is the major apparatus used to discipline managers following a firm's poor performance. Specifically, managerial turnover research assists companies in making helpful decisions, essentially by replacing incompetent directors and increasing incentives for better performance through the linking of executive turnover to firm performance. Studies on executive turnover support firms in seeking to achieve superior performance by sacking poorly performing managers. Indeed, the ability to change director in the firm is a form of internal control mechanism, which is the foremost function of the corporate governance system.

The final research area considers the impact of multiple directorships, ownership structure and managerial industry experience on firm performance. The main finding of this analysis indicates that firms analysed are characterised by a "performance trade-off effect" between productivity

and financial performance. Our system of simultaneous equations shows that each factor analysed demonstrates two major opposing impacts between productivity and financial performance measures. This suggests, then, that it is difficult to maximise both productivity and financial performance at once. In other words, it is only feasible to enhance productivity performance at the expense of poorer financial performance and vice-versa. The precise findings for each factor are as follows.

Firstly, the results show that directors with multiple directorships enhance a firm's net spending while weakening pre-tax profits. As a result, the enhancement of net spending promotes productivity performance while worsening financial performance. It is reasonable to assume that productivity performance mainly depends on the investment of working assets. This finding thus suggests that directors with multiple board seats bring various skills, which enhance productivity performance through promoting a firm's investment schemes. Ideally, the investment scheme that acquires quality working resources will enhance productivity performance. The improvement of productivity performance in the present is likely to generate better financial performance in the future.

While previous research showed that multiple directorships and firm performance are either negatively related (e.g. Fich and Shivdasani, 2006) or positively related (e.g. Perry and Peyer, 2005), my results demonstrate both relationships depend more on the nature of the analysed performance measure. This research enriches the literature by analysing multiple directorships in relation to productivity performance for the first time. Extant studies in multiple directorships have a long tradition of using market-to-book ratios as their performance metric in regression analysis (Ferris et al., 2003, Fich and Shivdasani, 2006).

Second, the analysis indicates that directors with substantial ownership stakes worsen productivity performance and do not improve financial performance considerably. This suggests that equity ownership of directors in the firm worsens productivity performance because of incentives to enhance their personal wealth. This is an indication of "Type II agency problem" where directors expropriate financial wealth at the expense of minority shareholders. This finding contributes to the literature by supplementing findings by Short and Keasey (1999) and Davies et al. (2005) who found a negative relationship between managerial ownership and firm performance at intermediate levels of ownership.

Third, the results show that blockholder investors tend to weaken productivity performance whilst enhancing financial performance. This implies that blockholder investors enhance financial performance at the expense of poorer productivity performance. In other words, blockholder investors fulfil the interests of shareholders that prefer financial performance and ignore other stakeholders that prefer productivity performance. This is consistent with agency theory, which proposes that the main role of blockholder shareowners is to enhance shareholder wealth. This finding contributes to the standard literature which argues that the role of blockholder investors is to boost shareholder wealth (e.g. Elyasiani and Jia, 2010, Woitke, 2002).

Fourth, the analysis reveals that directors with industry experience enhance productivity performance at the expense of financial performance. The main implication of this finding is that directors with substantial industry experience focus on productivity strategy and ignore financial strategy. This finding contributes to the previous literature by providing evidence on “expertise hypothesis” explained by Vafeas (2003). The hypothesis stipulates that long managerial tenure is associated with greater experience, commitment and proficiency because long tenures in the firm enable directors to gain firm-specific knowledge, which is relevant in the business environment. Thus, directors with substantial industry experience employ their firm-specific skills to improve productivity performance, which is likely to generate better financial performance in the future.

Fifth, the results give evidence that productivity performance significantly enhances financial performance and vice-versa. To some extent, this finding provides confirmatory evidence on the results found by Pinnuck and Potter (2006) using firms from the Australian Football League over the period from 1993 to 2002 as an example. Finally, this empirical chapter enriches the literature by considering three theories, including resource dependency theory, agency theory and human capital theory to explore the impact of multiple directorships, ownership structure and managerial experience on corporate performance. Specifically, this research extends the analysis done by recent papers on multiple directorships such as Fich and Shivdasani (2006), Kiel and Nicholson (2006) and Sarkar and Sarkar (2009) by incorporating the impact of ownership structure and managerial experience on firm performance measures. The findings of this analysis demonstrate partial support for each theory because of performance substitution effects in the firms analysed.

Overall, the investigation of the effects of multiple directorships, ownership structure and managerial experience on firm performance offers three practical major benefits. Firstly, the findings on multiple directorships gives guidelines to companies and their boards as to when the proposal of a director to hold multiple board seats is likely to enhance or weaken firm performance. It should be recognised that the value of resources obtained through multiple directorships depends on its importance to the company. For this reason, firms are required to consider all available sources of information before allowing multiple board appointments to its directors. Secondly, the findings assist firms in proposing limitations on multiple board seats that an individual director can hold by considering possible benefits and costs that may arise for the company. Finally, the results of this analysis assist firms in understanding the way ownership structure and managerial experience influences productivity and financial performance. This helps firms in deciding upon an appropriate ownership structure and managerial experience that conform to the firm's main objective.

#### **1.4 Structure of the Thesis**

The rest of the thesis is organised as follows. Chapter 2 presents a survey of finance research in the sporting sector. Chapter 3 presents a survey of corporate governance research mainly focusing on the themes of managerial compensation, executive turnover and multiple directorships. Chapter 4 discusses the industry background and institutional framework of the study. Chapter 5 provides a detailed description of the data, the changes that the data presents and descriptive statistics of the data that will be used in the subsequent analysis. Chapter 6 is the first empirical chapter and analyses the determinants of directors' remuneration. Chapter 7 is the second empirical chapter and presents my analysis of the drivers of executive turnover. Chapter 8 is the final empirical chapter and presents my analysis on the effects of multiple directorships, ownership structure and managerial experience on firm performance. Chapter 9 concludes with a summary of my main findings and contributions as well as suggestions for further research.

## **2 A SURVEY OF FINANCE RESEARCH IN THE SPORTING SECTOR**

### **2.1 Introduction**

This chapter reviews finance research conducted in the sporting sector, mostly focusing on the soccer industry. This strand of literature is limited in comparison to the finance literature in traditional industries. Several studies have used sports data on mainstream finance and economics research. The paper by Rottenberg (1956) was the first published research that used sports information in economics research. This study has analysed issues in the Major League Baseball from an economic perspective. Since this publication, scholars have employed sports records in broad areas of financial economics. For instance, Sloane (1971) described the economic theory of the firm using British soccer corporations.

The rest of the chapter is structured as follows. Section 2.2 discusses studies that associate managerial succession (i.e. team coaches) and productivity performance. Section 2.3 covers research on managerial efficiency and productivity performance. The focus of this section is to describe how the competence of a team coach leads to improvement in productivity performance. Section 2.4 describes research on productivity performance and financial performance. The literature in this section explains the way productivity performance influences financial performance and vice-versa. Section 2.5 presents a summary and conclusion of the chapter.

### **2.2 Managerial Succession and Productivity Performance**

One of the earliest bits of research on the link between productivity performance and managerial change is the study by Grusky (1963). The author found there to be an inverse relationship between the number of managerial changes and the average productivity performance in Major League Baseball. Research done subsequent to this by Gamson and Scotch (1964), described three theories of managerial turnover in team sports. The first theory was “common sense” which states that when a team is underperforming the manager is held accountable and is likely

to be replaced. In this theory, it was established that if a more effective manager is recruited and avoids his predecessor's mistakes, productivity performance should improve.

The second theory was named the "vicious circle" which states that poor productivity performance tends to activate managerial change, but the troublesome effects of this change tend to make performance worse rather than better. This theory explains why some teams can become trapped in a vicious circle of frequent managerial turnover and consecutive performance decline. The final theory was "ritual scapegoating" which states that on average, the appointment of a new manager makes no difference to productivity performance. In this theory, the authors emphasised that productivity performance depends on the quality of playing resources rather than a manager. In other words, the theory suggests that a change of a manager has no impact on productivity performance. These theories collectively have widened scholars' knowledge on managerial change patterns in the sporting sector.

In their study, Gamson and Scotch (1964) compare pre- and post-managerial turnover win-ratios in Major League Baseball. They eliminated the tendency of mean-reversion in their estimation by excluding any match results two weeks prior to each managerial change. Their main findings show that in the majority of cases, teams tended to perform better under new management than it did up to two weeks prior to the removal of the old manager. The assumption that the omission of two-week results before the managerial change eliminates the problem of regression towards the mean is a subjective criterion, however. Using the same data set, Grusky (1964) compared win ratios after new managerial succession with the previous season's win ratios. His findings were as follows. First, he found that inside succession (promotion of one of the existing coaching staff or players) led to better performance. Second, that outside succession (i.e. recruiting a new manager from another team) led to further performance decline.

Allen et al. (1979) examine similar issues using a more extensive data set from Major League Baseball for a longer period of time. Their main findings revealed that change of management after the end of the season produced an improvement in productivity performance, whilst a change within the season produced a further decline in performance. These findings imply that it is better to make managerial changes at the end of the season than during. Brown (1982) employed data from the National Football League (NFL) to compare win ratios of teams that experienced an early-season decline and changed the manager mid-season and win ratios of teams that experienced an early-season decline but kept their manager. His main findings reveal

that the recovery pattern following an early decline was very similar in the two compared groups. As noted in this finding, managerial change within the season has no impact on productivity performance.

Pfeffer and Davis-Blake (1986) examined the link between administrative succession and firm performance in the National Basketball Association. Their finding reveals that post-succession productivity performance improved if there was prior experience of the incoming manager. This finding suggests that apart from the experience of the new manager, overall effect of succession is neutral. Jacobs and Singell (1993) examined the baseball managers on productivity performance records in the Major League Baseball. Their main findings were as follows: firstly, they find that better managers win more games with playing quality held constant. Second, they documented that managers with good reputations tended to improve player performances. This implies that good managers have an understanding of the techniques that improve players' attitude and their performances. This finding is consistent with Pfeffer and Davis-Blake's (1986) results in the National Basketball Association.

Fizel and D'Itri (1997) investigated the impact of managerial succession in National Collegiate Athletic Association (NCAA) basketball. Their main findings demonstrate that managerial efficiency influences post-succession performance. Essentially, their results show that a manager's experience allied with players' performances are the main drivers of productivity performance. This is the same as the findings by Pfeffer and Davis-Blake (1986) and Jacobs and Singell (1993). Collectively, these studies suggest that managerial tactical skills are important ingredients in achieving superior productivity performance.

Audas et al. (1997) investigated the link between productivity performance and managerial change in the English Football League using all match results from 1972 to 1993. Their main findings were as follows. Firstly, the authors documented that poor recent performance determines managerial terminations. This suggests that managers are removed from their positions because of recent productivity performance. Secondly, they documented the higher managerial turnover in the lower divisions. Finally, the authors find a significant negative relationship between managerial change and productivity performance immediately after the removal of a manager.

Subsequent research by Audas et al. (1999) investigated similar issues, using a broader data set from the English Football League, covering the period 1972 to 1997. Their analysis used match-level data to identify short-term influences on managerial departures, which may be hidden when using data aggregated from an entire season. The main findings were documented as follows. Firstly, they find that the risk of managerial termination is largely determined by a team's current league position relative to its position when the manager took charge and winning percentage over the entire period. This finding conforms to earlier research done by Audas et al. (1997). Second, they find that managerial human capital attributes have a greater influence on voluntary termination than on involuntary termination.

Audas et al. (2002) reconsidered the link between managerial change and productivity performance in the English soccer industry using ordered probit regressions. The authors showed that teams that change their manager during the season are found to underperform over the following three months. Similarly, Koning (2003), using data from the top tier in the Dutch Football League published a paper that addressed the impact of firing a manager on productivity performance. In this paper, the author did not take into account managerial changes which brought about another club's offer to the manager or voluntary terminations. His main findings show that productivity performance does not always improve when a manager is fired. It was even observed that in some cases, the new manager performs worse than the recently-fired manager. The paper also highlighted the importance of the pressure of fans and the media as factors that may determine the length of tenure of a manager. Overall, these studies are consistent with "vicious circle theory" which suggests that a change of manager during the season worsens productivity performance.

Bruinshoofd and Weel (2003) examined whether forced resignations of managers in Dutch soccer led to an improvement in productivity performance. In analysis done from twelve seasons of the Dutch league, they found that forced resignations are preceded by poor performances and are followed by improvements in performance. They also observed, however, that performances following the appointment of a new manager were not superior to the average seasonal performance for both the old and new manager. In addition, their findings reveal that if the manager is not forced to resign, productivity performance would improve more quickly. The authors concluded that the firing of a manager was not a solution for improving productivity performance.

Rowe et al. (2005) reconsidered succession theories in the sporting sector, which were earlier developed by Gamson and Scotch (1964) and discussed by Grusky (1964). In their study, the authors employed a 60-year data set from the US National Hockey League. Their findings confirm previous results that within-season succession (vicious circle theory) tends to worsen productivity performance and between-season succession (ritual scapegoating theory) simply makes no difference to productivity performance. They also documented the significant time it takes for a new manager to establish firm control of the firm. To take control effectively, a manager requires time during both mid-season and off-season with his club for an improvement of productivity performance (common sense theory).

Consistent with Rowe et al. (2005), another study by Audas et al. (2006) uses match-level data from the US National Hockey League to identify factors that may trigger the departure of a team manager. In their analysis they also evaluated the effect of short-term management on subsequent game results. They find there to be a significant positive relationship between individual game results and the threat of dismissal for up to 15 matches prior to the point of removal. They also acknowledged that the threat of termination depends on the team's current position relative to a pre-season projection, current success in the Stanley Cup, the manager's age and previous employment records of the manager during his playing career. On top of this and consistent with "vicious circle theory", they find that teams which changed their manager during the season experienced relative subsequent performance decline (compared to teams which did not changed their managers), but that these negative effects were short-lived.

Other research by Tena and Forrest (2007) discussed the mid-season dismissal of managers in the Spanish Football League during the period 2002-2005. Their results indicate that firm directors tended to fire a manager to avoid the risk of relegation to a lower-level division. There suggestion is that changing a manager does bring a short-term improvement in productivity performance. Barros et al. (2009) discussed manager dismissal in relation to productivity performance in the Germany Football League. The authors find two main results. They find, firstly that managers of successful teams, and those recruited during the "Bosman Effect" period are more likely to survive threats to termination than other managers. They also find that managers of teams with relatively higher wage bill ratios are more at risk to dismissal. The primary implication of these studies is that managers are dismissed because of the threat of relegation.

Hill (2009) examined the impact of frequent managerial turnover on firm performance using professional baseball managers. Similar to most previous studies in professional team sports, his research had two principle implications. Firstly, his findings suggested that managerial succession had a negative impact on productivity performance. This finding conforms to “vicious circle theory” as described in the previous research (e.g. Rowe et al., 2005). Second, it is recognised that frequent succession events negatively effect on productivity performance. Their finding indicates that the relationship between frequent succession events and performance is non-linear in nature.

Recently, Frick et al. (2010) examined managers’ dismissals in the top tier of Germany professional soccer. They documented two main findings. Firstly, they find that the probability of a manager being sacked or resigning voluntarily is positively associated to recent defeats. This implies that superior productivity performance reduces the probability of manager turnover. This finding supports the “common sense theory” as explained in previous studies (e.g. Gamson and Scotch, 1964). This finding in essence suggests that the probability of a manager being sacked declines with his level of individual competence such as his career win-record and amount of experience in the specific league. Second, they documented that the probability of manager dismissal is positively related to the remuneration of the input factors (i.e. manager salary and player wage bill). The authors asserted that as teams’ expenses for the players and managers increased the managers became more exposed to risk of termination.

Another recent study of the Germany Football League by Wagner (2010) has analysed the impact of managerial successions on productivity performance before and after the introduction of the 3-point rule. In his paper, the author analysed 262 managerial replacement cases and found that manager replacements effectively improve productivity performance, but that the impact differs depending on regime. His results suggest that the impact of manager replacement on productivity performance is stronger under the 3-point rule than under the 2-point rule. Both simple univariate event-studies and multivariate regressions exhibit similar results. This finding is contrary to earlier studies such as those by Rowe et al. (2005) and Hill (2009) who suggest that manager replacement leads to poor productivity performance.

Ter Weel (2011) investigated the impact of manager turnover on firm performance in Dutch soccer for the period 1986-2004. Using difference-in-difference and 2SLS econometric techniques, his results show that there is no improvement in productivity performance following

manager change. This finding is consistent with “ritual scapegoating theory” analysed by Gamson and Scotch (1964), Grusky (1964) and Rowe et al. (2005). In addition, his results reveal that manager quality does not appear to be an important factor in predicting turnover rate. That implies that managers are removed because of performance criteria and not personal attributes.

### **2.3 Managerial Efficiency and Productivity Performance**

This section discusses studies that link managerial efficiency and firm productivity. The type of efficiency discussed in this literature is that of a team coach who is at the centre of the production process. Porter and Scully (1982) estimated managerial efficiency by the manager and by the firm by examining Major League Baseball teams over the period 1961 to 1980. The central focus of their study was on managers’ proficiency and actual productivity performance. Their key findings indicated that managerial expertise in baseball contributes very significantly in the production process (i.e. winning percentage). Pfeffer and Davis-Blake (1986) supported Porter and Scully’s (1982) results by providing evidence that manager ability and experience are essential determinants of productivity performance. The authors insisted that both experienced coaches and those with good previous records were in a position to bring performance improvement.

Clement and McCormick (1989) studied the relationship between managers’ skills and productivity performance in college basketball. Their main findings reveal that managers make a significant contribution to productivity performance. This suggests that the experience and skills of a manager *does* help to improve the firm’s winning percentage. Singell (1993), examined how managerial experience in Major League Baseball affected both the team and individual player performance. The results show that when team skills were held constant, productivity performance depends on the baseball-specific human capital attributes of the manager. Furthermore, the results suggest that well trained managers tend to increase individual player performance. These findings are consistent with earlier studies by Porter and Scully (1982) and Clement and McCormick (1989).

Kahn (1993) used data from the Major League Baseball for the period 1969 to 1987 to investigate the impact of managerial quality on productivity and individual player performance. The author documented two major findings. First, after controlling for player inputs, he finds

that higher-quality coaches led to improved winning percentages. Secondly, quality managers seemed to improve player performances relative to their previous performances under inferior managers. The implication of these findings proposes that managerial quality makes an important difference in productivity performance. Grouped together, these results are consistent with human capital theory.

Scully (1994) looked at the link between managerial efficiency and survival in professional team sports. He constructed measures of efficiency for American football, baseball and basketball. His main findings show that manager tenure is positively related to managerial efficiency. This finding implies that the higher the productivity performance, the longer the managerial tenure. Likewise, Cannella and Rowe (1995) used a sample of Major League Baseball to examine the relationship between managerial capabilities and subsequent productivity performance. Their findings provide evidence that manager ability and experience are associated positively to productivity performance. It was observed that after any managerial succession, the ability and experience of a new manager measured by his previous record is essential to subsequent performance. Their findings suggest that the abilities and experiences of a manager are more important when a team is competing with a strong rival than when a team is competing with a weak rival.

Other research by Hadley et al. (2000) evaluated performance of National Football League teams in the US. Using a Poisson regression model and they find evidence that quality coaching is an important element in the production process. Specifically, their findings reveal that efficient coaching leads to an extra three to four victories in a given season. That means manager efficiency contributes significantly in firm productivity. The production process requires a competent manager who converts player skills into games won. Another study has estimated coaching efficiency in English associational soccer for the period 1992-1998 (Dawson et al., 2000). Their findings documented two important results. First, that managerial efficiency is partially related with productivity performance- this is in line with some previous studies. Second, they showed that managerial efficiency is highly sensitive to measures of playing quality such as wage bills.

Dawson and Dobson (2002) evaluated the managerial efficiency in terms of human capital attributes and firm productivity in English associational football. They found that the manager's relationship with the firm and his previous achievements as an international player were crucial

factors for determining productivity performance. Notably, their findings show that initial experience matters considerably more than specific and general experience. Another study by Kern and Süssmuth (2005) examined the managerial efficiency in relation to productivity and financial performance in Germany's soccer industry. Their results reveal two main findings. First, they find that player talent is a crucial determinant of both financial and productivity performance. This suggests that playing quality is the most important element in the production process. Second, they prove that paying a higher salary to a manager has no substantial impact on productivity performance, implying that a higher salary does not increase a manager's efficiency in the production process.

Frick and Simmons (2008) investigated how variations in managerial compensation affect firm productivity in the top Germany Football League (Bundesliga). Two major results accrue from their findings. First, they show that teams that recruit high-quality managers achieve higher total league points by reducing technical inefficiency. This is consistent with the common sense perception that quality managers are more competent in the field. Second, they find that the market for football managers may be operating inefficiently in the sense that managers are paid below their marginal revenue products. This is due to preferences of managers to stay in the Bundesliga rather than go outside Germany. Also, the requirement that managers in the Bundesliga must have a diploma from an accredited German Sports University is a barrier to entry to foreign managers.

Berri et al. (2009) evaluated the role of managers in firm productivity using a sample of US National Basketball Association teams. Their main results are as follows. Firstly, they find that some managers with ordinary records have made considerable contributions to their players' performances. These managers deserve their rewards due to their ability in converting player talent into games won. On the other hand, their results show that most managers do not have a statistically significant impact on team success or player performance. This implies that the majority of managers in their sample are regarded principally as clerks who do not make a substantial contribution to the production process. This finding implies that managerial skill in supervising players is an important aspect in enhancing productivity performance.

## **2.4 Productivity Performance and Financial Performance**

This section reviews the literature that compares productivity and financial performance in the sporting sector. There are contradictory factors as to whether soccer corporations should maximise either productivity performance or financial performance. For instance, Szymanski and Kuypers (1999) argued that in the long-term, soccer firms should combine financial and non-financial performance. The same idea was expressed by Vrooman (2000) who argued that managers in professional team sports should seek to simultaneously maximise financial and productivity performance. In another paper, it was observed that team sports aim to maximise productivity success in conjunction with maintaining financial solvency of the firm (Gerrard and Dobson, 2000). In a later study, Dobson and Goddard (2004) asserted that English soccer companies chiefly aim to maximise revenue and wins rather than maximising profit. The essential aspect of these studies is to show that both productivity and financial performance are important to the firm.

One of the first empirical studies to analyse the link between productivity performance and financial performance was published by Arnold (1991). He conducted his analysis using a sample of four firms for the period 1905-1985. The author finds significant associations between sporting success levels in various competitions and the main club income (gate receipts) and expenditure (wages). The key implication of this finding is that success in various competitions, both domestic and international, helps to increase considerably both club revenues and wages for its workers. This suggests that productivity performance is achieved through incurring substantial costs although at the same time generating considerable revenues.

Another study by Szymanski and Smith (1997) analysing the English soccer industry finds a positive relationship between the league position and absolute levels of profits. Interestingly, their findings reveal that firms at the top of the league tend to make profit, firms at the middle make large absolute losses and firms at the bottom of the league make small absolute losses. This finding tells us that firms with superior productivity performance generate profits, while firms with inferior productivity performance generate losses. Overall, firm's revenues depend on productivity performance though this is attained by incurring considerable costs in playing talent.

Dobson and Goddard (1998) looked at annual league position to establish the relationship between productivity performance and gate revenue for 77 Football League firms, which maintained continuous league membership between 1946 and 1994. In their paper, they find that a relationship between productivity performance and gate revenue existed only in 10 firms, this relationship being stronger in small firms than in larger firms. Using Granger's causality tests, there is further evidence that the causality runs from lagged revenue to current productivity performance rather than in the opposite direction. The findings here are somewhat different from earlier findings by Arnold (1991) and Szymanski and Smith (1997).

Szymanski (1998) inspected the association between productivity performance and profit before tax for 40 firms over 20 years in the English Football League. The results indicate no systematic relationship between the two variables. His findings show that in only 54% of cases the increase (decrease) in productivity performance was reflected in an increase (decrease) in profits. This unsystematic relationship is due to the fact that the profit is the difference between revenue and cost. Further results indicate that league position is strongly positively correlated to revenue and wage expenditure. His findings also suggest that higher levels of wage expenditure lead to a higher level of league position. Finally, better league performance leads to a higher level of revenue. This is similar to the previous findings by Arnold (1991).

Szymanski (2001) finds that productivity performance in English association football is not affected by improved financial performance. His results reveal that there is no change in competitive balance despite the increasing income inequality between firms. Barajas et al. (2005) examined the impact of productivity performance on economic results in Spanish football. They find a non-linear relationship between expected income and productivity performance. To some extent, their results appear to show that productivity performance affects financial performance. Specifically, they find that a team's league position and accumulated points affects firm's revenues obtained through gate tickets, broadcasting and sponsorship. Despite the considerable statistical evidence found in their results, the explanatory power of independent variables is very low. This implies that there must be other factors that determine financial outcomes which are not included in their regression model.

Berument and Yucel (2005) study the relationship between Turkish industrial production performance and the success of Fenerbahce, a popular Turkish soccer firm. In their analysis, they interpreted Fenerbahce's productivity performance as a proxy for workers' morale,

implying that workers will work hard when the team wins. They reveal two interesting results. First, they find a positive relationship between games won by team in European tournaments and industrial production performance. There is an increase of 0.26% in monthly industrial growth rate every time the team wins games in European tournaments. Second, their results provide evidence that games against domestic rivals have no considerable impact on industrial production performance. This demonstrates that international tournaments have a greater impact on industrial production than domestic tournaments.

Pinnuck and Potter (2006) examined the factors that contribute to the financial performance of soccer companies in the Australian Football League over the seasons from 1993 to 2002. The primary focus of their paper is to explore the relationship between productivity and financial performance. Their analysis considers the nature of the association between soccer performance and each type of revenue stream. Their key findings are as follows. First, they find that match attendance is positively related to both the short-term and the long-term achievement of a firm as well as the winning momentum of a firm. Second, they observed that uncertainty of the match outcome leads to a higher level of match attendance. Thirdly, they revealed that membership levels are dependent considerably on the firm's previous success. Finally, they find a strong relationship between the level of marketing revenue and the level of productivity performance in the previous two years. Overall, these findings imply that productivity performance drives financial performance.

Barros and Leach (2006) evaluated the performance of English Premier League firms for the period 1998 through 2003. These authors find that efficient firms have a good combination of financial and productivity performance. In this paper, they argued that financial problems weaken the productivity performance, and in most cases may cause demotion from the league. In another study, Buraimo et al. (2007) stipulated that in theory, financial performance in sports leagues is the key determinant of productivity performance. The authors argued that firms with higher revenues will have a higher winning percentage than firms with smaller revenues. This theory suggests that financial performance precedes productivity performance. This finding also suggests that firms with a financial capability are able to buy quality players these being crucial ingredients in the production process.

## 2.5 Summary and conclusion

This chapter has surveyed the finance literature in the sporting sector. At a more general level, this stream of literature is scarce in comparison to finance research in conventional industries. However, this kind of research is still overwhelmed with debates not only between managerial turnover and productivity performance, but also between managerial efficiency and productivity performance. However, there are plenty studies that link productivity performance with financial performance. Although these debates have provided us with rich investigatory materials of finance research in the sporting sector, they are as yet, inconclusive.

This chapter finds inconsistent results in the first theme surveyed. In this topic, three major theories of managerial departure were surveyed. These theories, which were initially explored by Grusky (1963) are summarised as follows. First, common sense theory suggests that a new manager develops new processes and a strategy that will improve productivity performance as they learn and make required adaptations. According to this theory, the new manager should simply avoid his predecessor's mistakes to achieve superior performance. Secondly, vicious circle theory postulates that manager turnover ruins productivity performance because replacement events disturb well-established processes and bring instabilities that worsen performance. Thirdly, ritual scapegoating theory posits that manager turnover does not affect productivity performance. This theory tells us that managers are sacked as a ritual to signal that the board of directors have made the appropriate decision to address poor performance. While most studies find mixed results on these theories, Rowe et al. (2005) find comprehensive results that support them.

In the second theme, the majority of studies surveyed argued that managerial efficiency leads to superior productivity performance. This finding is consistent throughout many sports, including soccer (e.g. Dawson and Dobson, 2002, Frick and Simmons, 2008), baseball (e.g. Cannella and Rowe, 1995, Singell, 1993) and basketball (e.g. Clement and McCormick, 1989, Berri et al., 2009). These studies collectively established that managerial skills are important ingredients in attaining superior productivity performance. In the final theme, the survey's findings were more mixed. For instance, Barros and Leach (2006) and Buraimo et al. (2007) find that productivity performance is mainly determined by financial performance, while Szymanski (2001) finds that productivity performance is not affected by financial performance. In addition, Arnold (1991) finds that productivity performance is associated with higher levels of revenues and costs,

whereas Szymanski (1998) considers there to be an unsystematic relationship between productivity performance and profitability.

To sum up, this chapter demonstrates that there is no study that has linked productivity performance measures and corporate governance themes at the board level. The existing literature has primarily focused on the relationship between productivity performance and the team coach's features. Clearly, future research must focus on the relationship between productivity performance and directors' attributes. Overall, the discussion of this literature provides justification of the sample and variables analysed in the empirical chapters of this thesis. The next chapter surveys corporate governance research, mainly focusing on directors' remuneration, directors' turnover and multiple directorships. These three topics are thoroughly discussed in the subsequent empirical chapters of this thesis.

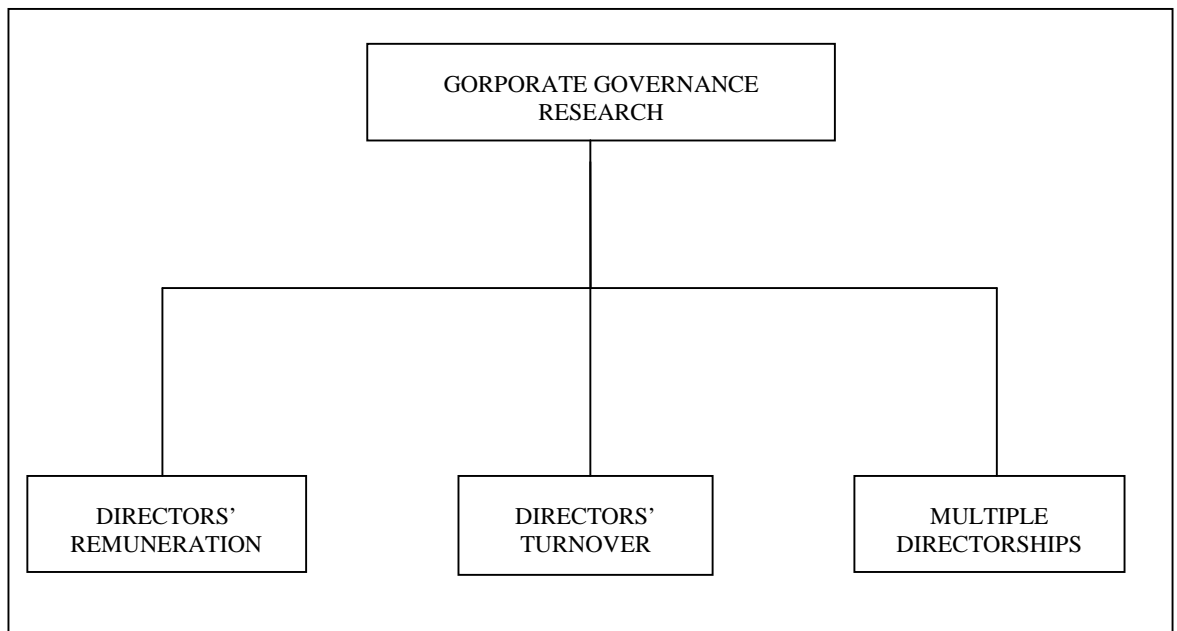
# 3 A SURVEY OF CORPORATE GOVERNANCE RESEARCH

## 3.1 Introduction

This chapter reviews corporate governance research with special attention to the themes of directors' remuneration, directors' turnover and multiple directorships. These three topics are empirically analysed in the subsequent chapters of this thesis. The rest of this chapter is organised as follows. Section 3.2 discusses the literature on managerial compensation. Section 3.3 describes literature on directors' turnover. Section 3.4 discusses the literature on multiple directorships and its accompanying theories. Section 3.5 presents a summary and conclusion of the chapter. Figure 3-1 provides the synopsis of the main coverage areas.

**Figure 3-1: The Synopsis of Corporate Governance Research**

This figure provides the summary of the main coverage of the corporate governance research. The three topics reviewed are; directors' remuneration, directors' turnover and multiple directorships.



Source: Own Construction

## **3.2 Directors' Remuneration**

The modern history of directors' remuneration studies started in the late 1970s in parallel with the emergence and acceptance of modern agency theory.<sup>1</sup> Agency problems originate from the separation of ownership and control in modern corporations. Berle and Means (1932) had described the distinction between management and shareholders in corporations. This idea was further explained in the seminal and acclaimed paper by Jensen and Meckling (1976). The most extensively researched executive remuneration criteria must, they contended, be corporate performance. Most of the early studies on executive compensation focused on an examination of the relationship between CEO compensation and company performance (e.g. Abowd, 1990, Coughlan and Schmidt, 1985, Jensen and Murphy, 1990, Murphy, 1985, Murphy, 1986, Leonard, 1990). Other papers sought to ascertain whether CEO compensation was related to relative performance in the respective market or industry (e.g. Antle and Smith, 1986, Gibbons and Murphy, 1990). The large body of empirical investigations addressing this debate has revealed mixed findings.

Most of the recently growing literature belongs in the disciplines of accounting, economics and finance. Accountants have investigated whether accounting-based bonuses have led to earning manipulations in the company by managers, whereas financial economists have explored the link between executive compensation and firm performance, dividend policy, capital structure, mergers, diversifications and investment decisions. The existence of a great number of previous studies on executive compensation provides evidence that compensation contracts are fundamentally multi-dimensional and complex, therein encouraging further empirical study of different environments. The proceeding subsection of this literature review provides some explanations for, and descriptions of, the main components and the structure of executive compensation.

### **3.2.1 Components and Structure of Executive Remuneration**

This section discusses the key components of managerial compensation and structure as described in the previously outlined literature. There are numerous benefits and benefits in kind across corporations, which are an integral part of managerial compensation. The most common are: base salaries, annual bonus schemes and executive stock option plans. In addition, there are other executive compensation components such as: restricted stocks, and retirement plans and

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<sup>1</sup> Key papers offering a broad review of this literature include Jensen and Meckling (1976), Mirrlees (1976), Holmstrom (1979) and Fama (1980).

these were studied in depth in the previously outlined literature. However, when discussing these components much care should be taken because the terminology deployed by both academics and practitioners is not always consistent and can, therefore, be confusing. In most cases, there are also differences between countries. For instance, performance share plans are a commonly used expression in the UK, whereas long-term incentive plans and deferred bonus plans are more common terms in the US. In general, the structure of executive compensation is highly complex and continually changes so as to reflect corporate governance practices in modern corporations.

#### *3.2.1.1 Base Salaries*

Base salary is the key component of executive compensation that guarantees a minimum increase over time. Contrary to other components of executive compensation, base salary is a fixed component in executive contracts and can be reviewed on an annual basis. Murphy et al. (1999) argued that target bonuses, option grants, defined pension schemes and severance arrangements all depend on salary levels. Given this situation, any change in base salary will have a significant effect on many other compensation components.

Base salaries of corporate executives are normally determined through competitive benchmarking basing on the relative industry salary survey, except for utility and financial companies that depend on industry-specific surveys and detailed analyses of market peers (Murphy et al., 1999). Most of these surveys use pay percentiles and adjust for corporate size either through size groupings or logarithmic transformation of salary and size. The traditional measures of corporate size are made according to company sales, total assets, number of employees and market capitalisation (e.g. Cichello, 2005, Dyl, 1988, Firth et al., 1999a). According to the literature, the use of surveys in determining the base salary of executives has several implications that are relevant in understanding the level and trend of executive compensation (Murphy et al., 1999).

#### *3.2.1.2 Annual Bonus Plans*

Most profit-making companies offer bonus schemes to their top executives that are paid annually, depending on the overall performance of the respective company. Previous research has shown that bonuses are strongly linked to performance and more so than other components of executive compensation (Finkelstein and Hambrick, 1989). Target bonuses are rewarded to

executives after they have achieved a certain standard of performance required by the company. The awarding of annual bonuses depends on the discretion of the company's board. In some companies, the board of directors can allocate a fixed amount of bonuses to all the executives of the company. In contrast, other boards can allocate bonuses depending on individual performance. In this situation, some of the executives in the firm receive distinctly higher bonuses than others.<sup>2</sup>

It has often been argued that despite the importance and prevalence of bonus plans in executive compensation, most of them are subjective and non-representative of the annual company proxy statements (Murphy et al., 1999). The logic behind this is that the board of directors have the power to make discretionary adjustments in the company's reported earnings. As a consequence, the board of directors can make small adjustments to the annual bonus payments in accordance with their own sound judgment. Generally, most bonus schemes are paid relative to pre-determined objectives and relative to the strength of the individual's performance.

### 3.2.1.3 *Stock Options*

Over recent years, stock options have become one of the key forms of compensation for CEOs. Stock options are defined as contracts granted to executives who give them the right to purchase shares of common stock in the future at a fixed exercise (strike) price. According to Murphy et al. (1999), executive stock options are exercisable over time and are *non-tradable*. These options are forfeited if the executive who holds them leaves the company before vesting them. In practice, most of the stock options expire after a ten-year period. On expiry, stock options are granted with exercise prices, which are equivalent to the fair market value at the date they were awarded (Murphy, 1985).

The main implication of the growth of stock options is that when a share price increases, the value of the option also increases, which means that managers' incentives are enhanced. In other words, there is a positive relationship between managerial rewards and share prices because the value of the options granted to managers of the firm increases with stock price appreciation. The benefits of stock options are different from the benefits derived from stock ownership. Stock options only reward stock price appreciation, whereas stock ownership rewards both dividends

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<sup>2</sup> In fact, the allocation of bonus plans to executives of the firm is decided upon by the company's board of directors. Thus, the procedure used to allocate bonuses payments resulting from good company performance depends solely on a particular board of directors.

and share price appreciation. However, previous studies such as those by Lambert et al. (1989) and Lewellen and Huntsman (1970) have found a negative correlation between managerial stock option plans and expected dividends in the firm.

#### *3.2.1.4 Other Components of Remuneration*

Other common components of executive compensation include restricted stocks (i.e. long-term incentive plans) and retirement plans.<sup>3</sup> Restricted stocks are defined as being portions of a company's stocks that are not fully transferable until certain conditions have been met (Kole, 1997, Neslihan, 2007). Some companies reward their executives by using restricted stocks rather than adopting option schemes. In this context, restricted stocks can be transferred by the person holding them after certain conditions have been satisfied. Ideally, the ownership of these stocks is transferred to the executive of the company if the given performance targets have been met.

Most of these performance targets are planned for in accounting and market measures such as growth in earnings per share or total shareholders' return over a period of time. There is an advantage of using total shareholder return as a performance measure because it cannot be manipulated by managers and is more aligned to shareholders' interests (Neslihan, 2007). Corporate managers are rewarded by long-term incentive plans relative to the industry index or group of peers. Kole (1997), emphasised that restricted stocks were more common in some firms such as those concerned with machinery, chemical engineering and manufacturing than in food, metal and consumer firms. Restricted stocks are also known as 'letter stocks' or 'restricted securities'.

Retirement plans are defined as arrangements that provide people with income during retirement (i.e. pension schemes). A retirement plan can be set up by the government, institutions, employees' associations, trade unions or insurance companies. There are two main categories of retirement plans identified in the literature: defined benefit and defined contribution (OECD, 2007). Defined benefit schemes provide a guarantee of a certain income upon retirement using a specific fixed formula, while defined contribution is a scheme in which an employee's benefit

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<sup>3</sup> In most cases "long-term incentive plans" represent any form of incentive plan such as deferred cash bonuses, executive share options or restricted stocks that deliver a pay-out over a period of greater than one year. In this paragraph it represents restricted stocks.

depends on the contributions made and the investment performance of the assets in his/her account.

### 3.2.2 Remuneration Committees

The appearance of remuneration committees came to the fore in the 1980s after the emergence of cultural changes associated with extreme top management compensation (Brown, 1995). Williamson (1985) pointed out that the non-existence of an independent compensation committee is similar to an executive director preparing his own employment contract with one hand and signing with the other. In the same way, later studies have suggested that independent remuneration committees are potentially crucial in exercising boardroom control (Canyon and Peck, 1998, Main and Johnston, 1993). The notion of remuneration committees is in line with agency theory because according to the underlying principles of corporate governance, no individual director can set his/her own remuneration (Canyon and Peck, 1998).

In the UK, remuneration committees have become more common after the Cadbury Committee's 1992 report. There were several recommendations made in this report, which were later combined in a single code in 2003. The key recommendation of the report was that the appointment of members in the remuneration committees should consist of mainly or wholly non-executive directors, and that the chairman of the committee should be the *non-executive* director. According to Canyon and Peck (1998), tracing the recommendations of the Cadbury Report of 1992, by 1994 larger UK corporations had generally installed remuneration committees in their board of directors. However, the lower level of top management compensation was not connected with the existence of these remuneration committees.<sup>4</sup>

The key responsibility of the remuneration committee is to fix the remuneration packages of individual directors (Brown, 1995, Finkelstein and Hambrick, 1988, Zajac and Westphal, 1994). The UK Combined Code (2003)<sup>5</sup>, indicated that the remuneration committee is responsible for the careful consideration of future compensation commitments (i.e. pension contributions and other elements of compensation). The code also stated that the committee is responsible for checking and approving directors' terms of appointment that are to be revealed on the

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<sup>4</sup> Canyon and Peck (1998) insisted that remuneration committees were constructed to set only top executive compensation packages.

<sup>5</sup> Since 2010, the Financial Reporting Council (FRC) has updated the formerly known Combined Code as the UK Corporate Governance Code.

occurrence of early termination. These responsibilities enable remuneration committees to avoid rewarding poor performing directors in their companies. Nevertheless, the remuneration committees are required to rely on specific factors in determining the levels of directors' pay (Jensen and Murphy, 1990, Firth et al., 2006, Conyon and Peck, 1998).

### **3.2.3 Determinants of Directors' Remuneration**

There are numerous determinants of managerial compensation that have been discussed in the existing literature. Both quantitative and qualitative studies have remarked that these factors are quintessentially complex. A number of determining variables play key roles. Ideally speaking, the factors that determine managerial compensation differ across industries and countries. It is difficult (perhaps impossible) to convey the depth and detail of their discussion in a single literature review. The objective of this section is to discuss and describe the main determinants of managerial compensation that have been studied in literature.

#### *3.2.3.1 Corporate Performance*

The link between managerial compensation and firm performance is one of the most extensively studied issues in the literature on corporate governance. Several previous studies have recognised that in order to align the interests of managers to those of shareholders, there is a need to design compensation contracts that ensure that executive rewards are tied to stock market performance. This idea has been discussed in compensation research papers such as those written by Conyon et al. (1995), Holmstrom (1979) and Jensen and Murphy (1990). Prior to a detailed discussion of firm performance as a determinant of executive compensation, the next paragraph gives a cursory review of the most common measures of performance that are deployed in research.

There are several measures of performance used in the empirical investigation of executive compensation. The most common measures include the return on equity (e.g. Dyl, 1988, Finkelstein and Hambrick, 1989, Boyd, 1994), sales growth and shareholders' realised return (e.g. Murphy, 1985, Neslihan, 2007) and return on assets (e.g. Kerr and Kren, 1992, Cheng and Firth, 2005, Doucouliagos et al., 2007). Specifically, some of the previous studies measured the stock market performance of the firm using earning per share and stock return calculations (e.g. Cordeiro et al., 2000, Core et al., 1999). Overall, these measures can be categorised as being (1) *stock market*-based and (2) *accounting*-based metrics. To enhance our understanding, the link

between firm performance and managerial remuneration is discussed based on two main evidence categories. The first category describes the empirical and theoretical evidence from studies conducted in the UK, and the second category evidence from the US and other countries.

### **Evidence from UK Studies**

There have been several previous studies which have linked executive compensation and firm performance in the UK. The majority of these studies are empirical and deploy quantitative methodology and analytical tools. The findings from these studies have produced mixed results. A large number of studies have suggested a positive association between managerial remuneration and company performance (e.g. Conyon, 1997, McKnight, 1996, Ingham and Thompson, 1995). Ingham and Thompson (1995) discerned a positive relationship between executive compensation and a firm's current profit rate. These authors also used return on assets as a measure of a firm's profitability. McKnight (1996) noted that a change in executive remuneration is positively associated with a firm's earning per share. Similarly, Conyon (1997) found that managerial compensation is positively correlated to current shareholders' return and to a lesser extent to the previous year's shareholders' return. Their results were based on the analysis of 213 larger UK firms over a period of six years from 1988 to 1993.

Some earlier studies discerned a positive link between top executive compensation and firm performance, but the link was distinctly weak (Gregg et al., 1993, Conyon, 1995, Conyon and Leech, 1994, Main and Johnston, 1993). For example, Gregg et al. (1993) found a weak and diminishing relationship between directors' remuneration and corporate performance. Furthermore, Main and Johnston (1993) found that the level of compensation for the highest paid director in the firm was linked to firm performance, though to a lesser extent in comparison to firm size. Conyon and Leech's (1994) findings showed a weak but positive relationship between top executive remuneration and firm performance. Buck et al. (2003) analysed 287 non-financial firms from the FTSE 350. Their empirical evidence shows a very low sensitivity of pay-performance relationships. Although all the studies reveal a positive pay-performance relationship, the strength of that relationship is different in each investigation.

Another study by McKnight and Tomkins (1999) found no obvious link between firm performance and executive remuneration in terms of both short and long-term performance. Their findings indicated that each component of executive compensation has its own

determinants. For example, salaries are mainly determined by firm size rather than firm performance. The detailed findings of their study can be explained as follows: in the analysis of long-term performance, they found that changes in share options were particularly sensitive to changes in shareholders' value. In the analysis of short-term performance, they found that executive salaries were more sensitive to a firm's growth than to a firm's economic performance.

Benito and Conyon (1999) used a sample of quoted companies from 1985 to 1994 and found a positive relationship between directors' compensation and pre-dated shareholders' returns. This relationship was not as strong as the relationship between corporate size and directors' compensation, however. This is similar to McKnight and Tomkins' (1999) findings. In work contradicting these studies, Ozkan (2007), found that firm performance as measured by stock return and shareholders' return had no impact on executive compensation. However, the author advised caution in the use of these findings because the study was only over a one year period. In other words, the relationship discerned was limited because the data analysed was only for one fiscal year. A sample over such a small time-period may give a misleading representation of the true pay-performance relationship. This implies that executive compensation can be influenced more by the previous year's performance than by that of the current year.

Other recent studies find a positive link between executive remuneration and firm performance, but the link is not strong as between executive compensation and firm size (Girma et al., 2007, Eichholtz et al., 2008). In the analysis of corporate governance reforms and executive compensation, Girma et al. (2007) finds the relation between pay and performance to be weak, the link with company size being stronger. In comparison with previous studies, their results indicate that the link between pay and performance increases for those firms above the median employment. Eichholtz et al. (2008), studying executive compensation in UK property firms finds that long-term compensation is chiefly determined by absolute and relative share performance. Their results also indicate that firm size is more important than firm performance in explaining executive's remuneration. Furthermore, it was observed that the link between pay and performance is much stronger when an executive holds shares in the firm.

Using a sample of 698 CEO years and 2,609 other executive years over the period 1995 to 2000, Stathopoulos et al. (2005) find three different levels of relationship between pay and performance for three different performance levels. Their results indicate that executives of

extraordinarily well-performing firms receive better remuneration than executives of mid-performing firms, who in turn receive better remuneration than executives of poorly performing firms. Specifically, their results showed that executives of extremely poor performing firms experienced cuts in their salaries and bonuses, whereas CEOs of poorly performing firms are likely to be fired from their position. In this context, these results confirm a positive relationship between executive remuneration and firm performance as measured by abnormal stock returns.

Bruce et al. (2007) investigated executive bonuses for the period 2001 to 2003. Their main finding demonstrates that executive bonuses are related to higher total shareholder returns. This finding supports agency theory because executive pay is linked to shareholder wealth. Using a sample of 169 non-financial listed companies that existed for the period from 1971 to 1998, Liu and Stark (2009) provide evidence that board cash remuneration is positively associated to accounting earnings but negatively linked with the peer group pre-tax accounting earnings. The authors provide some evidence that suggests board cash payment is connected to firm stock market returns, but none suggesting its connection to peer group market returns. The main implication of this finding is that board members are rewarded entirely depending on their own firm's performance rather than on the performance of other firms in the peer group.

Recently, Ozkan (2011) examined the relationship between CEO pay and performance using a sample of 390 non-financial firms from the FTSE All Share Index for the period 1999–2005. This analysis looks at cash and equity based components of CEO remuneration specifically. The following main findings were documented. She finds that an increase of 10% in shareholders returns led to an increase of 0.75% in cash compensation. Also, an increase of 10% in shareholders returns led to an increase of 0.95% in total compensation. Her results show that pay-performance elasticity is 0.075 for cash compensation and 0.095 for total compensation. This reveals that the pay-performance elasticity for UK firms is relatively lower than their US counterparts. The positive link between pay and performance is consistent with many prior studies.

### **Evidence from the US and Other Countries Studies**

There is much empirical and theoretical evidence from studies of the US and other countries that link managerial compensation and firm performance. Lewellen and Huntsman (1970) find a strong relationship between managerial remuneration and generation of profits. These authors

studied 50 firms drawn from Fortune 500's largest industrial firms in the US. Another study by Murphy (1985) studied 73 larger manufacturing firms from the Fortune 500 list. He finds that firm performance as measured by shareholders' realised return is a significant determinant of managerial remuneration. In addition, the author finds growth of sales, which is the alternative measure of firm performance to be positively related to managerial remuneration. These findings were consistent with Coughlan and Schmidt's (1985) findings. However, there is a difference in that the former study employed growth of sales as a measure of firm performance, whereas the later study employed it as a measure of firm size.

Deckop (1988) finds that the firm's profit is a significant determinant of CEO compensation in a study of 120 firms over five-year periods. However, the profit coefficients were statistically significant at the 5% level for only two years in the period of study. Likewise, Dyl (1988) analysed 271 industrial corporations in the US. The main findings indicate that firm performance as measured by the natural logarithm of return on equity is positively related to managerial compensation. Despite using different performance metrics, these studies collectively suggest that executive remuneration is determined by accounting and market measures of firm performance.

Finkelstein and Hambrick (1989) find a positive link between firm performance and managerial compensation. Firm performance was measured by return on equity and managerial compensation was measured by cash compensation (i.e. summation of salary and bonus). In this study, the authors used a sample of 63 executives and collected information from the US leisure industry. Their analysis documents some interesting results. They find that return on equity was unrelated to the salary component but positively related to bonuses. They explained this finding by claiming that bonus payments were the chief driver of a pay-performance relationship in the leisure industry. These results suggest that salaries and bonuses have different performance determinants.

Abowd (1990), analysing more than 16,000 managers in 250 larger corporations in the US from 1981 to 1986 finds that a small change in firm performance results in a larger change in executive remuneration. Their results indicate a 10% increase in bonuses for good performance comes from only a 0.3% to 0.9% increase in economic performance in the previous financial year. He also finds that an increase of 10% bonus for good stock performance resulted from a

4% to 12% increase in stock performance in the preceding year. Overall, his findings suggest that any improvement in firm performance leads to an additional increase in managerial pay.

Wilson et al. (1992) finds there to be an unclear relationship between top executive pay and firm performance in large US corporations. Their investigations show that the association between performance and executive pay may indeed be nonlinear. Among the alternative performance measures employed, total assets demonstrated the strongest positive relationship with executive pay. Mangel and Singh (1993) find that corporate performance is positively related to CEO cash compensation. In their study, the authors analysed 100 large companies in the Fortune 100 list. Their findings indicated that market capitalisation, which measures corporate performance as well as corporate size to be the chief determinant of cash compensation.

Another study by Mehran (1995) has studied executive compensation structure, ownership and firm performance in the US context. The author documented that firm performance as measured by Tobin's Q and return on assets is positively associated to total executive compensation. Similarly, Hubbard and Palia (1995) find that firm performance as measured by shareholders wealth is positively and statistically significantly linked to CEO compensation. These findings were consistent with many other previous studies in the US such as Barro and Barro (1990), Jensen and Murphy (1990) and Murphy (1985).

Barro and Barro (1990), for instance explored CEO compensation in the banking industry for the period 1982 to 1987. They documented two major findings. First, they found that remuneration for progressing CEOs depended on firm performance as measured by stock and accounting returns. Second, they find that for newly hired CEOs, the elasticity of remuneration with respect to assets is about one-third. Jensen and Murphy (1990) studied a larger sample of data on executive compensation spanning for about 50 years. They found that changes in CEO compensation do not reflect changes in firm performance. Their results indicate that CEO remuneration changes by \$3.25 for every \$1,000 change in shareholder wealth. The essence of these findings is to show that changes in managerial pay *are* influenced by changes in firm performance.

Attaway (2000) studied the link between firm performance and CEO compensation in the computer and electronics industry. These findings indicate a small positive relationship between

CEO pay and performance. In this paper, performance was measured by shareholder equity. The stated weak relationship is due to relatively small  $R^2$  of the model without considering the actual statistical significance found in the performance coefficient. Joyce (2001) extended the work by Attaway (2000) by examining a sample of publicly traded banks. Her finding reveals a weak relationship between firm performance and CEO compensation. Firm performance was measured by return on assets and CEO compensation was measured by salary and bonuses. Overall, this finding is similar to Attaway's (2000).

Another study by Sigler and Porterfield (2001) examined 31 publicly traded banks in the US. They find that a 0.1% increase or decrease in return on bank assets leads to an increase or decrease of CEO pay by \$93,870 per annum. This means that a slight change in performance leads to considerable change in pay. Ang et al. (2002) show how US banks compensate their top management teams. According to their findings, CEOs receive large pay in absolute dollars, but their pay is linked to firm performance. Compensation structure for other top executives is also linked to firm performance. In this paper, their findings offer robust evidence in alternative performance measure estimation. These findings are consistent with earlier studies such as Murphy (1985), Jensen and Murphy (1990) and Hubbard and Palia (1995).

Boschen et al. (2003) investigated the long-run impact of firm performance on CEO pay. Initially, they found that good accounting performance is related with increases in CEO remuneration. This relationship reverses in later years where accounting performance is associated with lower CEO remuneration. On top of this, they find that CEO's long-run cumulative remuneration is positive and statistically significantly related to stock price performance. Another study by Choo and Tan (2004) finds a relationship between CEO pay and firm performance in US firms using structural equation modelling. Their finding shows the direction of causality to be from pay to performance and not vice versa. Specifically, they find that previous pay affects future pay but previous performances do not always affect future performance. The direction of causality in this study is different from most previous studies. These inconsistencies of the relationship between pay and performance may be due to methods used in the analysis.

Crumley (2008) examined the relationship between firm performance and CEO remuneration. The sample of his study covered 36 firms in the US commercial banking industry for the period 2002-2003. His results show that there is a weak relationship between CEO remuneration and

firm performance. In this paper, performance was measured by percentage stock price return and percentage return on equity. The author finds there to be a strong relationship between measures of firm size and CEO remuneration. The results of this paper are consistent with earlier findings by Coughlan and Schmidt (1985) which demonstrated that firm size is the chief determinant of CEO pay rather than firm performance.

Contrary to the aforementioned studies, Kerr and Bettis (1987) discover surprising results on the pay-performance link. Using a sample of Fortune 500 firms, their main results indicate that board of directors do not consider stock market performance in the process of setting CEOs' compensation. These authors insisted that stock price performance is not a satisfactory measure to judge managerial performance. For that reason, the board cannot rely on stock market performance in setting directors' remuneration. Surprisingly, their findings indicated that boards of directors have ignored their obligations to shareholders and decided to reward corporate managers without considering company's stock market performance. Similarly, Tosi et al. (2004) find that CEO remuneration is not related to firm performance. Using a sample of Fortune 500 companies over a ten-year period, the authors employed alternative measures of firm performance but none explained CEO's pay. Their results reveal that CEO compensation is determined by CEO charisma and not performance.

Apart from the UK, other European countries exhibit mixed results on compensation research. For instance, some researchers have examined determinants of CEO compensation in a sample of Norwegian listed firms for the period 1986-1994 (Firth et al., 1996). They find no significant relationship between CEO remuneration and firm financial performance as measured by accounting profitability and stock returns. Their results demonstrate a stronger link with corporate size to CEO compensation than to corporate performance. This is consistent with studies in the US by Coughlan and Schmidt (1985) and Crumley (2008). Another study by Conyon and Schwalbach (2000) has compared Germany and the UK compensation structures. Their finding shows a positive and significant relationship between executive cash compensation and corporate performance in both countries.

Brunello et al. (2001), using a sample of Italian firms, finds evidence that an increase in real profit is positively related to executive compensation. Specifically, their results indicate that increases of real profit per firm by £1 billion leads to increases in compensation by £31,000 for upper and middle managers and £6,000 for lower managers. This means that performance-pay

relationship is stronger for top management members than for lower management members. Crespi-Cladera and Gispert (2003) find a positive association between board remuneration and firm performance in a sample of Spanish listed firms. Their results indicate a stronger link for book values than for stock market performance measures. In addition, they point out that industry performance is also a determinant of board remuneration and also provide another source of information that is useful for an evaluation of board behaviour.

Haid and Yurtoglu (2006) in studying Germany firms find a very weak association between performance and compensation in firms where ultimate owners have considerable voting rights. Other recent studies by Duffhues and Kabir (2008) and Fernandes (2008) fail to find a positive pay-performance relationship. Particularly, Duffhues and Kabir (2008), using a sample of Dutch firms listed in Euronext Amsterdam over the period 1998 through 2001, find robust empirical evidence that there is no link between executive pay and firm performance. Fernandes (2008), using data from Portuguese listed companies finds no link between pay and performance. In this analysis, the author employed annual stock returns as a measure of firm performance. The findings that demonstrate no link between pay and performance are comparable to the findings by Tosi et al (2004).

In the same way, Zhou (2000) finds a very weak relationship between executive remuneration and firm performance when using a sample of 755 Canadian firms over the period of 1991 through 1995. His results indicate that executives of utilities companies earn lower compensation than executives of other companies and compensation for these firms is less linked to corporate performance. As noted in the earlier discussion, this finding is consistent with several studies in the US (e.g. Attaway, 2000, Joyce, 2001), in the Netherlands (Duffhues and Kabir, 2008) and in Portugal (Fernandes, 2008).

There have been few studies analysing executive compensation in Japan. This is primarily due to the dearth of public data on top executive remuneration packages. From the 1990s onwards, increasing attention has been paid to executive compensation research, especially in the US and UK, some papers having been published with Japanese evidence. Some of these publications find a positive association between directors' remuneration and corporate performance (e.g. Kaplan, 1994a, Xu, 1997, Kato, 1997). According to Kaplan's (1994a) findings, there was a positive link between directors' pay and firm performance in the larger Japanese firms. In other words, this result implies that there were incentives for managers to work towards higher

corporate performance in larger Japanese firms. Likewise, Kato (1997) finds a positive relationship between CEO compensation and a firm's profit in Japanese corporations. Xu (1997) finds that executive bonuses depend on accounting income. The author insisted that executive bonuses are unlikely to be paid if the annual dividend per share is less than ¥5.

Contrary to these studies, an earlier paper by Kato and Rockel (1992) finds no link with Japanese firms between firm performance as measured by shareholders' return and managerial pay. Another recent study by Basu et al. (2007) finds a very weak relationship between executive pay and firm performance. In this paper, firm performance was measured by returns on assets and annual stock return. Among the three models estimated in the analysis only one indicated that return on assets is a significant determinant of executive remuneration. To a large extent, their findings recommend that the link between pay and performance is weak.

There are relatively few studies that examine the link between executive compensation and corporate performance in China. In the study of 351 companies that are listed in Hong Kong, Firth et al. (1999b) find that firm performance as measured by accounting profitability is a significant determinant of executive compensation. In addition, their results indicate that firm performance as measured by stock returns has an insignificant relationship with managerial remuneration and in some cases the relationship is negative. Another study by Firth et al. (2006) finds that firms owned by state agencies do not appear to use performance related remuneration, whereas firms owned by private blockholders compensate their CEOs in accordance with an increase in shareholders' wealth or increases in profitability. More specifically, their findings indicate low sensitivity between CEO compensation and firm performance.

In an analysis of non-financial companies listed in Shanghai and Shenzhen Stock Exchanges between 1998 and 2000, Firth et al. (2007) find that the firm's operating profit is in part related to CEO compensation. Their results indicate that a return on assets as a prime measure of performance *is* related to CEO remuneration but stock return as an alternative measure of performance is *not* related to CEO remuneration. Contrary to Firth et al.'s (2007) finding on stock return, Kato et al. (2007), using data comprising of 246 publicly-traded firms in Korea, find that executive cash compensation is significantly related to stock market performance. In particular, their findings are of magnitude comparable to prior studies in the US and Japan on executive compensation.

Another recent study using data from publicly-traded corporations listed in the Philippine Stock Exchange (PSE) finds a positive link between executive remuneration and firm performance for non-affiliated firms to a corporate group but no relationship is found for affiliated firms (Unite et al., 2008). Their analysis was based on a sample of 125 firms for the period 2001 to 2002 and 148 firms for the period 2002 to 2003. These findings imply that non-affiliated firms to a corporate group are keener on adhering to corporate governance directives than affiliated firms. The positive link found between pay and performance is similar to numerous earlier studies. Overall, research done on pay-performance sensitivity has been used in evaluating the effectiveness of agent's contract. It would seem reasonable to link measures other than corporate performance to directors' pay. For instance, alternative measures of performance such as customer satisfaction and product development may bring insights into managerial compensation research.

#### *3.2.3.2 Corporate Size*

There are several logical explanations for the link between corporate size and management compensation. According to previous literature, many organisations attempt to maintain salary differentials between executive levels within the firm (Simon, 1957). The author propounded that salary differentials between management levels should be kept in ratios rather than in absolute terms. As a result, the compensation of a CEO should be greater in larger corporations than in smaller corporations because they tend to have more management levels. A previous study in this vein of literature finds that the difference between two executive levels is normally equivalent to a 30% to 40% difference in compensation (Mahoney, 1979). The assumption that larger corporations will have more management levels is consistent with the span-of-control theory analysed in Blau (1970) and Gomez-Mejia et al. (1987).

Blau (1970) and Child (1973) find there to be a high, positive correlation between corporate size and numbers of levels in the organisation. In this perspective, larger firms have many employee levels in their organisation which suggests different levels of payments to company executives. Economic theory suggests that executive compensation and firm size are related (e.g. Roberts, 1959, Gomez-Mejia et al., 1987). Roberts (1959) insisted that there is a strong indication that executives in larger firms are more highly paid than their counterparts in smaller firms. Similarly, Gomez-Mejia et al. (1987) using a sample of 71 companies selected from Standard &

Poor's COMPUSTAT largest 400 manufacturing firms, advocated that the ability of the firm to pay its CEO is greater in larger corporations because CEO compensation levels relative to total revenues are inversely related to firm size.

There is empirical evidence across countries that confirms that corporate size is the chief determinant of executive remuneration (e.g. Eichholtz et al., 2008, Benito and Conyon, 1999, Main and Johnston, 1993, Ingham and Thompson, 1993) for UK firms, (Ciscel and Carroll, 1980, Coughlan and Schmidt, 1985, Finkelstein and Hambrick, 1989, Core et al., 1999) for US firms and (Parthasarathy et al., 2006, Ghosh, 2006) for Indian firms. In the analysis of 220 large British companies, Main and Johnson (1993) find that firm size plays a more significant role than performance in the determination of CEO compensation. These authors employed logarithms of sales and market return to measure firm size and performance respectively.

Similarly, Ingham and Thompson (1993) find firm size as measured by total assets to be the main driver of executive remuneration in a sample of 52 UK building societies over the period 1987 to 1989. Benito and Conyon (1999), examining a sample of UK quoted companies between 1985 and 1994, find that firm size has a stronger impact on directors' remuneration than firm performance. These findings were consistent with many other studies that find statistically stronger links of company size to executive pay than to company performance (e.g. Gregg et al., 1993, Conyon et al., 1995, Conyon and Peck, 1998). Another study by Eichholtz et al. (2008) finds firm size as the most important variable to explain the level of executive compensation in the UK property sector.

In the US, Cicsel and Carrol (1980), studying a sample of 230 largest industrial corporations in 1974 as ranked by the Fortune list, found that firm size as measured by sales has a stronger influence on the level of executive compensation. In this paper, they have analysed these companies for the period from 1970 to 1976. Coughlan and Schmidt (1985), using a sub-sample from 249 US corporations in the period 1977-1980, find that rates of change of compensation are positively related to firm size as measured by sales growth. Another study by Murphy (1985) finds that a 10% increase in corporate size leads to a 3% increase in managerial remuneration. In this paper, the author adopted sales growth as a measure of corporate size and salaries and bonuses as measures of managerial remuneration. Baker et al. (1988) supported Murphy's (1985) findings by arguing that CEOs can increase their pay by increasing firm size regardless of the impact of size on the firm market value.

Consistent with the above studies, Finkelstein and Hambrick (1989) find that firm size as measured by firm's assets plays a greater role in explaining CEO remuneration. In this study, these authors have analysed 63 executives for the years 1971, 1976, 1982 and 1983. By employing sales as a measure of corporate size, Core et al. (1999) finds a positive relationship between sales and CEO total compensation. In their study, they have analysed 205 publicly-traded firms using cross-sectional multiple regression models for three consecutive years from 1982 to 1984. Similarly Crumley (2008), finds strong relationships between CEO pay and alternative measures of firm size. All these results were consistent with many other results in the UK such as Gregg et al. (1993) and Ingham and Thompson (1993).

In China, Firth et al. (1999b) finds company size as measured by logarithms of total assets to be the chief determinant of the compensation level and compensation changes of CEOs and executive directors. Likewise, Cheng and Firth (2005), using a sample of companies listed in the Hong Kong Stock Exchange find that firm size measured by the logarithm of sales is by far the major determinant of pay levels. Consistent with the findings of Firth et al. (1999b) and Cheng and Firth (2005), Firth et al. (2006) find that firm size as measured by the logarithm of book value of firm's assets is positively and significantly related to CEO remuneration. These authors have analysed 549 non-financial companies listed in Shanghai and Shenzhen Stock Exchanges for the period 1998-2000.

In India, there are contrasting results reported on the impact of firm size on executive remuneration. Ramaswamy et al. (2000) using a sample of 150 firms, reported that firm size is not a significant determinant of executive compensation. In contrast, Ghosh (2006) and Parthasarathy et al. (2006) documented that firm size is a very significant variable in explaining CEO remuneration. Ghosh (2006) adopted logarithms of sales as a measure of firm size in a study of 462 manufacturing firms from the Indian corporate sector for the period 1997 to 2002. Likewise, Parthasarathy et al. (2006) adopted logarithms of sales as a proxy for firm size in a sample of large Indian companies. Overall, most studies in managerial compensation use sales and total assets as their measure of firm size. Undoubtedly, future research that employs different metrics of firm size such as the number of employees and market capitalisation would lead to a more sophisticated understanding of the underpinning logic of managerial compensation.

### 3.2.3.3 *Board Composition*

The link of board composition to managerial compensation has been widely examined in previous research. The findings have been mixed. Finkelstein and Hambrick (1989) find no link between executive remuneration and the percentage of outside directors on the board. In contrast, Boyd (1994), Lambert et al. (1993) and Ozkan (2007) document a positive link between CEO compensation and the percentage of outside directors on the board. Other studies by Core et al. (1999) and Hallock (1997) find that firms with interlocked directors offer higher level of CEO compensation. In addition, Core et al. (1999) and Lambert et al. (1993) find that firms with a greater proportion of members on the board who are appointed by the CEO have higher levels of CEO compensation. This implies that members of the board appointed by the CEO have less independence in the decisions over CEO compensation.

Core et al. (1999) measured less independent directors by three different variables, namely; all outside directors appointed by the incumbent CEO, gray outside directors and interlocked outside directors. The authors define gray outside directors as the number of outside directors of the firm of whose employer receives payment from the company in excess of their board pay. The implication of these results is that the CEO has the ability and power to influence those less independent outside directors in his compensation setting decisions during the board meetings. Consistent to Core et al.'s (1999) findings, Wade et al. (1990) find that the number of less independent directors is positively related to CEO compensation.

In fact, Core et al. (1999) find broadly similar results on the link between board structure and CEO compensation. They also find that a CEO who also serves as a board chairman receives higher compensation than other CEOs. Many researchers recognised that if a CEO serves as a chairman of the board of directors, it provides him/her with wider freedom in setting pay packages (e.g. Harrison et al., 1988, Boyd, 1994, Agrawal et al., 1991, Ramaswamy et al., 2000). Specifically, Harrison et al. (1988) argued that if a CEO and chairman of the board are two different individuals, there would be a greater objectivity in setting remuneration packages. Agrawal et al. (1991) and Boyd (1994) find a positive link between CEO duality and remuneration. Ramaswamy et al. (2000) find that CEO duality has a significant impact on CEO remuneration in non-family firms but has no significant impact in family-owned firms.

Other features of board composition that have been studied in the literature include board size and the percentage of insiders on the board. Core et al. (1999) and Ozkan (2007) find that board size is significant and positively related to CEO compensation. Likewise, Ozkan (2011) finds some evidence that board size is positive and statistically significantly related to CEO cash remuneration in a sample of UK firms. In addition, the study by Core et al. (1999) finds that total CEO compensation is negatively associated with the percentage of insider directors on the board. This is inconsistent with the assumptions of agency theory that managers will prefer to maximise their personal incentives than shareholders' incentives. The theory suggests that insider directors are expected to increase their compensation at the expense of shareholders. Evidence provided by Ramaswamy et al. (2000) show that the proportion of inside directors in the firm has no significant impact on CEO compensation for family-managed firms. This is contrary to the finding by Core et al. (1999). Collectively, these studies find mixed findings on board structure variables. Opportunities exist to replicate these variables on directors' compensation research in different frameworks, such as in separate industries or countries.

#### *3.2.3.4 Ownership Structure*

In earlier studies, some researchers provided explanations on the relationship between ownership structure and executive compensation using the framework of property rights (Jensen and Meckling, 1976, Alchian, 1977). These studies contended that incentives of the principal (shareholders) to monitor the executives of the company (agents) are affected by the ownership structure. In accordance with the agency theory perspective, it is impossible to observe both an agent's actions and monitoring costs. Thus compensation contracts are formed to align the interest of managers to those of shareholders. It is advocated that, when there is a dispersion of ownership, the link between pay and performance should be improved more than when there is a concentration of ownership.

In comparison with the analysis of corporate performance, size and board composition, there are few studies that link ownership structure with executive compensation. One previous study found evidence that managers who are majority shareholders in public held corporations receive slightly higher compensation than other officers in the same corporation (Holderness and Sheehan, 1988). In this study, the authors defined majority shareholders as individuals who own at least a half but not all the outstanding common shares. In contrast, an earlier study by Allen (1981) finds that the level of CEO compensation is negatively correlated to the percentage of

equity ownership held by the CEO and his family. Similarly, the study by Lambert et al. (1993) finds that CEO compensation is lower when there is high equity ownership by the CEO.

Specifically, Lambert et al. (1993) find that the level of CEO compensation is negatively affected by the percentage of ownership by the internal member on the board who own at least 5% of the shares outstanding. Likewise, Cheung et al. (2005) find that CEOs with large share ownership suppress their cash payments with dividend income according to a sample of 412 Hong Kong firms. Their findings reveal that CEOs with considerable ownership in the firm tend to demand less direct payment, because they are aware that they will receive substantial dividend income. According to Core et al.'s (1999) results, the level of CEO compensation is lower with a presence of a non-CEO internal board member or an external blockholder who owns at least 5% of the shares outstanding. This finding implies that external blockholders with substantial ownership are eager to oversee executive remuneration in the firm.

Hartzell and Starks (2003) find that institutional ownership is negatively related to the level of compensation but positively related to the pay-performance sensitivity of executive compensation. The implication of this finding is that institutions serve a monitoring role which reduces the agency problem between managers and shareholders. In the same way, Ozkan (2007) provides evidence of the role of institutional investors on CEO compensation. Her findings reveal that institutional ownership and blockholder ownership have a substantial negative impact on CEO remuneration according to an analysis of UK firms for the fiscal year 2003/2004. This finding is consistent with agency theory on the existence of active monitoring by institutional investors. The essence of this significant negative relationship is that institutional investors tend to increase shareholder wealth by way of reducing excessive payments to corporate executives.

On the other hand, Dong and Ozkan (2008) when analysing UK publicly-traded firms over the period 2000-2004, find that institutional ownership does not make a considerable difference in the determination of director pay level and pay-performance sensitivity. In their paper, the authors divided institutions in two groups namely; "dedicated" and "transient" institutions. Their results indicate that dedicated institutions minimise the level of executive pay and strengthen the pay-performance relationship. This confirms the fact that dedicated institutions serve as better monitors in overseeing remuneration of a corporate executive than transient institutions. Thus, dedicated institutions contribute significantly more in enhancing the firm

value than transient institutions. Since these findings have been indecisive, further research is needed that employs ownership structure measures to enhance scholars' knowledge in the field of managerial compensation.

#### *3.2.3.5 Human Capital Features*

Becker (1975) pioneered human capital theory and identified several employee features that are associated with lifetime earnings. He mentioned training such as formal education and on-the-job training as important human capital attributes, which can influence the level of individual remuneration. This was consistent with human capital theory as advocated by Mincer (1974) who argued that the number of years in education and labour market experience explains much of the variance in pay levels of employees. In addition, Hunter and Hunter (1984) argued that cognitive ability which generally minimises training costs through less required time for understanding is a strong determinant of job performance and can significantly increase employees' compensation. This introduces the notion that highly cognitive managers should be rewarded more than others because they reduce the overall cost of the company.

In the past, some studies found that CEO remuneration is determined by individual attributes (Mincer, 1974, Becker, 1964). These authors pointed out that the marginal product of a person is estimated by his/her human capital features such as education and experience. The empirical evidence on executive compensation in terms of human capital features and other labour market features is, however, limited and somewhat mixed. According to Agarwal (1981) who tested the relationship between CEO job complexity and human capital attributes, firm size which is a proxy for CEO job complexity was highly correlated with CEO compensation ( $r = 0.78$ ). In this study, CEO compensation was employed as one of the measures in human capital attributes. Also included was work experience and level of education as proxies for human capital attributes. Moreover, he finds that human capital variables such as experience and education have very little impact on the variance of CEO remuneration.

Starting from Becker's (1975) postulates, researchers have hypothesised that the level of compensation is positively related to the age of the executive. Despite the fact that the hypothesis is meaningful, the empirical findings are mixed. For instance, Ingham and Thompson (1995) find a significant positive relationship between CEO age and remuneration in a sample of UK building societies. Deckop (1988) finds partial support for a positive

relationship between executive age and remuneration in a sample of US firms. Contrary to these findings, Monti-Belkaoui and Riahi-Belkaoui (1993) find no link between CEO age and compensation. Similarly, Stathopoulos et al. (2004) noted that older managers in the organisation might be less effective in fulfilling their duties and responsibilities efficiently. As a consequence, these authors propounded that on average, management compensation may be negatively related to age.

In the recent study on directors' remuneration and performance in Australian Banking industry, Doucouliagos et al. (2007) use age as a proxy for experience. These authors established that age is an important factor that determines the level of executives' remuneration.<sup>6</sup> In the first place, these authors argued that additional experience may contribute to both performance and monitoring events of the company. However, if shareholders of the company are only focusing on firm performance in the process of determining managerial compensation, then the link between age and performance will not hold as a determinant of managerial remuneration (Doucouliagos et al., 2007).

Another important human capital feature that has been widely researched is the link between executive tenure and compensation. Most researchers have argued that tenure is a reflective measure of knowledge that an executive has accumulated over time and as a consequence has a positive impact on remuneration, (e.g. Finkelstein and Hambrick, 1988, Ramaswamy et al., 2000). These authors argued that CEOs who have held their position for long periods of time in the organisation build up power and are likely to be highly remunerated. In particular, Finkelstein and Hambrick (1988) propounded that CEO power in the organisation leads to a higher level of compensation benefits. This finding was consistent with many other studies such as O'Reilly et al. (1988) and Ungson and Steers (1984). Although some inconsistencies may be due to the adopted methodology, it is important to investigate further human capital features in the research of directors' remuneration.

### *3.2.3.6 Other Determinants of Directors Remuneration*

Determinants of executive compensation are complex and multi-dimensional and depend on the nature of the companies under investigation. There are other important factors that influence the

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<sup>6</sup> This finding was consistent with earlier studies such as Ingham and Thompson (1995) for UK firms as well as Deckop (1988) for US firms, although for this earlier American study the relationship was only partially supported.

level of executive remuneration in the literature. This section provides evidence of these factors from previous studies on executive compensation. According to marginal productivity theory, agency theory and also equity theory, executive remuneration can be influenced by market forces (Barkema and Gomez-Mejia, 1998). These authors emphasised that a firm needs to retain some relationship with the market going rate in order to attract and retain skilled executives in their organisations. Their results show that firms compensate their executives according to the comparison with other companies and the existing going rate in the executives' market. Ezzamel and Watson (1998) supported this view by providing evidence that CEO remuneration is significantly influenced by the market.

### **3.3 Directors Turnover**

#### **3.3.1 Introduction**

The theoretical background to directors' turnover stems from the research that links executive remuneration and corporate performance using the agency theory framework (Lausten, 2002). In recent research studying a sample of large US companies, Kaplan and Minton (2006) find an increase in CEO turnover from 10% per year in 1970 to 16.5% per year in 1998. Their paper finds an average of seven years for changes in a CEO position. In other words, by 1998 most of the larger US corporations had CEOs' tenures of seven years. Previous studies argued that managerial turnover is the best mechanism for encouraging corporate executives to achieve good performance for their firms (Holmstrom, 1979, Rosen, 1992). This argument suggests that managerial turnover seems to be a punishment to corporate executives following poor firm performance.

Over the last three decades several papers have been published that link CEO turnover to firm performance. While there are numerous studies that have predicted a negative relationship (e.g. Salancik and Meindl, 1984, Salancik and Pfeffer, 1980, Tushman and Elaine., 1985, Warner, 1985), other empirical findings have yielded mixed results. For example, studies by Allen and Sharon (1982) and Lubatkin and Chung (1985) show a significant negative relationship between changes in return on equity and managerial turnover, whereas studies by Harrison et al. (1988) and Robinson and Brief (1985) find there to be no significant relationship. A recent study by Kaplan and Minton (2006) finds that whilst internal turnover is significantly related to firm performance, external turnover is not significantly related to corporate performance. These authors defined internal turnover as the turnover associated to board of directors' decisions,

while external turnover is defined as a turnover resulting from a merger, bankruptcy or delisting from the stock market.

### **3.3.2 Executive Turnover and Corporate Performance**

Since the 1980s, empirical research has produced a large body of literature that examines the link between CEO turnover and firm performance. In the US context, Coughlan and Schmidt (1985) find a significant, negative correlation between yearly cumulative abnormal stock returns and the probability of CEO departure. This result accrued after controlling for routine retirements by eliminating CEOs aged sixty four and above. On top of this, these authors found an insignificant relationship in the older group of CEOs. Similarly, Warner et al. (1988) find an inverse relationship between the probability of management turnover and a firm's share performance.<sup>7</sup> Their finding relies on a sample of 269 firms listed in the New York and American Stock Exchanges. These authors have eliminated the managerial turnover that resulted from illness, death, takeovers, retirement and management succession. Their results suggest that corporate managers *are* punished through dismissal as a result of poor stock price performance.

Another study finds there to be a strong relationship between prior performance and the probability of directors' turnover (Weisbach, 1988). The author's findings indicated that companies with boards dominated by outsiders were more likely to dismiss their CEOs on the basis of performance than companies with insider-dominated boards. This study is more comprehensive than other earlier executive turnover studies since it has explored the difference in monitoring for managers who serve as inside directors and those who serve as outside directors. In the same vein of literature, Gilson (1989) and Murphy and Zimmerman (1993) find that the likelihood of executive turnover is inversely related to corporate performance. Using a sample of CEOs from 1971 to 1990, Murphy and Zimmerman (1993) find that any CEO's departure is preceded by poor performance. Overall, these results are consistent with the findings of Coughlan and Schmidt (1985) and Warner et al. (1988).

A pioneering paper by Kaplan (1994a) investigates the relationship between top executive turnover and corporate performance in the US and largest Japanese companies. In his paper, the

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<sup>7</sup> An earlier study by Furtado and Rozeff (1987) found a similar result that executives are replaced following firm poor performance.

author adopted four measures of firm performance, namely; sales growth, company stock returns, change in pre-tax income as a fraction of total assets and a dummy variable for negative pre-tax income. The results indicate that executive turnover is sensitive only to sales growth and company stock returns for US companies and for Japanese companies, to negative pre-tax income. These findings imply that shareholders of US companies are more concerned with stock performance and sales growth, whereas shareholders of Japanese companies are more concerned with the company's pre-tax profits.

The relationship between executive turnover and subsequent changes in the accounting measures of operating performance was previously analysed by Hotchkiss (1995) and Denis and Denis (1995). According to Hotchkiss (1995), executive turnover improves future firm performance. In her paper, she analysed a sample of 197 poorly performing firms and therefore, her findings may not be considered entirely conclusive. Denis and Denis's (1995) findings suggest that executive turnover tends to improve corporate performance. These authors studied 908 management succession events from 1985 to 1988. Their findings additionally indicate that a management dismissal tends to induce an improvement in firm performance, something not witnessed when a manager retires. The key insight of these findings is that the removal of poorly-performing executives is the best mechanism to improve future firm performance.

The study by Khorana (1996) has analysed the link between the performance of mutual fund managers and their being replaced in the firm. The findings of this paper indicate the presence of an inverse link between executive turnover and past fund performance. This result was significant for various measures of performance used in the study, such previous growth rates in fund asset base and objective, and risk adjusted portfolio returns. Likewise, Kim (1996) demonstrated empirically that firm stock returns have a persistent negative effect on the probability of CEO turnover. In this study, the author analysed the relationship between long-term performance and CEO turnover over the period 1981 to 1989 using 454 firms listed in the New York Stock Exchange.

In the late 1990s, Mikkelsen and Partch (1997) analysed secular changes in the turnover-performance relationship. Using a sample of 200 firms for two periods from 1984 to 1988 and 1989 to 1993, they compared the link between CEO turnover and company performance. Their results show a marginal decrease in CEO turnover rates across the two, five-year periods. It was also observed that 39% of CEOs left their firms in the first period and 34% left their firms in the

second period. Thus, CEO turnover rate declined by 5% during the two periods compared. They also additionally find evidence of a decline in disciplinary managerial turnover. The authors suggested that the fall in disciplinary executive turnover is due to the decline of takeover actions.

One of the UK studies by Dahya et al. (1998) finds a negative relationship between non-routine top executive turnover and abnormal stock returns from the previous year. These authors have analysed a sample of CEO departures taken from the Extel news service database and defined the top executive as either the CEO or chairman of the board. Similarly, Coffee (1999) finds that good corporate governance practices penalise managers for poor stock performance and low cash flow in the company. These findings are consistent with earlier studies in several countries such as Coughlan and Schmidt (1985) and Warner et al. (1988) for US firms, Kang and Shivdasani (1995) and Kaplan and Minton (1994) for Japanese firms, and Kaplan (1994b) for Germany's firms.

The work by Huson et al. (2001) has analysed CEO turnover and succession for a long period from 1971 to 1994. These authors divided their sample into four groups with six years of analysis and then separate between "forced" and "voluntary" CEO departures from their firms. Contrary to Mikkelsen and Partch's (1997) finding on a decline of CEO turnover rate, their study shows an increase in forced CEO turnover and outside replacement over time. Moreover, these authors find that boards of directors tended to be more effective in the later years of the sample period than earlier years. Their study is more comprehensive than many previous studies, because its analysis covers a very long period of time and also has a more comprehensive account of the reasons for CEO turnover.

Mian (2001) conducted empirical analysis basing on a sample of 2227 chief financial officer appointments from 1984 to 1997 in US firms. The author finds that turnover for a chief financial officer is preceded by negative excess returns and declining operating returns on assets in the period immediately prior. Additionally, the results indicate that turnover announcements for chief financial officers are related to a significant negative stock price reaction. The author also showed that abnormally high CEO turnover is followed with the turnover of a chief financial officer. This implies that the negative relationship between managerial turnover and firm performance is consistent for both CEOs and chief financial officers of the firm.

Consistent to Mian's (2001) findings, Dahya et al. (2002) argued there to be a negative relationship between CEO departure and corporate performance. Using specific data between seven years before and four years after the Cadbury report, their results indicate that both before and after adoption of the Cadbury report's recommendations the relationship is statistically significant. The relationship is much stronger, however after the issuance of the Cadbury Code of Best Practice in 1992. Their findings indicate that there is high sensitivity of turnover to performance for firms that followed the proposed code. This suggests that the introduction of certain corporate governance principles increased the managerial turnover-performance sensitivity.

Another study by Dedman and Lin (2002) analysed the impact of shareholder wealth on CEO turnover. This analysis involves UK firms listed on the All Share Index between 1990 and 1995. Their main findings were documented as follows. Firstly, they found that firms that do not release news about CEO turnover vary significantly from official announcers in their prior market performance. This suggests that firms with worse performance records and higher chances of failure choose not to declare CEO departures in contrast to those firms which perform well. Second, the results show that the market reacts negatively to the news of top executives' departures, especially when the CEO is fired or leaves to take up another job. These findings imply that the disclosure of a CEO's departure can bring considerable financial risks to the firm through affecting share prices.

In a study of managerial succession and firm performance, Huson et al. (2004) finds that weakening firm performance fosters management turnover. Their findings indicate that on average, unadjusted, industry-adjusted and control group-adjusted operating return on assets show significant declines from three years before through one year before the turnover year. A firm's improvement in performance seems to arise from management turnover and managerial quality. In addition, their results demonstrate that post turnover-performance improvements were greater in the years, 1983 to 1994, than from 1971 to 1982.

Numerous recent studies find relatively similar results. For instance, Maury (2006) finds that an increase in CEO, top management and board turnover is generally a response to operating losses and poor stock price performance. His results reveal that there is increased sensitivity in CEO

turnover to performance in firms with two-tier boards compared to firms where the CEO or board member is a controlling shareholder. Fidrmuc and Fidrmuc (2007) provide some evidence that poor firm performance in the Czech Republic leads to higher probability of executive turnover. Their results also suggest that replacing a CEO in a newly privatised firm leads to subsequent performance improvement. Brookman and Thistle (2009), using data from large publicly-traded firms for the period 1993-2001, find that CEO tenure increases with firm performance. This implies that poor performance *is* followed by CEO removal.

Contrary to several discussed studies above, Franks et al. (2001) were unable to draw conclusions on the link between CEO turnover and corporate performance. They analysed a sample of poorly performing UK companies for the period 1988 through 1993. Specifically, they were unable to confirm a negative relationship between the two variables because the firms under investigation comprised more outside directors in their boards. Likewise, an earlier study by Kang and Shivdasani (1995) finds the sensitivity of CEO departure to firm performance to be unrelated to the percentage of outside directors. These authors also analysed a sample of 270 publicly-traded firms in Japan. Showing the same trends, several US studies also failed to document any significant relationship between top-level management changes and firm performance (Puffer and Weintrop, 1991, Dalton and Kesner, 1983, Friedman and Singh, 1989, Davidson et al., 1990).

### **3.3.3 Executive Turnover and Ownership Structure**

Previous research that compared ownership structure and executive turnover tends to be limited and somewhat mixed. For instance, Weisbach (1988) finds no evidence that larger top executive ownership reduces the probability of turnover, whereas Ofek (1993), using a sample of financially distressed firms documents a negative relationship between managerial turnover and equity ownership of directors and officers. Using a sample of two groups with similar performances, Denis and Denis (1994) finds that majority-owned firms have lower rates of managerial turnover than dispersedly-owned firms. These authors find that a block-holding of 25% is required to reduce the degree of managerial entrenchment and increase the probability of managerial turnover. Other research found there to be a negative relationship between management turnover and equity ownership of officers and directors, but did not scrutinise the effect of ownership structure on the sensitivity of turnover to performance (Mikkelsen and Partch, 1997).

It is commonly noted that top executives with a substantial share ownership in their firms are relatively hard to dismiss, regardless of the extent to which their firms are poorly performing (Dahya et al., 1998, Dedman, 2003). Some previous studies have highlighted different problems associated with managers holding significant shares in their own firms (Morck et al., 1988, Stulz, 1988). For example, Stulz (1988) has focused on the non-financial benefits for managers holding substantial equity ownership in the firm. He suggests that managers holding substantial equity ownership receive benefits such as opportunities to undertake pet projects and giving employment to family members and friends. These benefits are large enough to affect firm performance and as a consequence influence the turnover decisions of other top executives in protection of their own interests

It is argued that the higher the percentage of managerial share ownership, the lower the probability of top executive turnover (Morck et al., 1989). In other words, these authors propounded, it is very rare and difficult for managers of the firm to sack themselves. Their findings imply that higher levels of managerial ownership in the firm is associated with lower levels of managerial turnover. According to agency theory postulates, managerial ownership reduces the agency conflict between managers and shareholders and is mostly associated with managerial entrenchment irrespective of how the firm performs (Dahya et al., 1998). This is an indication that managerial ownership solutions do not act to align the interests of managers and shareholders.

Denis et al. (1997) analysed top executive turnover and ownership structure. Their results exhibit two major findings. First, they show that managerial ownership reduces internal monitoring mechanisms and is associated with low executive turnover rates even when firms are performing poorly. This finding indicates that managerial ownership has weakened the link between firm performance and executive turnover. Moreover, when they control for poor stock performance, their results indicate the negative relationship between the probability of top management turnover and managerial equity ownership. Finally, they show the probability of turnover to be considerably less sensitive to performance when directors' ownership is between 5% and 25% of the shares. These findings demonstrate that high managerial ownership tends to override the role of firm performance on executive turnover decisions.

Canyon and Florou (2002) find no evidence that managerial share ownership reduces the probability of executive turnover. Their research measures managerial share ownership as the proportion of ordinary shares owned by top managers in a sample of 460 largest UK corporations during the period 1990-1998. Furthermore, their findings show that managerial stock ownership does not affect the relationship between management change and firm performance. Indeed, it was observed that top executives are dismissed for poor performance, and this relationship has not changed over time. These findings imply that corporate governance directives hold for large firms in the UK despite the existence of managerial ownership in most corporations.

One earlier study found that the presence of blockholders or institutions<sup>8</sup> that own firm's equity reduce the degree of entrenchment associated with managerial ownership (Shleifer and Vishny, 1986). In a similar way, Denis et al. (1997) find a small, positive relationship between an institution with the equity stake of more than 5% and the likelihood of top executive turnover. In other words, as the number of institutions holding more than 5% in the firm increases, the probability of higher-management turnover increases accordingly. This implies that institutions tend to be good monitors and therefore, penalise corporate executives by firing them when they perform poorly.

In contrast to Denis et al.'s (1997) findings, Dahya et al. (1998), studying UK firms, find a negative relationship between institutional ownership and the probability of top executive turnover. This apparently conflicting finding may result from the sample bias and the institutions' behaviour of investing in larger firms rather than in small firms. Similar to Dahya et al.'s (1998) results, Neumann and Voetmann (1999), using a sample of 81 turnovers and 81 matching companies listed on the Copenhagen Stock Exchange, find that institutional investors with share ownership in the firm tend to protect managers from being replaced.

Studying Italian firms, Brunello et al. (2003) finds there to be a strong relationship between changes in controlling shareholders' ownership and different probabilities of executive turnover. Their results indicate that ownership change does affect turnover-performance sensitivity. Specifically, there is a negative link between CEO turnover and growth of operating income for firms that change their controlling shareholders, but no link between CEO turnover and firm

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<sup>8</sup> In the previous literature, most studies use the term institutions to represent institutional investors such as insurance companies, mutual funds, pension funds etc.

performance for firms that do not change their controlling shareholders. In general, their findings suggest a strong relationship between executive turnover and ownership change but a weak relationship between executive turnover and firm performance. This is inconsistent with many other studies that find a strong relationship between executive turnover and firm performance. The research linking ownership structure with executive turnover is far from being at an end. Findings from studies so far are very mixed, and require further investigation under different conditions.

#### **3.3.4 Board of Directors and CEO Succession**

The most important role of the board of directors is to evaluate the performances of executive directors. Most CEO appointees are selected from the inside directors who are more familiar with the company. However, this is not a guarantee that a CEO from within the company will be appointed. The decision to promote an internal director or hire an outside director remains a decision solely for the board of directors (Huson et al., 2004). CEO succession planning is the second most important responsibility of the board after fiduciary responsibility. Thus, the board is expected to appoint a CEO who will increase the value of the firm. Under these conditions, the board is expected to consider each individual's abilities in the recruitment process. According to Dalton and Kesner (1985), most firms will appoint insiders as their CEOs unless they have poorer abilities than outsiders, simply because the expense of appointing outsiders.

On the other hand, the appointment of a CEO from outside the firm is viewed as more beneficial to stockholders than when an appointment is made from inside the firm (Borokhovich et al., 1996). Their results show that announcements of managerial change make abnormal stock returns positive for outside successions and negative for inside successions. All these results were statistically significant for forced turnover. In contrast, Chan (1996) explained the effects on inside incentives of the inclusion of outsiders in the competition for a high position in the firm somewhat differently. The author argued that increasing the number of outside candidates in competition for positions reduces the motivation of lower level executives to perform well for their firms. The implication of this is that part of the motivation of employees to achieve promotion in the future.

There are numerous scholars who documented that fewer than 21% of the executives appointed to the top managerial positions are recruited from other firms (Denis and Denis, 1995, Warner et

al., 1988, Reinganum, 1985). In other words, their finding indicates that more than 78% of executives appointed in managerial positions are recruited internally. According to these results, lower executives in the firm will be motivated to work hard because of expectations of future promotion to higher level managerial positions. In analysing CEO turnover and outside succession, Parrino (1997) argued that, the relative costs of inside and outside succession varied significantly across industries. In particular, industries with more homogeneity between firms incur lower costs from the external succession of management.

Some studies in managerial succession raise important questions about the role that CEO turnover decisions play in problems that firms face from structural changes. These studies argue that high-level executive turnovers are associated with financial events. For instance, DeAngelo and DeAngelo (1989) find that managerial turnover is related to conflict or firm bankruptcy. Weisbach (1995) finds that managerial change increases with the likelihood of removing an acquisition that is obviously considered unprofitable in the company, and Asquith and Gertner (1994) find that managerial departures are connected with the asset changes of the firm. Using information from firms listed in the Copenhagen Stock Exchange, Neumann and Voetmann (1999) find that managerial succession is caused by knowledge of production technologies, and business conducts. Besides, these authors argued that the potential benefit of a CEO succession is increased by the existence of a pool of skilled successors.

Farrell and Whidbee (2002) find evidence that investigation of poor firm performance by financial journalists increases the probability of forced CEO turnover. The authors compared news stories for 79 firms that forced CEO change and a matched sample that did not force CEO change. Their findings show that firms in a sample of forced CEO turnover were the subjects of 76% more news stories about poor firm performance. This implies that the financial press that investigates poor firm performance exercise significant influence on boards of directors to change the CEO. Recently, Hillier and McColgan (2009) have examined the link between firm performance and managerial succession in family firms. They find that non-family CEOs are more likely than family CEOs to leave their position following poor firm performance. This implies that CEOs with high equity ownership entrench themselves in the firm. They also find that firm performance in a family-firm improves after the announcement of the departure of the CEO.

### **3.4 Multiple Directorships**

#### **3.4.1 Introduction**

There are few studies so far that have examined the effect of multiple directorships on corporate performance.<sup>9</sup> The relationship between multiple directorships and firm performance is controversial. Many shareholders have criticised the practice of individual directors of accumulating multiple board seats on a large number of company boards (Yermack, 2006). In 1995, there were several directors holding multiple board seats simultaneously. On average, more than 120 persons held eight or more board seats in the major American corporations.<sup>10</sup> The large part of the literature on multiple directorships can be grouped into two competing groups. The first group is the “reputational hypothesis” which supports the existence of multiple directorships as beneficial to shareholders and the firm. The second group is the “busyness hypothesis” which views multiple directorships as a detrimental to shareholders and the firm. The next two subsections discuss the materials on multiple directorships under two competing hypotheses.

#### **3.4.2 The Reputational Hypothesis**

Studies that support the existence of multiple directorships in the board of directors originated from Fama and Jensen (1983) who asserted that multiple board appointments is signal sign of superior director quality. It is argued that the appointment of a director to several boards is a result of previous better performance enjoyed by the firm in which an individual serves as a director or an executive. These authors also added that, if the market for directors is linked to firm performance, firm achievements can create more offers of board employment. Following Fama and Jensen’s (1983) arguments, later studies such as Gilson (1990), Kaplan and Reishus (1990) and Vafeas (1999) suggested the measuring of the reputation of a director by number of directorships held by the individual. The implication is that the more boards the director serves on, the better reputation he is likely to have and the better his/her quality.

Initially, in supporting the reputation hypothesis both Fama and Jensen (1983) and Ricardo-Campbell (1983) argued that directors working on multiple boards acquire a greater diversity of experience. The experience gained thus helps them to provide better advice and monitoring of

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<sup>9</sup> Some papers studied the impact of multiple directorships on firm performance include Kaplan and Reishus (1990), Fich and Shivdasani (2006), Ferris et al. (2003), Perry and Peyer (2005) and Sarkar and Sarkar (2009).

<sup>10</sup> Yermack (2006) argued that, in the year 2000 the number had dropped, on average, two directors were holding eight or more multiple board seats simultaneously.

firms' management. Gilson (1990) also found that outside directors who leave the boards of financially distressed firms on average lose one-third of their directorships three years after their departure. This implies that the market punishes directors following poor performance. Likewise, Kaplan and Reishus (1990) find that directors who reduce dividends for their shareholders are 50% less likely to obtain additional directorships.

Consistent with these findings, Brickley et al. (1999) find that the number of directorships held by retired CEOs is related to their firm's performance prior to their retirement. They find that CEO's retention on boards after retirement depends mainly on stock returns and further work on outside boards depends primarily on accounting returns. These results provide evidence that firms choose board members according to their previous performance. Studies supporting the reputational hypothesis indicate that directors of poorly performing firms suffer from a weak reputation because of the poor performance of their firms. In this way, directors working with underperforming firms are unlikely to obtain additional board seats in other companies. This set of research supports the positive view of multiple directorships as it tends to increase the level of experience among directors and therefore, is beneficial to shareholders and the firm.

There is considerable evidence that supports the positive association of multiple directorships with firm success. Cotter et al. (1997) find evidence that shareholders receive larger payments in tender offers when the board incorporates multiple directors. Brown and Maloney (1999) find evidence that firms enjoy higher returns from acquisitions when they have directors who hold multiple board seats. Miwa and Ramseyer (2000) using a sample of the cotton spinning industry in Japan find a strong link between multiple directorships and firm performance. Also, in Ferris et al. (2003), their univariate comparisons between firms indicate multiple directorships to be positively related to firm performance.

Previous evidence has also suggested that directors sitting in multiple boards may learn about different management styles and strategies used by other firms, (e.g. Booth and Deli, 1996, Carpenter and Westphal., 2001). Another set of research suggested that directors sitting on other boards are more able establish a network amongst themselves and monitor their business relationships (e.g. Mace, 1986, Rosenstein and Wyatt., 1994, Loderer and Peyer, 2002). For instance, Loderer and Peyer (2002), using a sample of Swiss firms, find a positive relationship between the firm value as measured by Tobin's q and the number of directorships held by the chairman of the board. Another study by Perry and Peyer (2005), show that announcement

returns are higher when the executive accepts outside directorships in financial and other related-industry firms. In other words, their results indicate that accumulation of board seats by executives has a positive impact on shareholders' wealth.

Fairchild and Li (2005) argued that board effectiveness in the monitoring of managerial actions depends on the quality of directors. Their empirical findings also suggest that there is a positive link between director quality and firm performance. Likewise, Keys and Li (2005) find a positive relationship between a director's reputation and the overall value of his/her human capital. Their finding suggests that professional directors are three times more likely to receive extra directorships after a successful offer of tender for their own firms. Recently, Sarkar and Sarkar (2009) provide evidence that supports the quality hypothesis and the resource dependency theory. They find that multiple directorships held by independent directors and firm value are positively correlated. They also observed that multiple directorships provide linkages with external networks to the firm which allow directors to learn different operational business strategies

### **3.4.3 The Busyness Hypothesis**

The Busyness Hypothesis views that the holding of multiple board seats by directors as infringing on their effectiveness as monitors of firm management because they are simply too busy. Directors with multiple directorships are considered poor monitors and therefore, detrimental to the accumulation of shareholders' wealth. According to Core et al. (1999), the existence of directors holding multiple directorships correlates with excess CEO compensation, which is harmful to shareholders' wealth. This suggests that corporate managers rewards themselves unnecessary compensation at the expense of the shareholders. The primary insight here is that independent directors are too busy with external workloads to monitor CEO actions effectively.

Similarly, Shivdasani and Yermack (1999) provide evidence that questions the level of independence for directors holding multiple board seats. Their findings indicate that directors with multiple directorships are more likely to be selected for an additional board seat if the CEO of the firm is involved in the recruitment process. This implies that multiple directorships amongst firms provides an opportunity for CEOs to create boards supporting their own interests rather than boards which look to the interests of their shareholders. Fich and Shivdasani (2006)

reconsidered the link between multiple directorships and firm performance. Their results support the idea that busy directors impinge on firm performance. In particular, they find that firms with boards consisting of outside directors holding three or more directorships tend to have weaker corporate governance, lower sensitivity of CEO turnover to firm performance, lower profitability and lower market-to-book ratios.

Jiraporn et al. (2008) finds that directors' busyness and firm value are inversely related. Their findings reveal that firms whose board members hold multiple board appointments suffer a deeper diversification discount. Also, the negative impact of multiple board seats on firm value is more prominent in firms where agency costs are more severe. Another study by Jiraporn et al. (2009) has examined the effects of multiple directorships on board meeting attendances. Their results show that directors holding many board seats are more likely to be absent in the board meetings. This implies that multiple board appointments keeps directors uninformed about the progress of the firm. These studies collectively predict an inverse relationship between the number of multiple directorships and corporate performance.

#### **3.4.4 Factors Determining Multiple Directorships: A Discussion of Previous Studies**

Discussed in the literature are several factors that may determine the existence of multiple directorships. Booth and Deli (1996), for example have examined factors affecting the number of outside directorships held by CEOs. This is the most comprehensive study with so many factors analysed in this context. A member of the US popular press suggested that self-serving CEOs accepted multiple directorships as a form of perquisite consumption and that it was similar to a "CEO disease" in corporate America (Byrne et al., 1991). In support of this view, Booth and Deli (1996) argued that CEOs accept multiple board seats until the personal benefits from taking additional directorship was equal to the personal costs. In addition, the authors argued that shareholders prefer a CEO who acquires multiple board seats until the marginal benefits to the firm is equal to its marginal costs.

An earlier study by Mace (1986) mentioned prestige as a factor that may influence multiple directorships. Specifically, the author argued that some executives seek additional board seats in other firms for reasons of prestige. Their evidence shows that in the business community, a CEO holding multiple board seats enhances his status over time. Personal prestige influences the number of multiple board seats an individual director is willing to acquire. Smith and Watts

(1992) argued that CEOs who manage firms with growth opportunities are scarce and hold higher level of marginal productivity than those who manage firms with existing assets. This implies that CEOs of companies with growing opportunities hold fewer multiple board seats than CEOs of companies with existing assets.

Consistent with Smith and Watts' (1992) results, Booth and Deli (1996) find a negative relationship between a firm's growth opportunities and the number of outside directorships held by the CEO. This suggests that CEOs of firms with growth opportunities need fewer time-consuming multiple board seats. On the other hand, their findings indicate that CEOs of firms with existing assets need more time-consuming outside directorships. In summary, firms with existing assets influence the existence of multiple directorships, whereas firms with growth opportunities discourage the existence of multiple directorships.

Some earlier studies find that firms improve their networking through exchanging directors, (e.g. Allen, 1974, Schoorman et al., 1981). Also, Booth and Deli (1996) find that the relationship between corporate boards is an important factor in the number of multiple directorships held by CEOs. Specifically, their findings show that CEO participation in exchanging directors helps to strengthen the relationships between these firms, which allows the sharing of strategies in their business undertakings. Other previous evidence indicates that outside directorship is affected by CEOs who delegate authority to their eventual successors (Vancil., 1987). The author finds that CEOs hold more board seats as they delegate decision making to their eventual successors. This implies that CEOs' delegation of authority is positively related with multiple directorships.

CEO tenure and the number of outside directorships are positively associated (Booth and Deli, 1996). In plain terms, as the CEO tenure in the organisation increases, the CEO's number of outside directorships also increases. These authors also mentioned regulation of companies as another factor that affects the number of multiple board appointments held by the CEOs. They asserted that regulated industries are less competitive and therefore, the regulatory process itself controls CEO actions. The imposed controls can hinder the CEO taking outside directorships to work as a function of the firm's investment opportunities. Their results indicate that in regulated industries, the firm's investment opportunities are unrelated to the number of outside directorships accepted by the CEOs.

Lorsch and MacIver (1989) argued that the lack of time that directors have to fulfil their responsibilities in their boards may influence the number of outside directorships that an individual director can hold. In support of this view, Lipton and Lorsch (1992) mentioned that lack of time is a widely shared problem among corporate directors. The authors argued that most directors do not have adequate time to carry out their duties properly. Bryne (1996), argued that directors who spread their time by taking too many outside directorships, reduce their ability to attend board meetings regularly and monitor management properly. Directors who are able to meet on a regular basis are more likely to perform their responsibilities effectively in accordance with shareholders' interests. For this reason, the time constraints of corporate directors reduces the number of multiple board seats that an individual director can take.

### **3.5 Summary and Conclusion**

This chapter has surveyed several studies which reach a different conclusion. The chapter covers three main topics of corporate governance, namely; directors' remuneration, directors' turnover and multiple directorships. In the first topic, the survey revealed the following important issues. Firstly, directors are compensated in a variety of ways, including salaries, meeting fees and stock awards or options. Second, I noted that the casual direction between director remuneration and firm performance is unclear. Some studies find that directors' compensation is significantly affected by firm performance (e.g. Conyon, 1997, Hubbard and Palia, 1995), whereas other studies find no obvious link between directors' pay and corporate performance (e.g. Ozkan, 2007, McKnight and Tomkins, 1999). Other studies find there to be a very weak relationship between managerial remuneration and firm performance (e.g. Conyon and Leech, 1994, Girma et al., 2007). These findings create considerable confusion that requires further empirical investigation.

Thirdly, I found that most research on boards and compensation has focused on pay for executives rather than non-executives or the whole board (e.g. Core et al., 1999, Mehran, 1995). This suggests that future research should focus on pay for non-executives and the whole board. Finally, I observed that the majority of previous research employed the principal-agent theory to explain the pay-performance relationships (Jensen and Meckling, 1976). The findings from most studies suggest that firm performance may drive directors' pay rather than the other way

round. An attempt to use other theories such as stakeholder theory and stewardship theory would be of a great utility in directors' compensation research. It would seem equally plausible to employ alternative measures of performance such as customer satisfaction and product development instead of repeating the common measures of performance.

In the second topic, my survey observed the following major issues. Firstly, although there are several studies that find a significant negative relationship between top management turnover and firm performance (e.g. Warner et al., 1988, Dahya et al., 2002), other empirical findings have been mixed. For instance, Harrison et al. (1988) and Puffer and Weintrop (1991) find no significant relationship between managerial departure and firm performance, while Franks et al. (2001) were unable to draw a conclusion on the link between CEO turnover and firm performance using a sample of UK corporations for the period 1988 through 1993.

Secondly, I found that most studies analysed the relationship between managerial turnover and firm performance using only agency theory as the main foundation of the association (e.g. Dedman, 2003, Maury, 2006). Nevertheless, the nature of the results in the research suggests that there is no single theory that can fully describe the turnover-performance relationships. For this reason, any research that may analyse turnover-performance relationships in the context of multiple theories such as stakeholder theory, human capital theory, and social network theory along with agency theory would be important. Clearly, the adoption of alternative measures of firm performance will enhance scholars' understanding of managerial turnover research.

In the final topic, this survey observed two main things. Firstly, I discovered that the literature that links multiple directorships and firm performance is scarce. There are relatively few studies in multiple directorships in comparison with other corporate governance topics. The more prominent publications include the studies by Ferris et al. (2003), Perry and Peyer (2005) and Fich and Shivdasani (2006) among others. The limited research suggests that further empirical research is needed to broaden the literature of multiple directorships in the corporate governance research.

Secondly, I noticed that the findings from studies of multiple directorships have been inconclusive. For example, Core et al. (1999), Fich and Shivdasani (2006) and Jiraporn et al. (2009) reached a conclusion that multiple directorships leads to poor firm performance. The

findings by Perry and Peyer (2005) indicate that multiple directorships enhance the firm value, while the findings by Ferris et al. (2003) reveal no evidence that multiple directorships held by outside directors affects firm performance. The mixed findings of previous studies suggest that further evidence is needed on multiple directorships' research. Systematic studies are especially required to investigate if there is potential relationship between multiple directorships and corporate key strategic decisions.

Overall, much has been learned about corporate governance in public corporations in the past thirty years. Nevertheless, there is still much research to be done. This survey has demonstrated that the empirical literature on corporate governance in public firms is fairly well developed, but the theory is still in its infancy. This suggests that further developments in theory will lead to more stylish empirical analyses. Also, the governance of companies other than for-profit corporations is a comparatively unexplored topic. Both empirical and qualitative research aimed at understanding these corporations is likely to bear fruit shortly. The next chapter provides a discussion of the empirical context for this thesis, namely, the football industry with a specific emphasis on its institutional framework.

## **4 INDUSTRY BACKGROUND AND INSTITUTIONAL FRAMEWORK**

### **4.1 Introduction**

This chapter is divided into four main sections which are all essentially related. Section 4.2 focuses on the background of soccer firms in the UK. This section describes the formations and reforms of football companies, their associations and leagues in Britain. In addition, this section discusses the management of these firms in early years, the objectives and the special features of football companies. Section 4.3 focuses on the regulation of the industry. The section details how football authorities, legal authorities and the government interact to regulate the industry in the UK. Section 4.4 explains the accounting formalities that are concerned with football companies. The section analyses the accounting of players and other assets in the financial statements of the football firms.

Section 4.5 describes the corporate governance framework encompassing soccer firms. This section mainly explains the guiding principles used to control corporations in the UK. This means that the focus is on the underlying requirements of the Companies Act and Combine Code principles, which reveal provisions that make up the structure of UK corporate governance framework. The UK is a union of four constituent countries, including England, Northern Ireland, Scotland and Wales.<sup>11</sup> In this chapter I have focused on England and Scotland which are more relative to my area of investigation.

### **4.2 Background of Football Industry**

#### **4.2.1 Soccer Firms Reforms**

The establishment of soccer clubs arises from a range of social groups and institutions, which were connected to education, religion and workplaces. Taylor (2008) propounded that school

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<sup>11</sup> Two words needing clarification, within this dissertation the terms 'United Kingdom' and 'Britain' are used interchangeably throughout.

teachers were foremost in establishing football clubs in many areas. The popularity of the game was fully utilised by scholars following the massive increase in the numbers of teacher training colleges. It was found that new teachers were willing to establish soccer clubs with their pupils and were ready to play the game themselves. The author provided an example of Sunderland, where in 1879, James Allan, a Scottish national, was involved in organising the Sunderland and District club which later became Sunderland FC. Another example is that of William Harrison, a teacher originally from Liverpool, assisted the formation of the Redcar club. In Middlesbrough, earlier clubs were formed after a number of pupil teachers were heavily involved in their formation, especially after coming to understand how to popularise the game (Bilsborough, 1983).

The significant role played by churches, chapels and other religious bodies has long been recognised in the formation of football clubs in Britain. Some of the England's famous clubs such as Aston Villa, Birmingham City, Bolton Wanderers, Everton and Fulham originated from Sunday School teams during the 1870s and 1880s (Mason, 1980). In the mid-1870s, church-based teams were common competitors in the growing cultures of football around the areas of Blackburn, Nottingham and Sheffield. The study by Molyneux (1957) in the Birmingham District showed that about 24% of clubs were linked to religious organisations in the seasons 1876/77, 1879/80 and 1883/84. Despite the fact that soccer started relatively late in Liverpool, by 1885, just over 22% of clubs were church related (Taylor, 2008).

In Scotland, religious relationships particularly played a particularly large role in the formation of the earliest Scottish clubs. For instance, members of Young Men Christian Association (YMCA) established the Queen's Park club in Glasgow in 1867. Others were Moffatt FC formed in 1879 by the Rev. W. H. Churchill, and Hibernian formed in 1875 at St Patrick's Church in Edinburgh by the Catholic Young Men Society (CYMS).<sup>12</sup> A group of young men from Glasgow formed Rangers in 1873. About the foundation of Rangers, there has been considerable debate amongst scholars. Finn (1991) claimed that the formation of Rangers came from within a tradition of religious and politically affiliated clubs, whereas Murray (1998) argued that there was nothing religious in the formation of Rangers.

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<sup>12</sup> These descriptions originated from the recent book by Taylor (2008) that described the social history of the association game in the British context.

Workplaces were also important areas for the formation of soccer clubs. For example, Arsenal and West Ham United were originated at the Woolwich Arsenal and Thames Ironworks respectively. In particular, Arsenal was founded in 1886, whereas West Ham United was established in 1895. Molyneux (1957) documented that there were 25 work teams competing in Birmingham during 1871, 1875 and 1880. Similarly, Mason (1980) documented similar number of clubs competing in Sheffield in selected years between 1873 and 1885. It is important to recognise that the formation of football clubs did not only originate from institutions but also from the community, neighbourhood and streets. Most clubs today are named after their city or street names.

#### **4.2.2 Football Associations Formation**

The popularity of soccer in Britain grew rapidly in the mid-19<sup>th</sup> century. There is much evidence for the rise of football during this period. One element of this was the establishment of numerous national and local associations of football throughout the UK. This section examines particularly the formation of national associations. The first national association was the Football Association (FA) in England established in 1863 after a series of formal meetings held in London. The Scottish Football Association (SFA) was created in 1873, ten years after the formation of the FA. This was followed by the Football Association of Wales (FAW) formed in 1876, and in 1880 the Irish Football Association (IFA) emerged.

The expansion of football associations was intensified through the growth of club membership and development of cup competitions. The FA had 30 member clubs by 1868, which increased to 39 member clubs in 1870 (Williams and Wagg, 1991). In the 1870s, there were massive expansions of the city and county based associations throughout Britain. Mason (1980) noted that most associations in the country wanted to be associated with the FA. In the mid-1880s, the FA became an umbrella body and managerial mechanism for the local associations which were growing up throughout the country. The FA initiated the FA Challenge Cup in 1871/72 season, which was based on a public school competition at Harrow and inspired the FA's secretary of that time, Charles W. Alcock (Williams and Wagg, 1991). The author also mentioned the importance of Sheffield football to the innovation of this knock out competition.

Initially, the FA Cup attracted only 15 clubs in the competition. Most of these clubs were from London-based public school. The other participating clubs were Donington Grammar School

from Lincolnshire and Queen's Park from Scotland.<sup>13</sup> By 1876, the FA Cup entrants increased to 39 clubs and also included the Druids from Ruabon in Wales. In general, cup competitions were started after the creation of associations. In Wales, the Welsh cup competition started in 1877/78 season, one year after the formation of their national association. The only exception was in Scotland where the creation of SFA started at the same time as the cup competition in 1873. There were eight clubs in their first competition.

#### **4.2.3 Football League Formation**

The Football League was formed in England in 1888 following an advisory meeting of leading clubs organised by William MacGregor, a Birmingham draper and a member of the Aston Villa committee (Russell, 1997). The meeting was held in Manchester, and to begin with, its' founders were more concerned with quality control among participant clubs throughout the country. At the beginning, there were only 12 founder members of the league. Geographically, most of the club members were from the Lancashire and the Midlands regions. By 1905, the Football League had started to expand rapidly with 40 member clubs.

The Scottish Football League was formed in 1890 following a meeting of 14 clubs in Glasgow. The league started its operations in 1890/91 season with 11 club participants. Unlike the formation of the FA, the SFA preceded the legislation of professional football in Scotland (Taylor, 2008). The league started to grow in 1893/94 season by launching the Second Division with 10 member clubs. Both the English and Scottish leagues grew with several changes in their divisions and member clubs, especially in the inter-war period. In addition, the procedures for promotion and relegation between divisions changed from time to time, often radically.

By the mid-1980s, the leagues had become characterised by a highly unequal distribution of economic power and, as a consequence, became less competitive (Taylor, 2008). For instance, during the period of 1980 through to 1989, Liverpool won the Football League championship six times followed by Everton with two wins. In Scotland, Celtic won the Scottish League championship four times followed by Aberdeen who won three times. It was observed that leading clubs were gaining a greater share of the game's revenue through dismantling many of the cross-subsidisation arrangements, which had aimed to enhance the level of competition. The English Football League was restructured in 1992 following recommendations of the Taylor

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<sup>13</sup> Williams and Wagg (1991), as well as Taylor (2008) provide details of earlier cup competitions in Britain.

Report and the FA Blueprint (Taylor, 2008). The new structure separated the First Division into a new independent league called the FA Premier League, while the other three divisions remained under the control of the Football League.

In Scotland, the new structure started in 1997/98 season, when the First Division formed a breakaway league independent of the Scottish Football League known as the Scottish Premier League. The other three divisions remained under the control of the Scottish Football League. Currently, these league structures are still operating in both England and Scotland, although there have been some minor changes of club membership in their respective divisions. Since the introduction of these new league structures, the system of promotion and relegation has also undergone various changes.

#### **4.2.4 Management of Football Firms**

##### *4.2.4.1 Directors*

Historically, football clubs were voluntary organisations comprised of voting members and run by committees. The increase in financial demands from the growth of gate receipts and the emergence of professionalism contributed to the transformation of football clubs into limited liability companies, with shareholders and a board of directors (Russell, 1997). Also mentioned was the example of Small Heath Football Club which later became Birmingham City and the first club to make these changes, in 1888. By 1921, Northampton Town and Nottingham Forest were the only two clubs out of 86 member clubs of the Football League which had not followed suit. Interestingly, most previous studies indicated that skilled men and businessmen were those who held the majority of shares in football clubs (e.g. Tischler, 1981, Mason, 1980, Vamplew, 1988). Specifically, Vamplew (1988) found that among the shareholders, 37% were manual workers but these held only 18% of shares in the clubs, on average. Most of the rest of the shares were owned by business people and skilled workers.

The great majority of major shareholders became directors of these clubs. The motivation which drew these people into the boards of football clubs has proven to be a productive topic for academic theory (Russell, 1997). Some argue that the motivation was not to obtain any personal reward but rather the success of the club and sports in general. Others believe that there were indeed significant financial incentives behind their taking up positions on the board. It is, however, unquestionably the case that many directors were football fanatics who simply desired

to be involved in the sports that they had played or watched. Finally, the FA disallowed the payment of a salary to directors and restricted dividends to shareholders to 5%, which later increased to 7.5% after the First World War (Taylor, 2008).

The author noted that although there were no restrictions amongst the Scottish clubs, few shareholders received direct returns. Specifically, only Celtic and Rangers derived their joint business through paying dividends to shareholders on a regular basis. In their 1897/98 annual accounts, Celtic paid 20% as dividends followed by 10% for the next seven years. Taylor (2008) documented that Celtic paid £50 for each senior director in 1913. Vamplew (1988), observed that only two other Scottish clubs paid dividends from 1906/07 through the 1913/14 seasons. There were, however, other financial motives that were available for directors in football firms. Some authors mentioned the tendency of directors to award themselves contracts such as the supply of catering services and grounds maintenance (Tischler, 1981, Russell, 1997). Vamplew (1988) showed that indeed, only Newcastle United prohibited its directors from being involved in the tendering process.

#### *4.2.4.2 Supervisory Bodies*

The Football Association and the Football League forged a working relationship to oversee football clubs and their players. The league accepted the FA's position as the game's overall governing body (Russell, 1997). The two bodies were effective and productive in controlling common problems in the game, including the players' trade union which was often seen as a source of tension and conflict in the industry. Russell (1997) insisted that the FA was respected as the autonomous governing body and maintained a constant pressure to minimise the economic elements within the Football League and the professional game. In particular, the FA controlled the transfer system restricting its free operation between 1889 and 1904.

In 1905, the FA imposed a maximum transfer fee of £350 following the first ever £1000 transfer fee of Alf Common from Sunderland to Middlesbrough (Russell, 1997). The governing body was also active in controlling wage levels and bonuses through the introduction of maximum wages and banning bonuses after 1900 (Taylor, 2008). In England, the maximum wage was set at £4 per week from the beginning of 1901/02 season, whereas in Scotland, the SFA did not introduce the maximum wage schemes during this period. The author mentioned other measures

taken by the FA that included a restriction of dividends beyond 5% and the discouragement of the use of the betting market for football matches.

#### **4.2.5 Objectives of Football Firms**

The objectives of professional football clubs are not obvious and straightforward. There is still no widespread agreement as to whether football clubs are primarily societal or business organisations. Football firms state their objectives in the Memorandum and Articles of Association. The most common statement in the objective section is “to promote football as a sporting activity and as a business”. There is however, a conflict of interest in these objectives which has implications for corporate governance in terms of performance trade-offs (i.e. the balance between financial returns and sporting success). Thus, existing literature in professional team sports understands there to be two different objectives for these firms. Essentially, football clubs operate in abnormal markets with the objective of maximising some combination of financial returns and non-financial returns.

In studies made around 1970s and 1980s, it was common to describe clubs as utility maximisers, seeking to maximise playing success subject to a minimum financial performance requirement such as break-even (e.g. Sloane, 1980, Sutherland and Haworth, 1986, Sloane, 1971, Arnold and Benveniste, 1987). In particular, Sloane (1971) analysed British football clubs and concluded that utility maximisation was their chief objective. He insisted that clubs were planning to maximise playing success subject to a minimum profit constraint. Similarly, other later studies suggested that team sports aimed to maximise winning percentages (Szymanski and Smith, 1997, Kesenne, 1996, Kesenne, 2000). This description is in conflict with conventional companies’ objectives of profit maximisation. The objective of the firm for these studies is somewhat inconsistent with the agency theory viewpoint. Indeed, until the early 1980s, most British football clubs were loss-making. Thus during this time, most clubs were primarily social not commercial organisations.

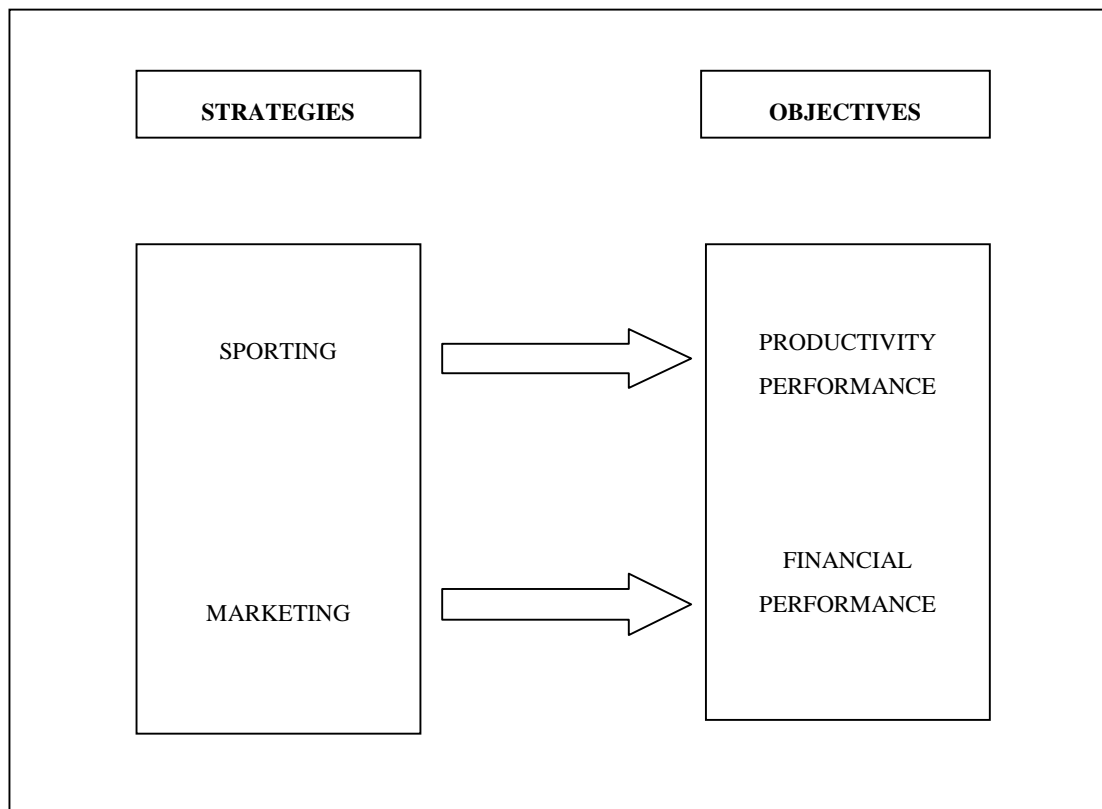
More recently, the emergence of a new breed of directors, especially in elite clubs, changed the nature of football towards more of business outlook in the UK. In 1982, the FA had decided to withdraw the well-known regulation of limiting shareholders’ dividends to 7.5% (King, 1998). This motivated entrepreneurial businessmen such as David Dein, Irving Scholar and Martin Edwards to establish themselves as directors of Arsenal, Tottenham Hotspur and Manchester

United respectively. These new directors rejected the traditional view of football as a unique business in which clubs were utility rather than profit maximisers. For them, football was essentially a business with a profit making objective. In consequence, Tottenham Hotspur became the first British club to be floated on the London Stock Exchange in 1983. This helped change the mind-set of other clubs' directors and many other clubs followed suit in the mid-1990s. It has been shown, however, that earlier commentators like William McGregor, the founder of Football League viewed football as business even in the early 1900s (Taylor, 2008).

Figure 4-1 illustrates the strategies and objectives of football companies. The sporting strategy deals with sales and acquisitions of players which aim to enhance productivity performance. The marketing strategy deals with the pricing of gate tickets, merchandising and sponsorships which intend to enhance the firm's revenues.

**Figure 4-1: Football Firms Strategies and Objectives**

This figure represents strategies and objectives of football companies. The sporting strategy aims to improve productivity performance, while the marketing strategy aims to enhance financial performance.



Source: Adapted and Modified from Callejo and Forcadell (2006).

#### **4.2.6 Special Features of Football Industry**

There are two important features of the football industry that differ from conventional industries. The first feature is based on league operations and coordination. The production of a football game requires the involvement of two distinct entities competing against each other. The teams which normally operate in a single league must agree on several matters before the competition takes place. There is no such arrangement in conventional industries where each firm is able to operate independently. It is obvious that football clubs cannot exist without rivals whilst other firms can in other industries. In plain terms, there is a monopoly in football at the league level but there cannot be at the club level. The FA Premier League is a monopoly but not the twenty teams that operate in that league structure.

There are three previous studies that have described the monopoly structure of sports leagues in the general sports industry. Neale (1964) propounded that the league is similar to the monopoly firm and the member clubs were the equivalent of multi-plant divisions of the monopoly firm. This suggestion assumes that any sporting league is in fact a natural monopoly. Sloane (1971) criticised Neale's (1964) view on this matter and suggested that professional sports leagues are cartels with the clubs being member firms of the cartel. He insisted that sporting leagues have several features similar to those of cartels. They include the size of the league (number of producers), the location of clubs (production centres), allocation of players (resources), pricing policies, merchandising sales, revenue sharing arrangements; in particular, that of TV deals and league sponsors.

A cartel arrangement in the sports industry is viewed as a necessary feature whilst in most industries it is generally viewed as illegal. This is one clear difference between the sports industry and other industries. Flynn and Gilbert (2001) as well as Noll (2003) suggested that professional sports leagues are similar to joint ventures. Both authors consider member clubs as independently owned and managed which collectively create a league as a joint venture for organising tournaments. Another important aspect of league coordination is competitive balance and the uncertainty of the outcome.<sup>14</sup> The output produced (the game), is maximised by two competing clubs when there is some degree of competitive balance and uncertainty of the outcome.

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<sup>14</sup> The literature on competitive balance and uncertainty of outcome is well explained by several papers such as Fort and Maxcy (2003), Fort and Quirk (2004), Hadley et al. (2005) and Sanderson and Siegfried (2003).

The theoretical literature argues that competitive imbalance in the league reduces the level of uncertainty of outcome and as a consequence reduces the level of consumer demand and thereby the revenue gained by individual clubs (Neale, 1964, Rottenberg, 1956, Kesenne, 2004, Fort and Maxcy, 2003, El-Hodiri and Quirk, 1971). The literature on uncertainty of outcome is mixed with contradictory findings from two main groups of scholars. Some studies have shown support of uncertainty of outcome hypothesis (Schmidt and Berri, 2001, Jennett, 1984, Cairns, 1987, Peel and Thomas, 1997), while other studies have shown weak or no support (Whitney, 1988, Peel and Thomas, 1988, Baimbridge and Cameron, 1996). Despite these differences in empirical findings on whether ‘uncertainty of outcome’ is an important determinant of customer demand it does make sense to argue that competition is essential for revenue generation.

The second feature is based on the potential conflict between the stability of financial and productivity performance. Football clubs are obligated to balance financial performance on the one hand with sporting performance on the other. Gerrard (2005) in his paper, called this phenomenon a “performance trade-off”. In actual fact, the balance depends on the ownership structure. There are quite different balances between productivity and financial performances in clubs which have rich owners compared to clubs that are listed on the stock market or are heavily geared. Productivity performance requires an incentive to invest in success, through buying players and paying high player wages to attract and retain best players. It is obvious that spending too much on playing talent leads to poorer operating profitability. Shareholders expecting return on investment will not appreciate irrational expenditures on playing talent and other facilities. The balance between playing success and financial performance of a club is a typical issue that requires application of stakeholder theory.

### **4.3 Regulation of Football Industry**

The regulation of the football industry is organised hierarchically from the top, the global authority of FIFA, the European remit of UEFA, the national Football Association, and at the bottom, the county associations as well as the individual clubs’ framework. The contemporary environment within which football industry operates is a combination of regulatory influences, including the football authorities, legal authorities, financial structures and governmental institutions, all of which have responsibilities for overseeing the way clubs behave and run their businesses. An insight into the regulation of the football sector is thus essential to a wider understanding of an individual club’s behaviour and performance. For the matter of clarity, this regulatory framework is set out in subsections as follows.

#### **4.3.1 The Football Authorities**

The football industry in the United Kingdom is regulated by football associations of its constituent countries. In the case of England and Scotland their respective football associations are the FA and SFA. The key objectives of these football associations include “*promoting the game at all levels, supporting and promoting the fair play and sportsmanship and furthering football’s commercial interests*” (Morrow, 1999 :pg 183). Members of these associations are the FA Premier League in England, Scottish Premier League in Scotland and respective Football Leagues in both England and Scotland. Morrow (1999), mentioned objectives of such leagues as, the “*provision of competitions, promoting and guarding the interests of the league’s constituent members and arranging commercial contracts*” (Morrow, 1999 :pg 183). According to these objectives, football clubs in England and Scotland are operating under the jurisdiction of dual regulatory bodies.

The principal responsibility of football regulatory bodies is to regulate on-field activities as well as the off-field activities of individual football clubs.<sup>15</sup> On-field activities include maintaining discipline among players and ensuring the rules of the game are enforced by match officials, whereas off-field activities include negotiation of television deals and other commercial contracts. Another responsibility of the regulatory bodies, particularly the FA and the SFA, is to ensure the overall health of the football game and its productive functioning for the community. It is insisted that these bodies are obliged to ensure the success of Association Football as a whole and not just the success of a few clubs (Morrow, 1999).

#### **4.3.2 The Legal Authorities**

In the past, many people believed that football was self-regulated and hence largely free from legal jurisdiction, both in terms of on-field activities and off-field activities (Morrow, 1999). Such belief, however, has disappeared in recent years after various high-profile legal interventions in football matters. Morrow provided an example of the on-field activity case that occurred in 1987, when three Rangers players (Terry Butcher, Graham Roberts and Chris Woods) and one Celtic player (Frank McAvennie) were charged with conduct provoking the breach of peace among spectators. The police and procurator fiscal did not accept that

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<sup>15</sup> Morrow (1999) described the key responsibilities of these football authorities on regulating the football industry in both England and Scotland.

misbehaviour in front of more than 40,000 spectators could be viewed as simply a matter for the football authorities. The players were prosecuted and the court fined Butcher and Woods after they were found guilty, discharged McAvennie, while the case against Roberts was adjudged, 'not proven'.

Another legal intervention in the football industry is that of Duncan Ferguson, a former Rangers striker who became the first Scottish professional player to be sent to jail after being convicted in 1994 of assault on a fellow professional player, John McStay, in a match against Raith Rovers (Morrow, 1999). An example of legal intervention on off-field activities is that of Bosman case. Jean-Marc Bosman, a former professional footballer with Royal Club Liegeois, sued his club and the governing body of Belgium's football (URBSFA). Bosman sued them after his club refused to instruct URBSFA to issue a transfer certificate to Dunkerque, a French club. In summary, Bosman successfully challenged the operation of the transfer system in Europe following the decisions made by the European Court of Justice in 1995.<sup>16</sup>

### **4.3.3 Government Interventions**

The government has several reasons to take an interest in the football industry which can be categorised as positive and negative reasons. In order to avoid government interventions in the regulation of football industry, strong and effective self-regulation is vital (Smith, 1997). In this way, the existence of effective and efficient self-regulation will safeguard the independence of football. Therefore, the main reason for government interference can be grouped in two areas. The first lies in the importance of football for the community. In the UK, the Government intervenes in the football industry for both negative reasons such as hooliganism and positive reasons such as enthusiasm for football, and its popularity and importance to both local and national communities.<sup>17</sup>

The second dimension lies in the imbalance between larger and small clubs in the industry. For example, the Labour Party had their policy document known as "A New Framework for Football, 1996" which considered the imbalance between top clubs and the rest, and the suitability of free market economics for the football industry (Morrow, 1999). Following their

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<sup>16</sup> More details can be found in the European Court of Justice on the case of Jean-Marc Bosman versus his club 'Royal Club Liegeois' and the Belgium governing body of football (URBSFA).

<sup>17</sup> The report by Sir John Smith to the Football Association highlights the main reasons for government intervention in the football sector.

success in 1997's general elections, the Labour Government fulfilled its commitment in the policy document by establishing a "Football Task Force" under David Mellor, as the chairman representing the views of ordinary fans with the objective of bringing football back to the people.<sup>18</sup> The Labour Government gave the "Football Task Force" several responsibilities, such as eliminating racism in football and encouraging wider participation by ethnic minorities (Football Task Force, 1999). Other responsibilities included improving disabled access to spectator facilities and encouraging supporters' involvement in running their clubs.<sup>19</sup>

#### **4.4 Accountancy of Football Firms**

The objective of this part is to examine and explain issues of accounting policies and procedures adopted by football companies in the United Kingdom. This section considers the nature and purpose of financial statements relevant to football firms. The discussion covers important issues unique to the football industry. Accounting policies and procedures are very wide and therefore, exhausting them all in a single institutional framework is almost impossible. The following materials are organised in subsections to provide an understanding of key elements in the accounting for the football sector.

##### **4.4.1 Accounting for Players**

The accounting treatment of players in the football industry has motivated much research for academics and practitioners. In recent years, both academics and practitioners have devoted much time explaining and analysing the treatment of players in the financial statements of a given club. In contrast to other traditional companies, it is interesting to consider players as assets in the company's balance sheet. In responding to the opinions of academics and practitioners, most major clubs started to adopt varieties of treatment of their investment in players since 1987 (Morrow, 1999).

Traditionally, there were no accounting practices that valued players in the company balance sheet, whether they were bought through the transfer market or developed internally by the club (Morrow, 1999). The transfer fees and associated costs were directly charged or credited in the

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<sup>18</sup> Morrow (1999) provides this example of Government intervention in the football industry.

<sup>19</sup> There are several responsibilities given to the "Football Task Force" by the Labour Government. More details of these responsibilities can be found in the report titled 1999. Investing in the Community: A Report Submitted to the Minister of Sport on 11 January. *London: Football Task Force*. Other details are also available at the national sports development website ([www.sportdevelopment.org.uk](http://www.sportdevelopment.org.uk)).

profit and loss account in their particular period (i.e. basing on the accrual principle of accounting). This method has affected the reported profits or losses by the amount of transfer fees receivable or payable since it does not consider the length of the player's contract. According to Morrow (1999), Tottenham Hotspur became the first club in 1989 to adopt an alternative treatment of players in their annual accounts. In their treatment, the cost of players' registration was recorded as an intangible asset on the balance sheet.

Most other clubs followed suit, including the Heart of Midlothian in 1990. They all recognised that the traditional practice did not reflect a true view of club's financial affairs. By 1996, there were 13 English clubs and five Scottish clubs that treated players' costs as assets in their financial statements (Morrow, 1999). The common treatment was to capitalise only those players acquired through the transfer market as intangible assets on their balance sheet. Morrow provided examples of clubs which has their own treatment in the amortisation procedures. For example, some clubs were taking acquisition costs less an estimated residual value at the end of the player's contract<sup>20</sup> over the period of an individual player's contract.<sup>21</sup> Other clubs incorporated a value of the entire squad on the balance sheet,<sup>22</sup> whether the player was bought through the transfer market or home-grown (Morrow, 1999).

The accounting treatment of players marginally changed in 1995 following Bosman Case under the European Court of Justice. The court ruled that, "*clubs could only charge a transfer fee for a player if he was sold during the period of his contract or if he was sold at the end of his contract to a club within the same EU member state*" (Morrow, 1999 :pg 125). Following this decision some clubs such as Rangers and Newcastle United reverted to their traditional methods (i.e. treating income and cost of player's registration in the profit and loss account), while the majority of the 18 clubs continued to capitalise those players acquired through the transfer market. This time the cost of acquiring player's registration was written off over his contract period. The author noted that during this period, the residual value was set as zero at the end of the contract and not estimated before.

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<sup>20</sup> Estimated residual value is the value of the player at the end of the contract computed using a UEFA multiplier dependent on a player's age being applied to his earnings.

<sup>21</sup> See clubs such as Northampton Town, Preston North End, Tottenham Hotspur, Aberdeen, Celtic, Heart of Midlothian and Rangers. Other clubs such as Derby County and Newcastle United were taking acquisition cost less an estimated residual value at the end of the player's contract over the period until the player attained the age of 33.

<sup>22</sup> Methods of valuation were different. For example, Portsmouth, Sunderland and Swansea adapted directors' valuation method, West Bromwich Albion adapted capitalised value method, and Dundee adapted valuation made by an independent panel of experience sports writers at the end of the year.

The formal accounting treatment of players in the club's financial statements is guided by Financial Reporting Standard number 10 (FRS 10) introduced by the Accounting Standard Board (ASB) in December 1997. This standard is titled "Goodwill and Intangible Assets" and was started to be used by companies since the accounting period ended on or after 23<sup>rd</sup> December 1998 (Black, 2003). The question of how football firms should account for players has been the subject of much controversy for several years,<sup>23</sup> where each club was adopting its own treatment method. However, the emergence of FRS 10 was a formal solution to these problems. It is argued that FRS 10 was primarily introduced to regulate the way larger multi-nationals such as McDonalds and Cadbury Schweppes account for goodwill and brand names which arises after acquisitions of other companies.<sup>24</sup>

Basically, the FRS 10 had two main objectives identified in the accounting and financial reporting literature. These objectives were mentioned as follows; "*to ensure that capitalised goodwill and intangible assets are charged in the profit and loss account in the period in which they are depleted; and to ensure that sufficient information is disclosed in the financial statements to enable users to determine the impact of goodwill and intangible assets on the financial position and performance of the reporting entity*" (Black, 2003 :pg 82). The next two subsections explain how FRS 10 is utilised in capitalisation and amortisation of players' registration costs in financial statements.

#### *Players Acquired Through the Transfer Market*

Why do we consider players as assets? Assets are defined as rights or access to future economic benefits controlled by an entity as a result of past transactions or events (ASB, 1995, Black, 2003). Players provide future economic benefits to the football company through their productivity performance at the ground. Productivity performance enables the club to generate revenue through gate receipts, merchandising, television contracts and sponsorships. Accordingly to this logic, the procedure of capitalising player's registration cost is unquestionable, given that a player generates future economic benefits to a firm. The important concern of FRS 10 is that intangible assets purchased separately from the business should be

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<sup>23</sup> There were also problems for conventional companies, especially in the treatment of goodwill and other intangible assets such as brand names, licences and newspaper mastheads on the company's balance sheet.

<sup>24</sup> It seems that the intention for FRS 10 was not specific for football firms, although its establishment served the same purpose.

capitalised at their cost, as long as the intangible assets are identifiable and controlled by the entity either through legal rights or physical custody (ASB, 1997b).

Under this framework, the football company does have control of a player during his contract period. Therefore, players acquired through the transfer market require recognition of them as intangible assets on the balance sheet (Morrow, 1996). In the practice of financial reporting, FRS 10 suggests capitalising the cost of a player's registration on the balance sheet, and then amortising that amount capitalised over the length of the contract (ASB, 1997b). Morrow (1999) mentioned that most clubs in the UK adopted this procedure except the West Bromwich Albion football company.<sup>25</sup>

Another important element of FRS 10 is the requirement for an impairment review at the end of each reporting period. The standard stated that, "*goodwill and intangible assets should be reviewed for impairment at the end of the first full financial year following the acquisition and in other periods if events or changes in circumstances indicate that the carrying values may not be recoverable*" (Black, 2003 :pg 85). In accounting, an asset is regarded as impaired when the recoverable amount (the higher the net realisable value and value in use) is less than the carrying value. The impairment review could prove difficulties for football firms, in particular, when there is a serious player injury or loss of a form by a player which requires the carrying value of an asset to be written off. In practice, the impairment provision protects users of financial statements by ensuring assets are never overvalued at higher amounts than the true recoverable amount.

In the UK, most clubs utilise the FRS 10 requirements, in particular for capitalisation, amortisation and impairment reviews. The following recent examples are taken from accounting policy notes of the 2005 annual reports illustrating the various treatments carried out by football firms.

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<sup>25</sup> Similarly, most Italian football clubs capitalised the player's registration cost through writing off the transfer fees over the contract life (Deloitte and Touche, 1988).

### *Intangible fixed assets*

The cost of players' registration is capitalised and amortised over the period of the respective players' contract in accordance with FRS 10 (Accounting for goodwill and intangible assets), (Aston Villa plc, Annual Report 2005).

### *Players transfer costs*

The costs associated with the acquisition of players' registrations are capitalised as intangible assets. These costs are amortised over the period of the players' initial contracts. The amortisation periods are between 1 and 5 years. An impairment review is also carried out on an annual basis, and, where there is evidence of impairment, players' registrations are written down as their recoverable amounts (Birmingham City plc, Report and Financial Statements 2005).

### *Home-grown Players*

Despite the convincing theoretical reasons for not distinguishing between home-grown and players acquired through the transfer market, the distinction is compulsory so as to comply with FRS 10.<sup>26</sup> This standard requires that an internally developed intangible asset be reported on the balance sheet if it has a readily ascertainable market (ASB, 1997b). It is clear that a football firm's players are good examples of assets that have a market value, but it is obvious that this is not the view of ASB. The ASB view that, "*an asset only has a readily ascertainable market value if, first, it belongs to a homogeneous population of assets that are equivalent in all material respect, and secondly, if an active market, evidenced by frequent transactions, exists for that population of assets*" (Morrow, 1999 :pg 129). The services offered by professional players are not homogeneous and therefore, fail to meet the ASB criterion for a readily ascertainable market.

#### **4.4.2 Benefits of FRS 10**

The advantages of FRS 10 to the football sector are straightforwardly observed. One clear observable advantage is the improvement of the quality and consistency of football corporations' financial reporting. Traditionally, football firms had chosen varieties of methods in accounting for players. It is beneficial to adopt FRS 10 because the standard requires all firms

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<sup>26</sup> Morrow (1999) reported that West Bromwich Albion is the only club which does not separate acquired and home-grown players on the balance sheet. This club incorporates every player's contract on its balance sheet using directors' valuation discretions.

to capitalise players acquired through the transfer market. This improves comparability within the football industry. Another obvious advantage is the improvement of the financial position for numerous firms as represented by their balance sheet, which enhances the ability of third parties to understand and analyse the financial statements of football firms. These benefits are also considered in other traditional companies because football firms are not the only firms for whom its primary assets are services of its people.

#### **4.4.3 Accounting for Other Assets**

Other than a player's registration cost, football firms own other fixed assets, including stadiums and other facilities such as hotels and restaurants. The accounting treatment for these assets is similar to those of conventional companies.<sup>27</sup> In the UK, companies' accounts are prepared under the 'historical cost convention'.<sup>28</sup> This requires that assets are to be shown in the balance sheet at their original cost. However, the Companies Act, 1985, modified the historical cost convention to allow for revaluations of land and buildings under specific conditions. In these situations, football companies can incorporate their stadiums on the balance sheet at either the original cost or valuations. In a few circumstances, a combination of the two ways can be adapted.

By 1997, there were 14 clubs that re-valued the quantity of assets on their balance sheet (Morrow, 1999). All clubs that re-valued their assets were adopting acceptable methods of valuation stipulated by the Royal Institution of Chartered Surveyors in its appraisal and valuation manual (RICS, 1995). Another relevant guidance of valuation was adopted from the ASB's Exposure Draft FRED 17 titled, "The Measurement of Tangible Fixed Assets" (ASB, 1997a). According to Morrow (1999), the majority of football firms adopted the Depreciation Replacement Cost (DRC) method of valuation. The ASB recommended this method as a basis of valuation for specialised properties (ASB, 1997a: para 48).

Similar to traditional companies, football firms provide depreciation charges for all fixed assets which have a finite economic life. The Accounting Standard Council (ASC) issued the Statement of Standard Accountancy Practice number 12 (SSAP 12) which deals with

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<sup>27</sup> The explanation on how companies' accounts are prepared is vast. However, for this research I have described only key parts of the explanation which are of importance in the present study.

<sup>28</sup> From 2005 onwards, all companies within European member states were required to use international accounting standards (IAS).

accounting for depreciation (ASC, 1997). According to this statement, the objective of the standard is to allocate the cost less any residual value over the useful life of an asset to reflect the use of an asset on an annual basis. It should be noted that in case of an asset revaluation, depreciation charge should be based on the revaluation amount of an asset and the estimated remaining life. In the past, some football firms<sup>29</sup> failed to comply with SSAP 12 by not depreciating their stadiums in a particular accounting period (Morrow, 1999).

## **4.5 Corporate Governance Framework**

### **4.5.1 Introduction**

Prior to the empirical analysis of this thesis, it is important to understand the framework of corporate governance mechanisms for soccer corporations. The system of governance encompassing the soccer industry includes the football authorities, corporate governance codes, stakeholders and the legal system. The guiding principles by which corporations are controlled are laid down in the Companies Act and supported with several codes of Best Practice that have developed overtime through reforms in corporate governance. This framework therefore, will focus on the Companies Act and the UK Corporate Governance Code.

The Companies Act 2006 has been issued to replace the Company Law provisions of the 1985, 1989 and 2004 Acts. The implementation of the new Companies Act was done in phases with the entire act taking place on October 2008.<sup>30</sup> The Combined Code has been improved several times by the Financial Reporting Council (FRC) that has led to the formation of the UK Corporate Governance Code 2010. However, the improvement was limited to the principles of the Combined Code 2003. Figure 4-2 provides the general overview of the way football corporations are governed. The system suggests that football firms are guided by a wide range of laws, regulations and governance codes. The overall aim for all of this is to ensure that firms are controlled with the objective of safeguarding the interests of all stakeholders involved in a football firm.

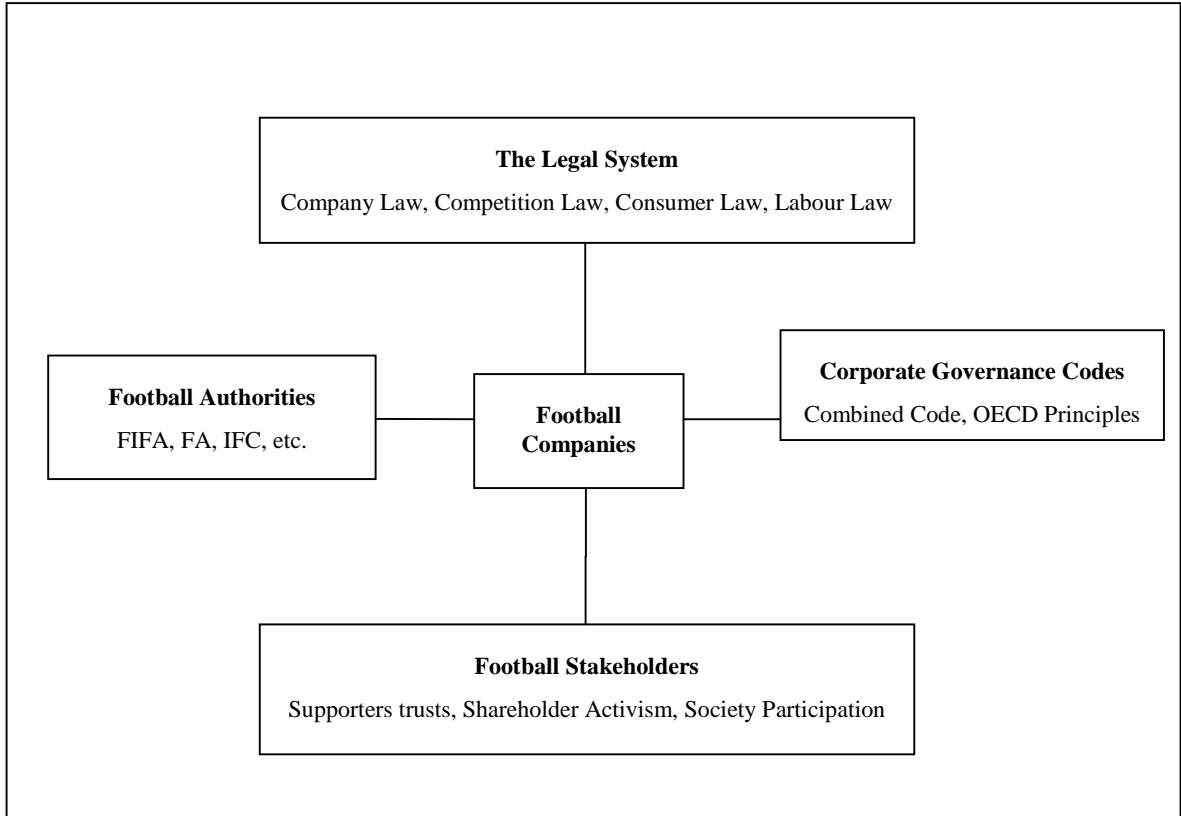
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<sup>29</sup> For examples, see clubs such as Arsenal, Blackburn Rovers, Coventry City, Everton and Manchester United in their 1997 annual reports. However, some of the traditional companies, especially in the industries of breweries, hotels and shops failed to adopt the standard too.

<sup>30</sup> This corporate governance framework is based on the Companies Act 1985 since it corresponds with the sample period.

**Figure 4-2: Corporate Governance System for Football Firms**

This figure provides the corporate governance system that encompasses the football industry. Football firms are guided by a wide range of regulators, including football authorities such as FIFA, FA and IFC. Other systems that guide football firms include corporate governance principles and the legal system such as company law, competition law and labour law. The main point behind these regulations is to make sure that these firms are controlled with the purpose of safeguarding stakeholders' interests.



Source: Adapted and Modified from Supporters Trust's Handbook

#### 4.5.2 The Companies Acts

The structure of corporate governance in the UK has its roots in the 1856 Joint Stock Companies Act which separated the owners (principals) from management (agents) and created the company as a legal entity. Prior to the full implementation of Companies Act 2006, the UK law regarding the operation and governance of companies is laid down in the Companies Act 1985 (amended by Company Law provisions of the 1989 and 2004 Acts). The UK corporate governance system works through bodies, in particular, the board of directors and the annual general meeting (AGM) where directors present annual reports to the shareholders. The following subsections describe these bodies as stipulated in the Companies Act 1985.

#### 4.5.2.1 *Functions of the Board of Directors*

Boards of directors are crucial in the process of running and controlling affairs of the company. The Companies Act 1985 mentioned that two or more directors may form a public company or one director if it is a private company.<sup>31</sup> The Act has made no distinction between the executive and non-executive directors; they all have the same duties in accordance with the company law provisions. In the UK, there is a single system of board of directors in contrast to other European countries like Germany and Netherlands where two tier-systems of board of directors operate. The Companies Act 1985 did not set out that a company should have non-executive directors as a legal requirement in its formation. However, the UK corporate governance reforms which began after the Cadbury Report 1992 and culminated in the UK Corporate Governance Code 2010 has stipulated the roles of non-executive directors and their importance in the business relationships with the company. The corporate governance literature views non-executives directors as effective monitors that oversee the executives' actions in controlling a company's affairs (Ezzamel and Watson, 1998, Cosh and Hughes, 1997).

The company law mentioned fiduciary duties that directors and other senior executives are required to comply with. Farrar et al. (1998 :pg 378-395) mentioned the following key duties as follows:

- the directors must act bona fide in the interests of the company and must not exercise their powers for any collateral purpose;
- a director who, by use of his position, makes a profit is liable to account for that profit;
- where a director finds himself in a position where his duty to the company and his personal interests conflict, any contract concerned is voidable at the instance of the company.

In addition to these duties, the Companies Act requires directors to keep accounting records, prepare and approve both company accounts and directors' reports. Despite these provisions that describe fiduciary obligations, directors are free to use their own judgment in running and controlling the company's affairs. Quoting from Article 70 of Table A (Companies Act 1985) it is stated that, "*subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolutions, the business of the company shall be managed by the*

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<sup>31</sup> Section 741(1) of the Companies Act 1985 defined a director as "[including] any person occupying the position of a director by whatever name called"

*directors who may exercise all the powers of the company*". It is important to note that shareholders should have nothing to do with the operation of the company. The operation of the company is to be handled completely by the company's directors.

#### *4.5.2.2 Functions of the Annual General Meeting (AGM)*

The AGM is the body through which shareholders are able to exercise their ultimate power over the company's directors. The Companies Act 1985 requires that every company should hold at least one general meeting at the end of each calendar year. In every AGM, shareholders are entitled to appoint and remove directors. This process is a formal decision that requires shareholders' approval in accordance with the Companies Act. Importantly, the Companies Act 1985 requires a copy of financial statements, a directors' report and auditors' report to be presented at the AGM. Overall, the company law recognises the AGM as the body in which shareholders are able to exercise their power over the directors of the company. For football firms, communication of shareholders with the company is normally limited to the receipt of the annual report and attendance at an AGM (Morrow, 1999).

#### **4.5.3 The UK Corporate Governance Code**

The first Combined Code was formed after the Hampel Report 1998 which reviewed the broad aspects of corporate governance; other reports incorporated were the Cadbury Report 1992 and the Greenbury Report 1995. The Combined Code was updated in 2003 to incorporate the Higgs Report 2003 and the Smith Report 2003 following the WorldCom and Enron Scandals in the United States. The Code was improved in 2006 but limited to the provisions of the Combined Code 2003. The Financial Reporting Council has recently published a new UK Corporate Governance Code 2010. This means that at present, companies are obliged to follow principles and provisions of the UK Corporate Governance Code 2010. However, this thesis incorporates the prescriptions from the Combined Code 2006 as it emerged during the sample period and includes all previous codes of corporate governance. The main principles of the UK Corporate Governance Code 2010 are attached in the appendix.

The main recommendations of the Combined Code 2006 which are relevant to the present research are summarised as follows:

- Every company should be headed by an effective board, which is collectively responsible for the success of the company.
- There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's affairs. No one individual should have unregulated powers of decision.
- The board should include the balance of the executive and non-executive directors (and in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision making.
- There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.
- The board should undertake the formal and rigorous annual evaluation of its own performance and that of its committee and individual directors.
- All directors should be submitted for re-election at regular intervals subject to individual performance.
- Levels of remuneration should be sufficient to attract, retain and motivate directors of the skills required to run the company successfully. However, a company should avoid excessive payments for unnecessary reasons. Payments should be linked to individual performance.
- There should be a formal and transparent procedure for fixing executive remuneration. No individual director should be involved in setting his /her own remuneration.
- The board should use the AGM to communicate with investors and encourage their participation in the company's business.

The above corporate governance principles are mandatory for all companies listed on the London Stock Exchange (LSE). Football companies are listed not only on the main market London Stock Exchange but also on the Alternative Investment Market (AIM) and the PLUS (formerly OFEX) market. The current rules for AIM and PLUS companies do not include any disclosure requirements with regards to corporate governance. That means it is not mandatory to comply with the requirements of corporate governance principles for those firms listed in the junior markets (i.e. AIM and PLUS). The complete list of football firms quoted on the stock exchange with their respective markets is attached in the appendices of chapter 5.

## **4.6 Summary and Conclusion**

This chapter has discussed the background, regulation, accounting formalities and corporate governance framework for UK soccer corporations. In doing so this chapter contributes to the academic literature in four important ways. Firstly, it makes clear how soccer corporations evolved from their early years to the present. The discussion has covered the formation and growth of soccer clubs, associations and leagues both in England and Scotland. It attempts to give an explanation for readers and scholars of the origin and development of soccer corporations in Britain. In addition, this chapter describes how football clubs were managed in earlier years. Secondly, this chapter explains the key objective of football firms as discussed in previous studies and in the Articles and Memorandum of Association. According to these discussions, the primary objective of football firms is to maximise some combination of financial and productivity performance.

Thirdly, this chapter makes clear the accounting treatment of players in the company's financial statements. My coverage of the debate shows that players acquired through the transfer market should be capitalised and amortised on an annual basis using the straight-line method. On the other hand, the discussion has suggested that home-grown players should not be capitalised because they are not identical and therefore, do not meet the criteria of a readily ascertainable market as stipulated in accounting standards. Finally, this chapter discusses the corporate governance framework surrounding soccer corporations in the UK. It was established that Companies Act and UK Corporate Governance Codes are major guiding handbooks used to govern UK firms. The discussion of this framework enhances our understanding of the functions of the board of directors and the Annual General Meeting (AGM). The next chapter describes sources of data and presents the descriptive and univariate analysis of the variables used in the empirical analysis.

## 4.7 Appendix

The main principles of UK Corporate Governance Code 2010 which are relevant to the present research are stipulated as follows.

- Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.
- There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.
- The chairman is responsible for leadership of the board and ensuring its effectiveness in all aspects of its role.
- As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.
- The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.
- There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.
- All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.
- All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.
- The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.
- The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.
- All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.
- The board should present a balanced and understandable assessment of the company's position and prospects.
- The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.
- Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid

paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

- There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.
- The board should use the AGM to communicate with investors and to encourage their participation.

## 5 DATA AND SAMPLE

### 5.1 Introduction

This chapter discusses data sources, collection procedures, the definition of variables, and descriptive and univariate analysis of key variables in this study. The sample comprises 117 firms with 1034 firm-years for the entire period 1998 through 2007. The complete list of these firms is attached in the appendix of this chapter. A separate list of the stock market quoted football companies is also attached. The UK Standard Industrial Classification of Economic Activities classified these companies as either UK SIC Code 92619 or 92629. These codes represent firms undertaking operation of sports arenas and stadiums or firms undertaking other sporting activities not elsewhere classified. The principal activity of these companies is the operation of a professional football club and other related commercial activities. There are three practical reasons that influenced the selection of the sample period.

The first reason relies on the adoption of FRS 10 in the preparation of financial statements for all companies. Prior to 1998, most clubs used a capitalisation approach, although there were a few clubs that treated transfer fees in the profit and loss account. Notably, Newcastle United expensed the whole of Allan Shearer's £15m transfer fee in 1996 when he was signed. The purpose was partly to improve the profit and loss account in subsequent years with a view of floatation in London Stock Exchange in 1997. This treatment is opaque and inconsistent because it affects reported profits or losses of a particular period. FRS 10 officially commenced in 1997, and all clubs adopted this standard in the next financial year. For this reason, analysing data from 1998 onwards can be consistent and allows comparability of financial figures between firms.

The second reason relies on the change of rules and procedures in the players' transfer market. This is the central part of productivity performance for all football corporations. Basically, transfer fees have a substantial impact on the financial performance of the club. In 1995, the European Court of Justice made an important decision in favour of Bosman against R.C. Liegeois, the Belgium Football Association and UEFA, that transfer fees could be paid for

players serving contracts with their clubs. This ruling had reversed previously existing arrangements and extended to the player the right of free movement when their contract expires.

The Bosman ruling has two major implications that require economic analysis for football clubs across Europe. First, clubs are likely to have to sign players for longer contracts than before so as to protect their investment against the risk of losing them on free transfers. This implies that a player's contract will be amortised over the longer period and probably improve the operating profits of the club. Secondly, the ruling has increased the power of out of contract players influencing them to demand higher wages and move to wealthier clubs that offer the best wages. This is consistent with other traditional industries where the better employees have more control over their career and are able to demand wages that reflect their relatively high level of skill. The post-Bosman transfer market universal for all football firms and has facilitated the efficient matching between players, football managers and clubs.

The final reason is online data availability, particularly corporate governance data. Initially, it was difficult to obtain companies' annual reports and other statutory documents prior to 1996. The ICC Plum database, since July 1996 however, started to provide online access of all companies' statutory documents which are filed at Companies House.<sup>32</sup> The documentation of each company's annual report for a longer period has motivated collection of data together with the empirical investigation of soccer corporations.

There are three databases available for this study. All data was collected at the firm level. The first database consists of corporate governance variables. Most of these data is manually collected from the firm's annual reports and every image of annual reports taken from the ICC Plum database. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on the ICC Plum database. Form 288A is a special form used to record director or company secretary appointment, whereas form 288B is used to record director or company secretary departure. Data on director tenure and age are manually collected from the Fame database.<sup>33</sup>

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<sup>32</sup> The ICC Plum database is the company information database available online for all UK and Irish companies.

<sup>33</sup> FAME is the database that contains information for companies in the UK and Ireland regions.

Some firms, however, have more than one board meaning that directors in the holding company are different from directors in the subsidiary company. Most of these clubs are listed or were previously listed on the stock market. For example, in 2002 Celtic has seven directors in a holding company (Celtic plc) and six directors in a subsidiary company (The Celtic Football and Athletic Company Limited). Three directors of a subsidiary company were not directors of a holding company. Under such circumstances, all data was collected from a holding company provided that its principal activity was that of a professional football club together with related activities. Many other firms such as Bristol City and Hearts have the same board in the holding and subsidiary company. In such situations, data is collected from a holding company provided its principal activity meets the criterion. It is, indeed advantageous to collect data from a holding company because there is detailed information than in a subsidiary company.

The second database consists of financial performance and other variables. Most of these variables are collected from the ICC Plum database. Little data for inactive companies is manually collected from the FAME database. The third database consists of productivity performance variables. This data was collected from two main sources. Data on league competition performances are collected from the website [www.soccerbase.com](http://www.soccerbase.com) and data on match attendances from the website [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). The use of different sources simplifies the collection process as it makes it possible to download different variables.

The remainder of the chapter is structured as follows. Section 5.2 defines the variables used in this thesis. Section 5.3 discusses descriptive statistics of the variables in each sub-sample. Section 5.4 describes univariate analysis of key variables in this research. Section 5.5 discusses the correlation matrix for FA Premier League firms, quoted football firms and full sample firms. Outliers are discussed in Section 5.6. Section 5.7 contains a summary and conclusion of the chapter. An appendix is attached in Section 5.8.

## **5.2 Variable Definitions**

### **5.2.1 Corporate Governance**

*Board size* is the total number of directors serving on the board at the end of the financial year. *Executive directors* are defined as the number of directors who are full-time employees of the firm. *Non-executive directors* are those directors who are not full-time employees of the firm.

*Non-executive directors (%)* are the proportion of non-executive directors on the board of directors. *CEO duality* is a dummy variable recorded as one if there is a separation of duties between CEO and Chairman of the board, and zero otherwise.

*Board ownership* is the percentage of shares in the firm owned by members of the board either directly or indirectly through other companies or their families. *CEO ownership* is the percentage of shares in the firm owned by the CEO of the firm. *Blockholder ownership* is the percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firm's share capital. The ownership is disclosed if it amounts to three percent or more of the shares outstanding. I aggregate all such three percent (or more) holdings for a specific firm. Goyal and Park (2002) and Denis et al. (1997) used a similar technique in defining ownership structure variables.

*Board remuneration* is the total cash paid to the members of the board during the financial year. This definition does not include stock options because they are rarely used as directors' remuneration in football firms. In fact, very few firms used stock options as part of their board remuneration. *Executive remuneration* is the total cash paid to all executive directors. *Non-executive remuneration* is the total cash paid to all non-executive directors, and *CEO remuneration* is the highest amount of cash paid to a particular director of the board.

*Director appointments* are the total number of new directors appointed to the board. *Director departures* are the total number of directors removed from or who left the board. Under normal circumstances, the departure of a director can be caused by illness, death, retirement, forced resignation or voluntary retirement. Unfortunately, published sources do not allow us to identify the causes of turnover. *Director tenure* is the average number of years a director served on the board. *Director age* is the average age of an individual director. *Multiple directorships* are the average number of board seats held by an individual director. Consistent with other previous studies, this definition considers all existing directorships in a particular year. Ferris et al. (2003) and Jackling and Johl (2009) defined this variable using the same approach.

### **5.2.2 Productivity Performance**

*Attendance* is the average number of spectators watching football matches in a particular season. *League points (%)* is the proportion of points accumulated by an individual club relative to total

points that can be accumulated during the season. *Winning (%)* is the percentage of matches won by a club in every season, in this case draws are considered as a half-win.

### **5.2.3 Financial Performance**

*Pre-tax profit* is the net trading figure of the core business before paying taxes. *Operating profit* is the amount of profit and loss arising from core business activities. Profit variables are taken after considering player trading and other operating expenses, including amortisation of player registrations. *Turnover/Total asset* is the ratio of turnover to total assets of the firm. Turnover is the amount of total revenue collected for the period. This includes revenue generated through gate receipts, television and broadcasting, sponsorship, branded products and catering. Total assets are the summation of current assets and non-current assets of the company.

### **5.2.4 Other variables**

*Number of employees* is the total number of full-time workers in the firm. *Employees' remuneration* is the total value of wages and salaries paid. *Wage bill ratio (%)* is the ratio of total employee wages to total turnover. Brief definitions of the variables used in the descriptive statistics, and in the subsequent empirical analysis are attached in the appendix.

## **5.3 Descriptive Statistics**

Summary statistics are presented in sub-samples that allow comparisons between different league competitions. All value variables are in 1998-constant sterling pounds. Table 5-1 to 5-7 reports summary descriptive statistics of sub-samples and the full sample. For the full sample, the average board size is 5.75 of which 33% are executives and 67% are non-executives. Most sub-samples find relatively similar proportions in board size, including listed clubs and clubs that are in the top three divisions in the English Football League System. The proportion is different in Football League Two where 60% of the average board members are executives and 40% are non-executives. In the Scottish Premier League, the average board size is 6.54 of which 43% are executives and 57% are non-executives.

The overall mean of board size is slightly lower than the median, which suggest that this variable is slightly negatively skewed with most firms having a relatively similar number of

directors. The small standard deviation for board size reveals that there is a narrow spread in the number of directors across time and between firms in the sample. By way of comparison, Bennedsen et al. (2008) report an average board size of 3.7 in small and medium-sized firms. Cheng and Firth (2005) report an average board size of 9.12 in a sample of 1,252 S&P 1,500 firms and Yermack (1996) report an average board size of 12.25 in a sample of 452 large US public corporations for the period 1984 to 1991. This implies that my sample average board size is significantly lower when compared to larger firms but is significantly higher when compared to small firms.

The average board ownership is largest in Football League One, where they hold 50.17% of firm equity, with the CEO accounting for 3.68% of total share capital. On the other side, board ownership is smallest in Scottish Premier League where directors hold 35.73% of their firm's equity, with the CEO accounting for 5.85% of total share capital. In comparison to the Scottish Premier League, the FA Premier League has a slightly larger board ownership of 36.42% with the CEO accounting for 9.56% of total share capital. In general, the figures suggest substantial differences in managerial ownership amongst the divisions studied.

Although board ownership is drastically lower in FA Premier League clubs than in other FA Football League clubs, its CEO ownership is much higher than any other sub-sample in this study. The FA Premier League and Scottish Premier League have a relatively similar level of board ownership in their clubs. Listed clubs have relatively lower board ownership of 33.64%, with the CEO accounting for 7.01% of total share capital. Most of these listed clubs belong to the FA Premier League Division, and their ownership structure is fairly similar. For the full sample, the average board and CEO ownership are 43.37% and 6.73% respectively, of total share capital.

By way of comparison, Denis et al. (1997), report that officers and directors control an average of 10.8% of firm shares. Morck et al. (1988) report an average managerial ownership of 10.6% in a sample of 371 Fortune 500 firms and Mikkelsen and Partch (1989) report an average managerial ownership of 19.6% in a random sample of US listed corporations. Davies et al. (2005) report an average ownership of all directors to be 13.02% for industrial companies quoted in the London Stock Exchange in 1996 and 1997. The average board ownership in my sample is significantly higher than the average from these previous studies. This implies that my sample contains the larger number of closely held firms.

**Table 5-1: FA Premier League Firms**

Data is based on a sample of 37 FA Premier League firms over the period 1998 to 2007. The structure of Premier League competition comprises 20 firms every year. There are changes of members in the competition from one season to another due to three clubs being promoted from Championship Division and three clubs being relegated from the Premier League Division. Each year there are three new members which are different from the last season. Corporate governance data are manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. A firm's financial data is collected from ICC Plum and FAME databases. Productivity performance data is collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	195	5.90	6.00	2.06	1.00	12.00
Executive directors	168	2.46	2.00	0.97	0.00	5.00
Non-executive directors	168	3.55	4.00	1.86	0.00	10.00
Board ownership (%)	188	36.42	33.72	30.18	0.00	100.00
CEO ownership (%)	178	9.56	0.03	19.99	0.00	99.99
Blockholder ownership (%)	105	49.68	52.70	26.66	3.87	100.00
CEO duality	179	0.65	1	0.48	0.00	1
Board remuneration (£000)	192	621.60	477.70	656.50	0.00	5,797.90
Executive remuneration (£000)	150	523.60	412.80	477.30	0.00	2,023.30
Non-executive remuneration (£000)	150	70.90	19.70	163.80	0.00	1,596.60
CEO remuneration (£000)	183	343.30	245.40	380.10	0.00	3,302.80
Director appointments	197	1.04	0.00	1.63	0.00	7.00
Director departures	197	1.08	0.00	1.63	0.00	8.00
Director tenure	195	5.80	5.50	2.94	1.00	16.80
Director age	195	53.39	53.50	7.42	27.13	83.40
<i>Productivity performance</i>						
Attendance	200	33,051.00	32,700.00	11,629.00	15,115.00	75,826.00
League points (%)	200	46.00	44.00	13.00	13.00	83.00
Winning (%)	200	50.00	48.00	13.00	16.00	87.00
<i>Financial performance</i>						
Pre-tax profit (£000)	197	-2,868.00	-812.00	18,182.00	-127,938.00	67,375.00
Turnover (£000)	197	52,279.00	40,016.00	35,963.00	11,275.00	182,793.00
<i>Other variables</i>						
Total assets (£000)	197	92,228.00	59,156.00	94,431.00	10,858.00	636,303.00
Number of employees	195	346.60	237.00	256.70	59.00	1,416.00
Wage bill ratio (%)	194	54.15	53.13	16.80	5.74	97.69

Consistent with board ownership, the average blockholder ownership is largest in the Football League One, amounting to 61.05% of total share capital. The Football League Championship has the smallest blockholder ownership amounting to 46.84% of total share capital. For the full sample, the means of board ownership and that of blockholder ownership are slightly lower than the median, which indicate that both variables are slightly negatively skewed with most firms having reasonably similar percentages. The small standard deviations for these ownership

variables demonstrate there is a narrow spread of ownership percentages across time and between firms in the sample. In contrast, the mean CEO ownership is much greater than the median, which suggest that this variable is positively skewed with a small number of firms having unusually large percentages. This is confirmed by the larger standard deviation that suggests a wide spread of CEO ownership percentages across time and between firms in the sample.

**Table 5-2: Football League Championship Firms**

Data is based on a sample of 54 Football League Championship firms over the period 1998 to 2007. The structure of the league competition comprises 24 firms every year. There are changes of members in the competition from one season to another due to three clubs being promoted from League One Division and three clubs being relegated from Premier League Division. In total, there are six clubs, which change from one season to another. Corporate governance data are manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data are collected from ICC Plum and FAME databases. Productivity performance data is collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	226	5.70	6.00	1.96	2.00	11.00
Executive directors	132	1.95	2.00	1.14	0.00	5.00
Non-executive directors	132	4.05	4.00	2.09	0.00	8.00
Board ownership (%)	213	48.40	50.91	33.18	0.00	100.00
CEO ownership (%)	136	5.38	0.00	15.71	0.00	100.00
Blockholder ownership (%)	72	46.97	45.15	23.74	8.79	100.00
CEO duality	145	0.79	1	0.41	0.00	1
Board remuneration (£000)	220	150.20	100.10	195.00	0.00	1,525.30
Executive remuneration (£000)	121	90.30	0.00	142.40	0.00	642.30
Non-executive remuneration (£000)	121	15.99	0.00	80.29	0.00	844.00
CEO remuneration (£000)	154	102.00	67.60	129.10	0.00	919.70
Director appointments	238	1.16	1.00	1.91	0.00	16.00
Director departures	238	1.12	1.00	1.62	0.00	8.00
Director tenure	221	5.06	4.67	2.80	1.00	13.50
Director age	225	52.59	52.60	7.61	30.00	78.00
<i>Productivity performance</i>						
Attendance	240	15,688.00	14,939.00	6,772.00	2,787.00	38,745.00
League points (%)	240	45.00	44.00	11.00	19.00	77.00
Winning (%)	240	50.00	48.00	11.00	22.00	82.00
<i>Financial performance</i>						
Pre-tax profit (£000)	221	-2,683.00	-1,781.00	4,503.00	-30,034.00	10,565.00
Turnover (£000)	218	9,981.00	8,278.00	5,767.00	0.00	28,351.00
<i>Other variables</i>						
Total assets (£000)	225	19,317.00	13,514.00	17,627.00	633.00	112,120.00
Number of employees	216	188.45	153.00	133.27	2.00	995.00
Wage bill ratio (%)	216	74.70	68.08	26.81	27.62	204.30

The average board remuneration is highest in the FA Premier League and amounted to £621.6k and lowest in Football League Two and amounted to £23.25k. Using an absolute figure comparison, board remuneration differs considerably from one division to the division immediately below across the whole English Football League System. The average board remuneration in the Scottish Premier League amounted to £178.4k and is significantly lower than the FA Premier League but slightly higher than the Football League Championship which amounts to £151.8k. Listed clubs as a whole have an average board remuneration amounting to £516.4k which is lower than the FA Premier League average but substantially higher than the Scottish Premier League clubs. Obviously, the reason is that more listed clubs are in the higher divisions than in the lower ones. For the whole sample, the average board remuneration amounts to £225.4k which is about 1.25% of total turnover.

By way of comparison, Dong and Ozkan (2008) report an average CEO remuneration of £285k and an average remuneration of £226k for all executive directors in a sample of UK publicly traded firms in 2004. These averages are considerably lower than the average remuneration in the FA Premier League in each respective category. However, the average CEO remuneration in the full sample is significantly lower than the average in conventionally listed companies. There is no significant difference between my full sample and traditional listed firms in terms of executive directors' remuneration. On top of this, executive directors' remuneration in listed football firms is much higher than in listed traditional firms, whilst there is a little difference in CEO remuneration between the two groups.

The mean of all remuneration variables (i.e. board, executives, non-executive and CEO) is much greater than the median, which suggests that remuneration variables are right skewed with a few firms having unusually large figures. The larger standard deviations for all remuneration variables specify that there is a wide spread of pay levels over time and between firms in the sample. The spread is slightly lower in listed clubs in comparison to other sub-samples in the study. Over the whole period, there has been a general rise in board remuneration with a slight fall in the 2005 accounting year. The mean board remuneration increased from £137.32k in 1998 to £392.09k in 2007, a rise of 285.53% over a period of ten years.

**Table 5-3: Football League One Firms**

This table presents the sample of 61 Football League One firms over the period 1998 to 2007. The structure of the league competition comprises 24 firms every year. There are changes of members in the competition from one season to another due to four clubs being promoted from League Two Division and three clubs being relegated from Championship Division. In total, there are seven clubs that change from one season to another. Corporate governance data is manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data is collected from ICC Plum and FAME databases. Productivity performance data are collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variable	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	190	5.29	5.00	2.05	1.00	11.00
Executive directors	58	1.59	1.00	0.86	1.00	6.00
Non-executive directors	58	3.97	4.00	2.05	0.00	9.00
Board ownership (%)	158	50.17	60.11	37.71	0.00	100.00
CEO ownership (%)	70	3.68	0.00	14.12	0.00	92.02
Blockholder ownership (%)	67	61.05	76.29	35.21	0.00	99.15
CEO duality	75	0.69	1	0.46	0.00	1
Board remuneration (£000)	155	47.23	12.00	64.80	0.00	237.00
Executive remuneration (£000)	84	16.21	0.00	45.25	0.00	232.00
Non-executive remuneration (£000)	83	0.24	0.00	1.81	0.00	16.00
CEO remuneration (£000)	90	23.90	0.00	55.56	0.00	232.00
Director appointments	234	1.08	0.00	1.79	0.00	10.00
Director departures	234	1.09	0.00	2.10	0.00	16.00
Director tenure	175	5.61	5.33	2.53	1.00	12.60
Director age	180	52.94	53.16	6.51	36.50	71.75
<i>Productivity performance</i>						
Attendance	240	7,144.00	5,906.00	3,635.00	2,935.00	28,273.00
League points (%)	240	45.00	43.00	10.00	19.00	73.00
Winning (%)	240	50.00	49.00	10.00	22.00	77.00
<i>Financial performance</i>						
Pre-tax profit (£000)	169	-1,078.00	-532.00	1,837.00	-9,910.00	2,023.00
Turnover (£000)	162	3,793.00	3,320.00	2,125.00	0.00	12,915.00
<i>Other variables</i>						
Total assets (£000)	203	6,185.00	3,354.00	8,341.00	26.00	54,261.00
Number of employees	161	102.28	87.00	59.41	2.00	421.00
Wage bill ratio (%)	155	78.44	69.96	29.34	44.46	191.97

On average, one director enters and departs from the board in each financial year-end. This is consistent with all sub-samples and the full sample. In essence, most boards have more or less the same members over this period of time. The mean of both director appointments and departures is much greater than the median, which implies that both variables are positively skewed with a few firms having extremely large appointments and departures. The larger standard deviations for both variables demonstrate that there is a wide spread of appointments and departures across time and between firms in the sample.

**Table 5-4: Football League Two Firms**

Data is based on a sample of 53 Football League Two firms over the period 1998 to 2007. The structure of the league competition comprises 24 firms every year. There are changes of members in the competition from one season to another due to two clubs being promoted from Conference National Division and four clubs being relegated from League One Division. In total, there are six clubs which change from one season to another. Corporate governance data is manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data is collected from ICC Plum and FAME databases. Productivity performance data are collected from the websites www.soccerbase.com and www.european-football-statistics.co.uk. All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	196	5.65	6.00	2.10	1.00	12.00
Executive directors	24	2.75	2.00	1.87	1.00	6.00
Non-executive directors	24	2.08	2.00	2.30	0.00	8.00
Board ownership (%)	141	42.87	44.50	33.43	0.00	100.00
CEO ownership (%)	49	5.27	0.00	18.92	0.00	92.02
Blockholder ownership (%)	55	57.75	79.42	36.95	0.00	100.00
CEO duality	50	0.82	1	0.39	0.00	1
Board remuneration (£000)	134	23.25	0.00	41.88	0.00	231.00
Director appointments	234	1.36	1.00	2.11	0.00	17.00
Director departures	234	1.19	0.00	1.78	0.00	9.00
Director tenure	188	4.94	4.41	2.81	1.00	14.00
Director age	188	52.91	53.28	7.28	27.33	78.20
<i>Productivity performance</i>						
Attendance	240	4,192.00	3,827.00	1,804.00	1,715.00	16,847.00
League points (%)	240	45.00	43.00	10.00	14.00	74.00
Winning (%)	240	50.00	49.00	10.00	17.00	77.00
<i>Financial performance</i>						
Pre-tax profit (£000)	151	-199.00	-149.00	1,381.00	-3,422.00	12,044.00
Turnover (£000)	140	2,171.50	2,003.00	1,089.00	0.00	6,729.00
<i>Other variables</i>						
Total assets (£000)	218	2,284.00	1,604.00	2,158.00	29.00	16,418.00
Number of employees	130	93.47	79.00	56.88	26.00	342.00
Wage bill ratio (%)	124	77.42	67.00	36.82	24.84	253.25

For the full sample, a director has an average age of 52.73 years and serves on the board for an average of 5.27 years. There is a trivial difference in sub-samples where the lowest average director age is 51.24 years in the Scottish Premier League, and the highest average director age is 53.39 years in the FA Premier League. The overall mean for both director age and tenure is roughly equivalent to the median, which suggests that both variables are normally distributed. The small standard deviations for both variables reveal there to be a narrow distribution of these variables across time and between firms in the sample.

**Table 5-5: Scottish Premier League Firms**

Data is based on a sample of 16 Scottish Premier League firms over the period 1998 to 2007. The structure of the league competition comprises 10 clubs from 1998 through 2000 and 12 clubs from 2001 through 2007 every season. Change can occur from one season to another if one club will be promoted from Scottish First Division and one club will be relegated from the Scottish Premier League. However, this occurs only if the promoted club meets the stadium capacity criteria set by the regulatory bodies. Corporate governance data are manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data is collected from ICC Plum and FAME databases. Productivity performance data are collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	112	6.54	6.50	1.96	2.00	10.00
Executive directors	47	2.62	2.00	1.41	1.00	6.00
Non-executive directors	47	4.21	4.00	1.41	2.00	7.00
Board ownership (%)	101	35.73	36.32	28.65	0.00	94.62
CEO ownership (%)	44	5.85	0.01	11.74	0.00	50.34
Blockholder ownership (%)	56	48.36	39.03	28.15	3.66	98.00
CEO duality	46	0.85	1	0.36	0.00	1
Board remuneration (£000)	103	178.40	105.00	205.40	0.00	1,094.00
Executive remuneration (£000)	55	220.20	192.00	210.70	0.00	789.00
Non-executive remuneration (£000)	55	38.40	0.00	123.70	0.00	877.00
CEO remuneration (£000)	58	135.40	125.00	142.90	0.00	785.00
Director appointments	114	1.37	1.00	1.59	0.00	9.00
Director departures	114	1.11	1.00	1.40	0.00	7.00
Director tenure	112	4.80	4.67	1.72	1.00	8.60
Director age	112	51.24	52.69	6.32	30.00	67.17
<i>Productivity performance</i>						
Attendance	104	16,237.00	8,176.00	17,125.00	4,067.00	59,353.00
League points (%)	114	46.00	42.00	17.00	16.00	90.00
Winning (%)	114	50.00	45.00	16.00	18.00	92.00
<i>Financial performance</i>						
Pre-tax profit (£000)	108	-2,421.00	-1,075.00	6,560.00	-35,328.00	15,040.00
Turnover (£000)	104	13,620.00	5,354.00	18,715.00	2,245.00	75,237.00
<i>Other variables</i>						
Total assets (£000)	114	26,223.00	10,549.00	41,009.00	253.00	164,728.00
Number of employees	108	164.70	102.00	119.90	48.00	496.00
Wage bill ratio (%)	104	65.25	63.04	19.37	27.31	135.94

For the full sample, 73% of firms indicate that they have separated duties between the CEO and the chairman of the board. However, this differs between sample subgroups ranging from 65% in the FA Premier League to 85% in the Scottish Premier League. For all sub-samples, the median is much greater than the mean implying that this variable is negatively skewed with a few firms having no separation of duties between the CEO and Chairman of the board. For listed clubs, one director holds an average of three directorships. The mean of multiple

directorships is, to some extent, greater than the median, which suggests that this variable is slightly right skewed with most firms having the same number of directorships. In addition, the standard deviation is small, which implies a narrow spread of multiple directorships across time and between firms in the sample.

Most football clubs are classified as medium or small firms and transparency of their corporate governance information is minimal in comparison with larger conventionally listed companies. The corporate governance data is greatly more observant of the higher-level divisions than the lower-level divisions. For example, the disclosure of board remuneration, ownership and board structure is significantly higher in FA Premier League than in Football League Two. In this low division, there is less information on disclosed corporate governance variables during the full sample period.

The mean (median) firm pre-tax loss shows a somewhat healthier picture in Football League Two and amounted to £199k (£149k), whilst in the FA Premier League it amounted to £2,868k (£812k). For the full sample, the mean (median) pre-tax loss is £1,929k (£615k) which implies that this variable is negatively skewed with a few firms having exceptionally larger losses. The larger median than the mean is consistent with all sub-samples indicating that in every division, there are few firms that have extremely high pre-tax losses. It is noticeable that firms with smaller board ownership have a higher pre-tax loss compared to other firms with relatively large board ownership. Throughout the sample, there are larger standard deviations for pre-tax profit/loss, which suggests a wide spread of profit/loss levels across time and between firms in the sample.

The FA Premier League has a larger match attendance than other groups in the sample. Using an absolute figure comparison, attendance is much higher from one top division to the next bottom division throughout the English Football League System. Attendance is far higher in the FA Premier League than in the Scottish Premier League. In English leagues, the mean is slightly greater than the median indicating that most firms have a relatively similar number of spectators but in the Scottish Premier League the mean is much greater than the median which is simply representative of there being fewer clubs that have extremely larger attendances, namely the two Glasgow clubs, Celtic and Rangers. For the full sample, the mean is greater than the median implying that this variable is right skewed with a few firms having extremely higher attendance.

The larger standard deviation shows that there is a wide spread of attendance levels across time and between firms in the sample.

**Table 5-6: UK Listed Football Firms**

Data is based on a sample of 26 listed firms over the period 1998 to 2007. The summary statistics include all firm years during the listing period only. That means data are collected from the year listed to the year delisted from the stock market. Corporate governance data are manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data are collected from ICC Plum and FAME databases. Productivity performance data are collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	197	6.16	6.00	1.74	2.00	11.00
Executive directors	189	2.39	2.00	1.03	0.00	6.00
Non-executive directors	189	3.84	4.00	1.52	0.00	9.00
Board ownership (%)	194	33.33	30.02	26.14	0.00	98.34
CEO ownership (%)	170	6.97	0.06	12.24	0.00	50.34
Blockholder ownership (%)	175	41.38	40.09	23.01	3.28	100.00
CEO duality	180	0.68	1	0.47	0.00	1
Board remuneration (£000)	196	516.40	350.50	489.30	0.00	2,377.00
Executive remuneration (£000)	154	458.10	307.50	433.30	0.00	2,241.00
Non-executive remuneration (£000)	154	77.90	27.50	190.00	0.00	1,835.00
CEO remuneration (£000)	178	271.10	202.00	253.20	0.00	1,624.00
Director appointments	198	1.30	1.00	1.94	0.00	16.00
Director departures	198	1.22	1.00	1.68	0.00	8.00
Director tenure	197	4.80	4.50	2.34	0.67	15.50
Director age	197	51.69	51.83	7.08	26.33	80.50
Multiple directorships	155	2.97	2.75	1.03	1.00	6.20
Board meetings	126	9.38	12.00	3.24	4.00	14.00
<i>Firm-specific characteristics</i>						
Attendance	196	30,382.00	29,110.00	15,086.00	6,958.00	67,748.00
Winning (%)	198	56.00	54.00	14.00	20.00	92.00
<i>Financial performance</i>						
Pre-tax profit (£000)	197	-1,523.00	-1,635.00	12,479.00	-49,505.00	72,478.00
Turnover (£000)	197	42,108.00	33,917.00	37,730.00	2,923.00	200,843.00
<i>Other variables</i>						
Total assets (£000)	197	82,622.00	48,691.00	96,722.00	10,763.00	731,295.00
Number of employees	195	278.90	209.00	221.50	89.00	1,416.00
Wage bill ratio (%)	195	56.97	52.84	21.55	5.74	136.01

The FA Premier League has the highest mean (median) turnover and total assets amounting to £52,279k (£40,016k) and £92,228k (£59,156k) respectively. The mean (median) turnover and total assets are lowest in Football League Two amounting to £2,171.5k (£2,003k) and £2,284k (£1,604k) respectively. The means are much greater than the medians which demonstrate that

these variables are right skewed with a few firms having relatively large values. The standard deviations are larger for both turnover and total assets, which imply that there is a wide spread of these variables between firms and across the sample period. The spread is much greater in total assets than in turnover throughout the sample. Using absolute figure comparisons, the difference in turnover and total assets is much greater when comparing higher-level divisions than when comparing lower-level divisions.

**Table 5-7: All Sample Firms**

Data is based on a sample of 118 firms with 1034 firm years over the period 1998 through 2007. Corporate governance data is manually collected from firms' annual reports. Data on director appointments and departures are manually collected from form 288A and 288B respectively available on ICC Plum database. Firm's financial data are collected from ICC Plum and FAME databases. Productivity performance data is collected from the websites [www.soccerbase.com](http://www.soccerbase.com) and [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above.

Variables	Observation	Mean	Median	Std. Dev	Minimum	Maximum
<i>Corporate governance characteristics</i>						
Board size	919	5.75	6.00	2.06	1.00	12.00
Executive directors	429	2.22	2.00	1.18	0.00	6.00
Non-executive directors	429	3.75	4.00	2.00	0.00	10.00
Board ownership (%)	801	43.37	44.15	33.42	0.00	100.00
CEO ownership (%)	477	6.73	0.00	17.36	0.00	100.00
Blockholder ownership (%)	355	52.32	52.91	30.23	0.00	100.00
CEO duality	495	0.73	1	0.44	0.00	1
Board remuneration (£000)	804	225.40	67.70	414.30	0.00	5,797.90
Executive remuneration (£000)	494	208.70	0.00	355.30	0.00	2,023.30
Non-executive remuneration (£000)	493	29.81	0.00	110.64	0.00	1,596.64
CEO remuneration (£000)	569	155.90	63.00	267.90	0.00	3,302.80
Director appointments	1017	1.19	0.00	1.85	0.00	17.00
Director departures	1017	1.12	0.00	1.76	0.00	16.00
Director tenure	891	5.27	5.00	2.69	1.00	16.80
Director age	900	52.73	53.00	7.15	27.13	83.40
<i>Productivity performance</i>						
Attendance	1024	14,438.00	8,205.00	13,264.00	1,715.00	75,826.00
League points (%)	1034	45.00	43.00	12.00	13.00	90.00
Winning (%)	1034	50.00	48.00	12.00	16.00	92.00
<i>Financial performance</i>						
Pre-tax profit (£000)	846	-1,929.00	-615.00	9,460.00	-127,938.00	67,375.00
Turnover (£000)	821	18,039.00	6,462.00	27,341.00	0.00	182,793.00
<i>Other variables</i>						
Total assets (£000)	957	28,483.00	8,304.00	56,880.00	26.00	636,303.00
Number of employees	810	191.00	129.00	180.75	2.00	1,416.00
Wage bill ratio (%)	793	69.59	64.00	27.99	5.74	253.25

The average number of employees in the firm is 191 for the full sample. The FA Premier League has an average of 346.6 employees which is larger than other sub-samples. Football League Two has an average of 93.47 employees which is the lowest in the sample. Listed firms have an average of 278.9 employees which is, to a large extent, lower than the FA Premier League but considerably higher than other sub-samples. By way of a comparison, Hillier and McColgan (2009) report an average number of employees of 2,159 and 6,757 in family and non-family firms respectively in a sample of non-financial companies listed on the LSE. In these circumstances, the number of employees in football firms is substantially small compared to other traditional companies.

For the full sample, the average wage bill ratio is 69.59%. This ratio is lowest in the FA Premier League where it amounts to 54.15% and the highest in Football League One where it accounts for 78.44% of turnover. It is interesting that the FA Premier League has the best wage bill ratio of all sub-samples in the study. The greater part of employee costs is consumed through players' salaries, where higher league players are paid more than lower league players. However, the FA Premier League generates substantial revenue that maintains its wage bill ratio lower than other lower league divisions. The Scottish Premier League has a wage bill ratio of 65.25%, which is significantly higher than the FA Premier League.

#### **5.4 Univariate Analysis**

Table 5-8 reports mean-comparison tests of key variables of the subgroups in this research. The table is attached in the appendix. The findings indicate that managerial remuneration (i.e. the whole board and CEO remuneration) is significantly different depending on the divisions investigated. The results reveal that the FA Premier League substantially exceeds both the Football League Championship and the Scottish Premier League in terms of directors' pay. The overall trend shows that every higher division club pays its directors considerably more than the next lower division across the English Football League. In Panel A, the findings show that the FA Premier League has significantly lower managerial ownership (i.e. the whole board and CEO ownership) than the Football League Championship. Also in Panel D, the results demonstrate that Football League One has a considerable higher level of board ownership than Football League Two.

CEO duality appeared to be substantially higher in both the Scottish Premier League and Football League Championship than in the FA Premier League. This implies that the former leagues have separated the positions of the CEO and Chairman more than in the lower league. Similarly, in Panel A and B the findings show that the proportion of non-executive directors is higher in Football League Championship and the Scottish Premier League than in the FA Premier League. Attendance, however, is much higher in the FA Premier League than in both the Football League Championship and the Scottish Premier League. Throughout the English Football League, attendance differs significantly from one higher division to the next lower division. That means a higher league tends to attract more spectators than a lower league.

In Panel C, the pre-tax loss is observed to be considerably higher in the Football League Championship than in Football League One. Likewise, in Panel D the pre-tax loss is shown to be considerably higher in Football League One than in Football League Two. These findings imply that exempting the FA Premier League, the pre-tax loss tends to be larger, the higher the division. In Panel A, C and D, turnover and total assets also appeared much higher the higher the division across the English Football League. Similarly, Panel B reveals that turnover, and total assets are substantially higher in the FA Premier League than in the Scottish Premier League. These findings suggest that a prestigious league has higher turnover and assets than a less prestigious league. Overall, this analysis suggests that firms with higher attendances tend to have higher turnover and assets, with these differences being substantial between each division.

Panel A and B provides statistical evidence that the FA Premier League has a larger number of employees than both Football League Championship and the Scottish Premier League. In Panel C, the finding suggests that Football League Championship has a larger number of employees than Football League One. Finally, this analysis reveals evidence that the wage bill ratio is substantially lower in the FA Premier League than in both the Football League Championship and the Scottish Premier League. Furthermore, the findings suggest there is no statistical evidence that the wage bill ratio differs to a large extent between other analysed divisions. The univariate analysis of this chapter provides a clear representation of variation in key variables between the subgroups analysed.

## 5.5 Correlation Matrix

This section describes correlations of independent variables that will be used in the subsequent empirical chapters of this thesis. The results are presented in Table 5-9, 5-10 and 5-11 for the FA Premier League, listed football firms and full sample firms respectively. Table 5-9 reveals that percentage of league points, winning percentages and attendances are positively correlated with pre-tax profits. This tells us that productivity performance and financial performance are positively interrelated. These correlations are statistically significant at the 5% level or better. However, the highest correlation level of 0.1829 is between the percentage of league points and pre-tax profits. Table 5-10 reveals that among the productivity performance measures, only attendance is positively correlated to profitability. The correlation level is 0.2915 and is statistically significant at the 1% level.

Table 5-9 and 5-11 provides evidence that the percentage of league points, winning percentages and attendances are negatively correlated with the ratio of turnover to total assets. In Table 5-9, the correlations are significant at the 10% level, whereas in Table 5-11, the correlations are significant only at the 1% level. In these results, the highest correlation level is 0.2210, between attendances and the ratio of turnover to total assets. Table 5-10 shows that the ratio of turnover to total assets is negatively correlated to the winning percentage but positively correlated to attendance. These correlations are statistically significant at the 1% and 5% level respectively. Across all three tables, the productivity performance measures are highly correlated to each other, their relationships being statistically significant at the 1% level. The lowest and highest correlation levels are 0.3240 and 0.9958 respectively. This suggests that these variables should not be included in a single regression model to avoid the problem of multicollinearity.

Across all three tables, the number of employees is positively correlated with productivity performance measures. Although the correlations are statistically significant at the 1% level, the correlations' levels are moderately low. This simply suggests that larger firms (i.e. in terms of the number of employees) have superior productivity performance. Tables 5-9 and 5-11 reveal that number of employees is negatively correlated to the ratio of turnover to total assets. In both tables, the relationship is statistically significant at 1% although the correlation levels are low at -0.1955 and -0.1381 respectively. This implies that larger firms are inefficient in generating revenues using available resources. Table 5-10 shows that number of employees is positively correlated to pre-tax profits at the 1% level. This tells us that the larger the firm, the higher the

profitability. However, the correlation level between the two variables is relatively low at 0.1857.

In all correlation matrix tables, there is evidence that board ownership is positively correlated to director age and tenure. The correlation levels are fairly low, but the relationships are statistically significant at the 1% level. The contention of this correlation is that older and more experienced directors invest more in these firms than younger and inexperienced directors. Table 5-10 demonstrates that board ownership is positively correlated to pre-tax profits and number of employees at the 5% and 10% level respectively. Table 5-11 shows that board ownership is negatively related to attendances and number of employees at the 1% and 5% level respectively. In both tables, the correlation levels between these variables are relatively low.

I observed that the proportion of non-executive directors is positively correlated to profitability, CEO duality, director age and tenure. I also observed that this variable is negatively linked to attendance and number of employees. These correlations are statistically significant at the 5% level or better, but none of the correlation level is greater than 0.3784. Table 5-10 demonstrate that director age is positively related to performance measures. The relationships are only statistically significant at the 10% level or better, but the actual correlation levels are small. Further evidence indicates that director tenure is positively correlated to productivity performance measures. Both relationships are statistically significant at the 5% level. Overall, these correlations are low and the highest level is 0.1642, between director tenure and attendance. Finally, there is evidence that CEO duality is positively linked to productivity performance measures. The correlations are statistically significant at the 10% level or better, but the correlation levels are logically low.

## **5.6 Outliers**

It is common that regression estimates can be influenced by a few strange observations in the data sets. Outliers are data points with extreme values that could have a destructive effect in regression estimations. These unusual values may indicate faulty data that cannot be covered by the theory under consideration. I observed that some data points are far away from the sample mean. For instance, I found that Watford Leisure Plc had two full-time employees for the period 1998 to 1999, while the actual mean is 191 for the full sample firms. During this time, the company treated all employees as part-time workers except for the two executive directors.

Throughout the sample, my criterion is to record purely full-time workers as the actual number of employees. As a result, this observation is probably low as a typical football firm cannot operate with only two employees.

Other strange figures include the number of executive directors and non-executive directors in the sample. The full list of firms with this problem is mentioned below with respective years in brackets. Firms that comprise no executive directors in their boards include Middlesbrough (2004-2006), Millwall (2005), Norwich City (1998-2005), Queen Park Rangers (2005) and Sheffield United (1999). Firms that comprise no non-executive directors include Middlesbrough (1998-2003), Stoke City (2006-2007), Crystal Palace (2001), Mansfield Town (2001-2007), Wycombe Wanderers (2005-2007), Sheffield United (1999) and Chelsea (2003) during the takeover by Roman Abramovich. Other variables that indicate the presence of outliers include total assets, turnover, pre-tax profits, attendance, and remuneration variables. It is rational to consider alternative estimations of the data in the presence of outliers. For this reason, the subsequent empirical chapters will also consider analysing data while excluding outliers in the given sub-samples. This will guarantee the robustness of the results.

## **5.7 Summary and Conclusion**

This chapter covered three important issues. Firstly, the chapter described the sample, data sources and collection procedures. Secondly, this chapter presented definitions of variables that to be employed in the subsequent empirical chapters. Lastly, this chapter described descriptive statistics, univariate analysis and a correlation matrix of the variables. In doing so, I identified the nature and extent of missing data. The descriptive statistics revealed that corporate governance data is more widely available in higher-level divisions than in lower-level divisions of the FA Football League. For this reason, subsequent empirical chapters analyse corporations that participated in FA Premier League and listed football firms. These sub-samples have adequate corporate governance information to permit an in-depth analysis to explore the objective of this thesis.

The analysis of descriptive statistics helped to identify the nature and extent of outliers. This provided clear overview and direction of the empirical procedures, such as estimating some regressions while excluding outliers. This approach will be used to check for the robustness of the results. The univariate analysis presents the obvious picture of the differences between

divisions in the sample. This demonstrates the practical sense of British football firms and establishes how they differ from one division to another. Finally, the analysis of the correlation matrices assisted to identify highly correlated variables that may lead to the multicollinearity problem. In this context, the successive empirical chapters will avoid the inclusion of these variables in the single regression model. The next chapter analyses determinants of directors' remuneration.

## 5.8 Appendices

**Table 5-8: Sub-samples t-tests for Key Variables**

Panels below reports mean comparison between sub-samples in this study. This comparison analyses key variables in the research. All value variables are in 1998-constant sterling pound. All variables are defined in the variable definitions' section above. P-values are reported in parentheses. \*\*\*, \*\*, \* Denotes statistical significance at 1%, 5%, and 10% respectively.

### Panel A

Variables	FA Premier League firms	Football League Championship firms	t-statistic (p-value)
<i>Corporate governance</i>			
Board remuneration (£000)	621.59	150.18	10.151*** (0.00)
CEO remuneration (£000)	343.32	101.96	7.522*** (0.00)
Board ownership (%)	36.42	48.40	-3.762*** (0.00)
CEO ownership (%)	9.56	5.38	2.012** (0.05)
CEO duality	0.65	0.79	-2.643*** (0.01)
Non-executive directors (%)	56.36	64.47	-3.215*** (0.00)
<i>Productivity performance</i>			
Attendance	33,051.29	15,688.39	19.503*** (0.00)
Winning (%)	49.99	49.95	0.037 (0.97)
<i>Financial performance</i>			
Pre-tax profit (£000)	-2,867.87	-2,682.75	0.146 (0.88)
Turnover (£000)	52,279.32	9,980.57	17.126*** (0.00)
<i>Other variables</i>			
Total assets (£000)	92,227.93	19,317.04	11.359*** (0.00)
Number of employees	346.65	188.45	7.948*** (0.00)
Wage bill ratio (%)	54.15	74.70	-9.176*** (0.00)

### Panel B

Variables	FA Premier League firms	Scottish Premier League firms	t-statistic (p-value)
<i>Corporate governance</i>			
Board remuneration (£000)	621.59	178.38	6.674*** (0.00)
CEO remuneration (£000)	343.32	135.38	4.071*** (0.00)
Board ownership (%)	36.42	35.73	0.189 (0.85)
CEO ownership (%)	9.56	5.85	1.181 (0.24)
CEO duality	0.65	0.85	-2.574*** (0.01)
Non-executive directors (%)	56.36	62.19	-1.864* (0.06)
<i>Productivity performance</i>			
Attendance	33,051.29	16,237.38	10.113*** (0.00)
Winning (%)	49.99	49.99	0.001 (0.99)
<i>Financial performance</i>			
Pre-tax profit (£000)	-2,867.87	-2,421.38	-0.246 (0.81)
Turnover (£000)	52,279.32	13,619.58	10.249*** (0.00)
<i>Other variables</i>			
Total assets (£000)	92,227.93	26,222.54	7.083*** (0.00)
Number of employees	346.66	164.72	6.952*** (0.00)
Wage bill ratio (%)	54.15	65.25	-5.150*** (0.00)

Panel C

Variables	Football League Championship firms	Football League One firms	t-statistic (p-value)
<i>Corporate governance</i>			
Board remuneration (£000)	150.18	47.23	6.329*** (0.00)
CEO remuneration (£000)	101.96	23.90	5.445*** (0.00)
Board ownership (%)	48.40	50.17	-0.480 (0.63)
CEO ownership (%)	5.38	3.68	0.759 (0.45)
CEO duality	0.79	0.69	1.518 (0.13)
Non-executive directors (%)	64.47	67.08	-0.721 (0.47)
<i>Productivity performance</i>			
Attendance	15,688.39	7,143.61	17.224*** (0.00)
Winning (%)	49.96	50.04	-0.088 (0.93)
<i>Financial performance</i>			
Pre-tax profit (£000)	-2,682.75	-1,077.96	-4.362*** (0.00)
Turnover (£000)	9,980.57	3,792.54	13.012*** (0.00)
<i>Other variables</i>			
Total assets (£000)	19,317.04	6,185.09	9.681*** (0.00)
Number of employees	188.45	102.28	7.655*** (0.00)
Wage bill ratio (%)	74.70	78.44	-1.276 (0.20)

Panel D

Variables	Football League One firms	Football League Two firms	t-statistic (p-value)
<i>Corporate governance</i>			
Board remuneration (£000)	47.23	23.25	3.671*** (0.00)
CEO remuneration (£000)	23.90	1.92	3.570*** (0.00)
Board ownership (%)	50.17	42.87	1.762* (0.08)
CEO ownership (%)	3.68	5.27	-0.522 (0.60)
CEO duality	0.69	0.82	-1.593 (0.11)
Non-executive directors (%)	67.08	34.29	5.238*** (0.00)
<i>Productivity performance</i>			
Attendance	7,143.61	4,192.38	11.267*** (0.00)
Winning (%)	50.00	50.00	0.000 (1.00)
<i>Financial performance</i>			
Pre-tax profit (£000)	-1,077.96	-198.80	-4.794*** (0.00)
Turnover (£000)	3,792.54	2,171.51	8.148*** (0.00)
<i>Other variables</i>			
Total assets (£000)	6,185.09	2,283.73	6.671*** (0.00)
Number of employees	102.28	93.47	1.282 (0.20)
Wage bill ratio (%)	78.44	77.42	0.259 (0.76)

**Table 5-9: FA Premier League Firms Correlation Matrix of Independent Variables**

This table reports the correlation matrix of key independent variables for FA Premier League firms over the period 1998 to 2007. Data on corporate governance characteristics is collected from company annual reports. Data on attendance are collected from the website [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). Data on firm financial characteristics is collected from ICC Plum and FAME databases. All variables have been defined in the definition section above. The symbols \*\*\*, \*\*, and \* indicates statistical significance at 1%, 5% and 10%.

	1	2	3	4	5	6	7	8	9	10	11
Ln (Pre-tax profits) (1)	-										
Turnover/Total assets (2)	0.0506 0.4798	-									
League points (%) (3)	0.1829*** 0.0101	-0.1963*	-								
Winning (%) (4)	0.1783*** 0.0122	-0.1901*	0.9958***	-							
Ln (Attendance) (5)	0.1620** 0.0229	-0.1392*	0.5767***	0.5749***	-						
Ln (Number of employees) (6)	-0.0820 0.2545	-0.1955***	0.2538***	0.2456***	0.3273***	-					
Board ownership (%) (7)	0.0084 0.9090	0.0900	-0.0160	-0.0078	-0.0721	0.0042	-				
Non-executive directors (%) (8)	0.1784** 0.0207	0.0202	0.0428	0.0368	0.1004	0.0506	-0.0124	-			
Director age (9)	0.0452 0.5318	0.1056	0.0913	0.0911	0.0277	0.0902	0.1828***	0.1521**	-		
Director tenure (10)	-0.0817 0.2577	-0.0173	0.0651	0.0668	-0.0249	-0.1449**	0.3784***	0.2092***	0.4389***	-	
CEO duality (11)	-0.0356 0.6358	-0.0717	0.1646**	0.1625**	0.1380*	0.0583	0.0398	0.1433*	0.1079	0.1538**	-
		0.3399	0.0277	0.0298	0.0654	0.4380	0.6025	0.0646	0.1505	0.0398	

**Table 5-10: Listed Football Firms Correlation Matrix of Independent Variables**

This table reports correlation matrix of key independent variables for listed football firms over the period 1998 to 2007. Data on corporate governance characteristics is collected from company annual reports. Data on attendance is collected from the website [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). Data on firm financial characteristics is collected from ICC Plum and FAME databases. All variables have been defined in the definition section above. The symbols \*\*\*, \*\*, and \* indicates statistical significance at 1%, 5% and 10%.

	1	2	3	4	5	6	7	8	9	10
Ln (Pre-tax profits) (1)	-									
Turnover/Total assets (2)	0.0812	-								
Winning (%) (3)	0.0207	-0.2008***	-							
Ln (Attendance) (4)	0.2915***	0.1695**	0.3592***	-						
Ln (Number of employees) (5)	0.1857***	0.0292	0.2584***	0.6892***	-					
Board ownership (%) (6)	0.1682**	0.0681	-0.0275	0.1022	0.1262*	-				
Non-executive directors (%) (7)	-0.0867	-0.0780	-0.0311	-0.2893***	-0.1519**	0.0925	-			
Director age (8)	0.1555**	0.1838***	0.1364*	0.2383***	0.1961***	0.3105***	0.0939	-		
Director tenure (9)	0.1091	0.0492	0.1429**	0.1642**	0.0036	0.3138***	0.1633**	0.5130***	-	
CEO duality (10)	-0.1045	-0.0961	0.1873*	0.0858	0.0695	0.1440*	0.0097	0.1218	-0.0088	-
	0.1627	0.1995	0.0118	0.2534	0.3542	0.0552	0.8977	0.1033	0.9070	

**Table 5-11: Full Sample Correlation Matrix of Independent Variables**

This table reports correlation matrix of independent variables for all firms over the period 1998 to 2007. Data on corporate governance characteristics is collected from company annual reports. Data on attendance is collected from the website [www.european-football-statistics.co.uk](http://www.european-football-statistics.co.uk). Data on firm financial characteristics are collected from ICC Plum and FAME databases. All variables have been defined in the definition section above. The symbols \*\*\*, \*\*, and \* indicates statistical significance at 1%, 5% and 10%.

	1	2	3	4	5	6	7	8	9	10	11
Ln (Pre-tax profits) (1)	-										
Turnover/Total assets (2)	0.0599*	-									
League points (%) (3)	0.0095	-0.1393***	-								
Winning (%) (4)	0.0072	-0.1350***	0.9940***	-							
Ln (Attendance) (5)	0.0202	-0.2210***	0.3367***	0.3240***	-						
Ln (Number of employees) (6)	-0.0141	-0.1381***	0.2212***	0.2049***	0.6715***	-					
Board ownership (%) (7)	-0.0145	0.0181	-0.0272	-0.0240	-0.1219***	-0.0798**	-				
Non-executive directors (%) (8)	-0.0027	-0.0039	0.0469	0.0497	0.0227	-0.1508***	0.0690	-			
Director age (9)	0.0604*	0.0007	-0.0061	-0.0029	-0.0304	0.0005	0.1519***	0.1716***	-		
Director tenure (10)	0.0800**	-0.0342	0.0191	0.0181	-0.0084	0.0128	0.2457***	-0.0518	0.4209***	-	
CEO duality (11)	-0.0646	-0.1558***	0.1295***	0.1313***	-0.0104	-0.0477	0.0327	-0.0106	-0.0161	0.0578	-
	0.1524	0.0005	0.0039	0.0034	0.8183	0.2937	0.4783	0.8318	0.7216	0.2023	

**Table 5-12: Definition of Variables**

This table provides brief definitions of variables used in both descriptive statistics and empirical chapters of this thesis.

<b>Corporate governance</b>	<b>Definitions</b>
Board size	This variable is defined as the total number of directors serving on the board at the end of the financial year.
Executive directors	This variable is defined as the number of directors who are full-time employees of the firm.
Non-executive directors	This variable is defined as those directors who are not full-time employees of the firm.
Non-executive directors (%)	The proportion of non-executive directors on the board of directors
CEO duality	This variable is defined as a dummy variable, recorded as one if there is a separation of duties between CEO and Chairman of the board, and zero otherwise.
Board ownership	The variable is defined as the percentage of shares in the firm owned by members of the board either directly or indirectly through other companies or their families.
CEO ownership	This variable is defined as the percentage of shares in the firm owned by the CEO of the firm.
Blockholder ownership	The variable is defined as the percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firm's share capital. I aggregate all such three percent (or more) holdings for a specific firm.
Board remuneration	This variable is defined as the total cash paid to the members of the board during the financial year.
Executive remuneration	The variable is defined as the total cash paid to all executive directors.
Non-executive remuneration	The variable is defined as the total cash paid to all non-executive directors,
CEO remuneration.	The variable is defined as the highest amount of cash paid to a particular director of the board
Director appointments	This variable is defined as the total number of new directors appointed to the board.
Director departures	This variable is defined are the total number of directors removed or left from the board.
Director tenure	The variable is defined as the average number of years a director served on the board.
Director age	The variable is defined as the average age of an individual director
Multiple directorships	The variable is defined as the average number of board seats held by an individual director.
<b>Productivity performance</b>	
Attendance	This variable is defined as the average number of spectators watching football matches in a particular season.
League points (%)	This variable is defined as the proportions of points accumulated by an individual club relative to total points that can be accumulated during the season.
Winning (%)	This variable is defined as the percentage of matches won by a club in every season, in this case draws are considered as half won.
<b>Financial performance</b>	
Pre-tax Profit	This variable is defined as the net trading figure of the core business before paying taxes.
Operating profit	This variable is defined as the amount of profit and loss arising from core business activities. This definition is taken after considering player trading and other operating expenses, including amortisation of player registrations.
Turnover/Total assets	This is the ratio of turnover to total assets. Turnover is the amount of total revenue collected for the period. This includes revenue generated through gate receipts, television and broadcasting, sponsorship, branded products and catering. Total asset is defined as the summation of current assets and non-current assets of the company.
<b>Other variables</b>	
Number of employees	This variable is defined as the total number of full-time workers in the firm.
Employees' remuneration	This variable is defined as the total value of wages and salaries paid.
Wage bill ratio (%)	This variable is defined as the ratio of total employee wages to total turnover.

**Table 5-13: List of Firms in the Full Sample**

This table comprises the 117 firms that operate in the UK football industry. The firms included in this sample have participated in the FA Premier League, the FA Football League and Scottish Premier League for the period from 1998 to 2007.

Firm Name	Sample Period	Firm Years
Aberdeen	1998-2007	10
Accrington Stanley	2007-2007	1
Arsenal	1998-2007	10
Aston Villa	1998-2007	10
Barnet	1998-2001 and 2006-2007	6
Barnsley	1998-2007	10
Birmingham City	1998-2007	10
Blackburn Rovers	1998-2007	10
Blackpool	1998-2007	10
Bolton Wanderers	1998-2007	10
Boston United	2003-2007	5
Bournemouth	1998-2007	10
Bradford City	1998-2007	10
Brentford	1998-2007	10
Brighton and Hove A	1998-2007	10
Bristol City	1998-2007	10
Bristol Rovers	1998-2007	10
Burnley	1998-2007	10
Bury	1998-2007	10
Cambridge United	1998-2005	8
Cardiff City	1998-2007	10
Carlisle United	1998-2004 and 2006-2007	9
Celtic	1998-2007	10
Charlton Athletic	1998-2007	10
Chelsea	1998-2007	10
Cheltenham Town	2000-2007	8
Chester City	1998-2000 and 2005-2007	6
Chesterfield	1998-2007	10
Colchester United	1998-2007	10
Coventry City	1998-2007	10
Crewe Alexandra	1998-2007	10
Crystal Palace	1998-2007	10
Darlington	1998-2007	10
Derby County	1998-2007	10
Doncaster Rovers	1998 and 2004-2007	5
Dundee	1999-2005	7
Dundee United	1998-2007	10
Dunfermline Athletic	1998-1999 and 2001-2007	9
Everton	1998-2007	10
Exeter City	1998-2003	6
Falkirk	2006-2007	2
Fulham	1998-2007	10
Gillingham	1998-2007	10
Grimsby Town	1998-2007	10
Halifax Town	1999-2002	4
Hartlepool United	1998-2007	10

Heart of Midlothian	1998-2007	10
Hereford United	2007	1
Hibernian	1998 and 2000-2007	9
Huddersfield Town	1998-2007	10
Hull City	1998-2007	10
Inverness CT	2005-2007	3
Ipswich Town	1998-2007	10
Kidderminster Harr	2001-2005	5
Kilmarnock	1998-2007	10
Leeds United	1998-2007	10
Leicester City	1998-2007	10
Leyton Orient	1998-2007	10
Lincoln City	1998-2007	10
Liverpool	1998-2007	10
Livingston	2002-2006	5
Luton Town	1998-2007	10
Macclesfield Town	1998-2007	10
Manchester City	1998-2007	10
Manchester United	1998-2007	10
Mansfield Town	1998-2007	10
Middlesbrough	1998-2007	10
Millwall	1998-2007	10
Milton Keynes Dons	2005-2007	3
Motherwell	1998-2007	10
Newcastle United	1998-2007	10
Northampton Town	1998-2007	10
Norwich City	1998-2007	10
Nottingham Forest	1998-2007	10
Notts County	1998-2007	10
Oldham Athletic	1998-2007	10
Oxford United	1998-2006	9
Partick Thistle	2003-2004	2
Peterborough United	1998-2007	10
Plymouth Argyle	1998-2007	10
Port Vale	1998-2007	10
Portsmouth	1998-2007	10
Preston North End	1998-2007	10
Queens Park Rangers	1998-2007	10
Rangers	1998-2007	10
Reading	1998-2007	10
Rochdale	1998-2007	10
Rotherham United	1998-2007	10
Rushden and Diamonds	2002-2006	5
Scarborough	1998-1999	2
Scunthorpe United	1998-2007	10
Sheffield United	1998-2007	10
Sheffield Wednesday	1998-2007	10
Shrewsbury Town	1998-2003 and 2005-2007	9
Southampton	1998-2007	10
Southend United	1998-2007	10
St Johnstone	1998-2002	5

St Mirren	2001 and 2007	2
Stockport County	1998-2007	10
Stoke City	1998-2007	10
Sunderland	1998-2007	10
Swansea City	1998-2007	10
Swindon Town	1998-2007	10
Torquay United	1998-2007	10
Tottenham Hotspur	1998-2007	10
Tranmere Rovers	1998-2007	10
Walsall	1998-2007	10
Watford	1998-2007	10
West Bromwich Albion	1998-2007	10
West Ham United	1998-2007	10
Wigan Athletic	1998-2007	10
Wimbledon	1998-2004	7
Wolverhampton Wndrs	1998-2007	10
Wrexham	1998-2007	10
Wycombe Wanderers	1998-2007	10
Yeovil Town	2004-2007	4
York City	1998-2004	7

**Table 5-14: Quoted Sample Firms**

This table comprises the 26 quoted football firms in the Stock Market Exchange. The table shows the date in which each company was listed and the market segment in which they operate. It also indicates the date for de-listed companies. The abbreviation “N/A” means the firm was still listed on the respective stock market at the end of the financial year 2007. LSE represents the main market known as London Stock Exchange. AIM represents the Alternative Investment Market, which is the junior market of London Stock Exchange. OFEX represents Off-Exchange market. This is the over-the-counter market specialising in smaller companies. OFEX has changed its name to PLUS.

Club	Market Listed	Date Listed	Date Delisted	Firm Years
Aberdeen	AIM	2000	2004	5
Arsenal	PLUS	1995	N/A	10
Aston Villa	LSE	1997	N/A	10
Birmingham City	AIM	1997	N/A	10
Bradford City	OFEX	1998	2002	5
Bolton Wanderers	AIM	1997	2003	6
Celtic	LSE	1995	N/A	10
Charlton Athletic	AIM	1997	N/A	10
Chelsea (Village)	AIM	1996	2003	6
Hearts	LSE	2002	2007	6
Queens Park Rangers	AIM	1996	2001	4
Leeds United	LSE	1996	2004	7
Leicester City	LSE	1997	2003	6
Manchester City	OFEX	1995	2007	10
Manchester United	LSE	1991	2005	8
Millwall	AIM	1995	N/A	10
Newcastle United	LSE	1997	N/A	10
Nottingham Forest	AIM	1997	2002	5
Preston North End	AIM	1995	N/A	10
Rangers	PLUS	1995	N/A	10
Sheffield United	AIM	1997	N/A	10
Southampton	LSE	1997	N/A	10
Sunderland	LSE	1996	2004	7
Tottenham Hotspur.	LSE	1983	N/A	10
West Bromwich Albion	AIM	1997	2005	8
Watford (Leisure)	AIM	2001	N/A	7

Source: The Political Economy of Football website

## **6 PERFORMANCE, PRODUCTIVITY AND DIRECTORS' REMUNERATION**

### **6.1 Introduction**

This chapter intends to investigate empirically the factors that determine directors' remuneration. Since the 1990s, the issue of directors' remuneration has garnered attention from both practitioners and academics. Though the business press focus is on executives' excessive compensation, academic research usually investigates the determinants of remuneration from an agency theory perspective. Analysis finds that the structure of directors' compensation differs across industries. Football firms have special features and thus analysing them only from the perspective of agency theory is not very rigorous. Several theories have been developed in corporate governance from the disciplines of economics, law, organisational theory, sociology and strategic management. This chapter follows three major theories of corporate governance: agency theory, stewardship theory and stakeholder theory. The inclusion of stakeholder theory in the analysis provides new insights in the corporate governance literature.

The motivations of this study rely are twofold. First, there are motivations based on the issue of directors' remuneration itself, and second there are industry-specific motivations. For decades, directors' compensation remained the unresolved issue in finance literature. There is a huge academic debate regarding the determinants and quantum of directors' pay. The magnitude of remuneration is linked to several factors related to the company in question and other external factors. However, the findings from previous research remain confusing with mixed results. For example, in earlier studies, Murphy (1985) employed shareholders' realised return and sales growth as measures of firm performance and found a positive link with directors' remuneration, whilst Kerr and Bettis (1987) employed stock price movements but found no link with directors' remuneration. The findings on this research area depend on several factors, including the definition of performance employed and the data analysed.

Another motivation comes from increased public attention on executive remuneration culture in various industries. In the real world, both policymakers and practitioners are involved in heated debate on the issue of excessive compensation for corporate directors. Also, previous literature indicates that directors' compensation is worthy of further inquiry because it is one of the most important mechanisms used to resolve conflicts of interest between managers and shareholders (Jensen and Murphy, 1990, Jensen and Meckling, 1976). In a real sense, further research on directors' remuneration provides benefits to practitioners and stakeholders on understanding the proper way of resolving agency problems in their companies. It is necessary to be aware of the agency problems of a corporation because they are chief drivers of agency costs, which are detrimental to corporate value.

Other motivations are driven specifically from the football industry. The industry offers a wide range of data from financial returns to non-financial returns (i.e. productivity performance). This provides a chance to conduct an in-depth empirical analysis. Importantly, directors' compensation, board and ownership data are available in the firm's annual reports. At present, the football sector brings more attention to finance researchers due to its high public profile, growing financial importance and the possibility of undertaking objective analysis. It is possible to use the production process (sporting performance) information to investigate the determinants of directors' compensation. This has not been done to any real degree in other studies. As a result, this is my main motivation for undertaking this research study. Thus by using unexploited measures of performance, this chapter provides new evidence on the determinants of directors' remuneration.

This chapter aims to reconsider the influence of performance, size and governance structure on directors' compensation. In this chapter, the term 'directors' remuneration' refers to the remuneration of the whole board, executive directors and the highest paid director (whom I term the CEO). I examine the relationship between directors' pay and industry specific performance variables. Performance measures are used to conform to stakeholder theory as well as the objectives of football firms. I find that all categories of director remuneration are linked to productivity performance. My results reveal that financial performance has no impact on board and executive compensation. In addition, I find little evidence of a relationship between CEO compensation and profitability. Consistent with other studies in managerial remuneration, I have included measures of firm size and corporate governance variables in the analyses.

This chapter differs from other compensation studies for the following reasons. First, I present estimates for the whole board, executive directors and CEO remuneration and compare the results between these categories. Most existing studies have used the agency theory perspective to analyse one or two of these categories but not all at one time. For example, Brick et al. (2006), used only agency theory to analyse CEO compensation, director compensation and firm performance, whereas Lin (2005) used agency theory and stewardship theory to analyse CEO compensation, firm performance and corporate control mechanisms. This chapter considers agency theory, stewardship theory and stakeholder theory in the analyses of board compensation, executive compensation and CEO compensation. This is comprehensive in comparison with other compensation studies.

Secondly, the chapter uses industry-specific measures of performance that are pertinent in the context of the football industry such as the percentage of league points, winning percentage, attendance, pre-tax profits and the ratio of turnover to total assets. Specifically, I consider alternative measures of productivity performance that might have an impact on directors' remuneration. Most previous studies used common measures such as return on equity (e.g. Dyl, 1988), return on assets (e.g. Core et al., 1999), Tobin's Q (e.g. Mehran, 1995) and operating profits (e.g. Samuels and Piper, 1998). In this context, my analysis comprises original measures of firm performance. Thirdly, while most studies use old data from the 1980s and early 1990s, this chapter uses more recent data that covers the ten-year period from 1998 to 2007. Fourth, the existing studies combine observations for many industries. This chapter is more focused by exploring only the football industry.

The structure of the chapter is as follows. Section 6.2 describes corporate governance theories used in this analysis. Section 6.3 describes the theoretical framework and formulates testable hypotheses. Section 6.4 discusses the research method and samples. Section 6.5 contains and discusses the results of the determinants of directors' remuneration both in contemporaneous and lagged relationships. Section 6.6 presents additional tests using data from the full sample. Section 6.7 reports regression results that exclude outliers in estimations. The summary and conclusion are discussed in section 6.8. Section 6.9 contains appendices with results that exclude outliers in regression estimations.

## **6.2 Corporate Governance**

Corporate governance has broad cross-disciplinary applications. There is no single agreed definition of corporate governance and numerous researchers have defined it in different ways. Shleifer and Vishny (1997) defined corporate governance as the ways in which owners of corporations assure themselves of getting a return on their investment. Another paper argued that “corporate governance is concerned with the relationship between the internal governance mechanisms of corporations, and society’s conception of the scope of corporate accountability” (Deakin and Hughes, 1997). By similar means of analysis, Aoki (2000) states that corporate governance is concerned with “the structure of rights and responsibilities among the parties with a stake in the firm”. These definitions have been relying on the efficacy of the various mechanisms available to protect shareholders from opportunistic behaviour of executives.

Alternatively, Daily et al. (2003) defined corporate governance as the determination of the broad uses to which company resources will be deployed and the resolution of conflicts among the myriad participants in organisations. This definition appears different from many definitions of corporate governance research, in which researchers have focused mainly on the control of the self-interested behaviour of managers and the protection of shareholder interests in settings where company ownership and control are separated. Despite having multiple meanings, there are three theories of corporate governance whose applications can enrich our understanding about how football clubs are governed. The next three sub-sections review these principal theories of corporate governance.

### **6.2.1 Agency Theory**

Agency theory has its roots in information economics and has been applied by researchers in accounting (e.g. Demski and Feltham, 1978), economics (e.g. Spence and Zeckhauser, 1971) and mostly in finance (e.g. Jensen and Meckling, 1976, Fama, 1980, Fama and Jensen, 1983). The theory is based on the premise that a corporation is run by managers (agents) on behalf of owners (principals), and that managers attempt to maximise their own interests rather than shareholders’ interests (Jensen and Meckling, 1976). Agency theory has been developed with both a theoretical and empirical basis that encourages the investigation of agency problems arising from goal incongruence between managers and shareholders.

In modern literature, Ali et al. (2007) discussed two types of agency problems that exist in public corporations. The first type of agency problem, commonly known as the “Type I agency problem” arises from the separation of ownership and administration. The separation of stockholders from managers who run and control the company may lead to managers not acting in the best interest of stockholders. The second type of agency problem is known as “Type II agency problem”. This arises from conflicts between controlling and non-controlling shareholders. Majority shareholders may seek private benefits at the expense of minority shareholders. Apart from these two, the third type of agency problem arises from the conflicts of shareholders and creditors. However, this is less related to the central focus of this research. Type I agency problem is prevalent in the literature and mostly applicable to listed corporations where there is diffused share ownership.

Dalton et al. (2003) divide agency theory research in two broad themes. The authors termed the first category as ‘alignment’ and the second as ‘control’. The alignment view is generally concerned with the attainment of resemblance in the interests of shareholders and managers (Fama and Jensen, 1983, Fama, 1980). The main problem of this concept is managerial self-interest behaviour. There are two solutions to this problem. The first is to align the interests of owners and managers through payment packages. This is done through tying managerial pay to corporate performance. The second solution is to employ managers with equity ownership in the firm. This implies that managers holding a substantial stake in the firm will not invest in loss making projects. Jensen and Murphy (1990) asserted that if these solutions are closely aligned to the interests of shareholders and managers, then firm performance will be improved.

The control approach is concerned with the monitoring of managers through the concentrated shareholding of firms. It is argued that concentrated ownership may facilitate the monitoring of managers’ actions that are detrimental to firm performance. Demsetz and Lehn (1985) suggested that significant ownership by institutions and blockholders encourages the monitoring process of management which as a consequence leads to superior firm performance. The implication for corporate governance from the agency perspective is that satisfactory monitoring or control mechanisms need to be established to protect shareholders from managerial opportunistic behaviour. Fama and Jensen (1983) suggest that this control mechanism is required due to the existence of agency costs in modern corporations. Generally, agency theory is the most researched tenet in corporate governance literature. However, the empirical evidence that supports the prediction of this theory is mixed depending on the circumstances.

### *Agency Theory and Family Firms*

Family-owned or closely-held firms dominate the English football industry. For the period 1997 to 2007, of the 92 English Football League clubs, only 22 firms were listed, and some have already been delisted. This is about 24% of the total amount. In this research, the database includes firms with a wide range of ownership with manager/owner structures. Some firms are owned by one or more individuals and other firms are managed by outsiders with no equity or very low equity ownership. Shleifer and Vishny (1997) emphasised the study of characteristics of family firms in order to understand properly the economic efficiency of different corporate governance architecture.

Ali et al. (2007) find that family firms are characterised by more severe Type II agency problems and by less severe Type I agency problems. There is a concentration of ownership and management in the hands of a family which provides power to that particular family and enables them to act in a way beneficial to the family and detrimental to the non-controlling shareholders. Examples of this kind of agency problem are for the family paying excessive remuneration, investing in loss making projects, consuming perquisites and tunnelling. The implementation of good corporate governance practices should prevent expropriation of wealth from minority shareholders to majority shareholders.

#### **6.2.2 Stewardship Theory**

Stewardship theory originated in psychology and sociology and takes the opposite view to agency theory. In this theory, managers are regarded as basically trustworthy individuals who look after shareholders' interests (Donaldson and Davis, 1991, Davis et al., 1997). The stewardship theory views the individual as primarily pro-organisational and cooperative in his attitude whilst agency theory views the individual as individualistic and opportunistic. Proponents of stewardship theory assert that better firm performance is associated with managers as they work to maximise shareholders' wealth. This is based on the view that executive directors understand the business they run better than non-executive directors and so can make suitable decisions (Davis et al., 1997, Donaldson, 1990).

In plain terms, the stewardship framework regards managers as naturally honest, thus the board of directors should have a significant proportion of inside directors to ensure more effective and efficient decision-making. The reputation of executive directors is superior as they act in the best interests of the company's owners. In this context, the tendency towards combining the posts of CEO and Chairman is regarded as a positive development because there is a clear leadership for the company. Similar to agency theory, stewardship theory suggests that the firm's objective is the maximisation of shareholder value. The empirical evidence for this theory is mixed.

### **6.2.3 Stakeholder Theory**

Freeman (1984) developed stakeholder theory arguing that managers should balance the financial interests of the shareholders against the interests of other stakeholders such as employees, customers and the local community, even if it reduce shareholder wealth. This theory addresses the issue of corporate governance from a different perspective. Donaldson and Preston (1995) provide a useful framework for understanding stakeholder theory in detail. The authors propose and justify three types of stakeholder theory; descriptive, instrumental and normative. The descriptive theory is used to describe, and sometimes to clarify, specific corporate characteristics and behaviours. For example, it has been used to explain the nature of the firm (Brenner and Cochran, 1991) and how corporations are actually governed (Kreiner and Bambri, 1991). Some studies of stakeholder concept labelled the descriptive theory as 'empirical'.

The instrumental theory is used in conjunction with descriptive theory to identify relations or the lack thereof between stakeholder management and the achievement of corporate objectives (e.g. firm value, profitability, growth). For example, Preston and Sapienza (1990) adopted instrumental theory in the analysis of stakeholder management and corporate performance. Instrumental theory suggests that those corporations that effectively manage stakeholders will achieve the highest level of firm performance. The implicit conjecture deriving from instrumental theory is that firms that adopt a stakeholder approach will do better than firms that adopt a shareholder approach (Jones, 1995).

The normative theory is used to understand the functions of a corporation, including the identification of ethical guidelines for the proper operation and management of corporations.

Essentially then, the normative form of stakeholder theory is largely focused on how organisations should manage company stakeholders. Phillips et al. (2003) suggests that stakeholder theory seeks to connect economics and morality because the theory is more concerned with organisational management and ethics. The classic stakeholder theory is dominated by normative theory since the very early study of Dodd (1932) to the recent paper by Friedman and Miles (2006).

The first application of stakeholder theory as a model in corporate governance research was carried out by Freeman and Evan (1990). The authors utilised Williamson's transaction cost framework in analysing diversity of stakeholders within an organisation. Williamson (1984), as well as Freeman and Evan (1990), advocated that corporate governance is at the centre of the modern theory of the firm. Williamson (1984) asserted that the prime stakeholders of a corporation are in fact the customers, suppliers, owners, managers, employees and communities. He stipulated that there is multiplicity of governance mechanisms for those stakeholders who have a stake in the firm.

Furthermore, Williamson (1984) suggested that the voting rights of stakeholders must strictly be limited to those who share a firm's residual risk. He identifies the group that bears the residual risk to include owners, and under special circumstances, managers and suppliers. The main implication of his view is that the firm is seen as a governance mechanism for the set of contracts between interested parties who make economic gains through their participation in these contractual relationships. The stakeholder theory adds interesting dimensions into the corporate governance research. The theory goes beyond agency theory by considering the firm's multiple objectives rather than the singular objective of enhancing shareholders' value, as is seen in agency theory.

Stakeholder theory advocates a different measure of performance, that is, the maximising of the balanced interests of various stakeholders of which shareholders are just one of them. Some studies have criticised the stakeholder concept arguing that the theory lacks one clearly defined objective function on which the firm's performance can be measured. For example, Jensen (2002) argued that it is logically impossible to maximise in more than one dimension at the same time, unless the dimensions are "monotonic transformations" of one another. He added that the ambiguity of multiple objectives can be resolved by specifying the trade-offs among the various dimensions.

Despite the substantial literature on stakeholder theory, there is little which applies the theory specifically to governance research. In fact, the stakeholder model has not been subjected to any significant amount of empirical research in finance. Few papers have systematically enquired into how corporate managers believe themselves to pursue multiple stakeholder objectives. Preston and Sapienz (1990) is the first empirical study that investigated stakeholder management and corporate performance. The authors have analysed stakeholder performance and financial data assigned in four major industries. A further empirical study is that conducted by Berman et al. (1999) which examined whether the stakeholder approach enhances the firm's financial performance.

### **6.3 Theoretical Framework and Hypotheses**

Corporate governance in the football sector is a somewhat complex subject matter. I use previous research as a starting point for formulating testable hypotheses and building empirical models of directors' remuneration. In order to develop explicit hypotheses, I augment past research by incorporating knowledge of firm-specific characteristics and the business environment of football clubs. Theoretically, the design of managerial remuneration is an agency issue which is an important matter in finance literature. The football industry has special features, which are different from traditional industries. These features are incorporated in the hypotheses' development.

#### **6.3.1 Remuneration and Firm Performance**

There is considerable literature that examined linkages between managerial remuneration and the performance of corporate entities.<sup>34</sup> Directors' remuneration is an important instrument for soliciting effort, rewarding productivity and ensuring compliance with stakeholders' interests. According to corporate governance codes, corporate entities are required to ensure that the level and composition of directors' remuneration is sufficient and reasonably linked to corporate performance. Football clubs, unlike traditional companies, have conflicting objectives resulting

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<sup>34</sup> Some examples include Murphy (1985), Jensen and Murphy (1990), Gregg et al. (1993), Conyon and Leech (1994), Core et al. (1999) and Doucouliagos et al. (2007).

from their business environment. Clubs have responsibilities to several stakeholder groups of which shareholders are just one.

According to agency and stewardship theories, the firm's objective is to maximise shareholder value, whilst stakeholder theory of the firm suggests that the corporation's objective is to maximise the balanced interests of the various stakeholders. The standards for judging performance differ between the shareholder model and stakeholder approach. According to the shareholder model, the objective of the firm is to maximise profits through allocative, productive and dynamic efficiency. In the stakeholder approach, performance is judged in a wider constituency through considering satisfaction of several stakeholders such as customers, suppliers, employees and shareholders.

Accordingly, the view of stakeholder theory seems to be more appropriate to football clubs than that of agency and stewardship theories. A list of stakeholders in a football club includes owners, employees (e.g. players), fans, creditors, sponsors, media and the league itself. The maximisation of playing success will inspire fans, players, creditors, sponsors, shareholders and directors of the club. On the other hand, financial performance will inspire owners, directors and creditors. To achieve the objective suggested by stakeholder theory, a football firm is obligated to balance on-the-field performance as well as off-the-field performance. In doing so, the interests of various stakeholders will be attained. Actually, a greater number of stakeholders prefer sporting achievement and so, we may see a stronger relationship between productivity performance and directors' remuneration than financial performance. This leads to the following formal hypothesis.

*H1: There is a stronger relationship between productivity performance and directors' remuneration than financial performance.*

### **6.3.2 Remuneration and Firm Size**

The impact of firm size on board and CEO remuneration has attracted the attention of many researchers. Several papers found firm size to be an important controlling variable influencing managerial remuneration (Murphy, 1985, Conyon, 1997, Bliss and Rosen, 2001, Gregg et al., 1993). Past research has used different logic in their comparisons of firm size and board remuneration. First, it is argued that larger companies have an extensive hierarchical management structure, and each level is expected to have a salary differential. Football clubs are

akin to traditional companies that have hierarchies in their organisation structure. A typical club structure contains boards of directors, executive employees, team managers and other coaching staff. This shows there to be a hierarchical structure in the organisation. Thus, directors' pay at a larger size club exceeds directors' pay at a small size club because larger clubs contain more hierarchies in their organisation structure.

Second, the degree of complexity of tasks and decisions is greater in larger companies than in smaller firms. Firth et al. (1999b) documented that in a larger company, the CEO and other top managers have more scope to exercise their skills because of the complex nature of the organisation. This means that directors in a larger company should be rewarded more than directors in a small company. Some football clubs are larger than others and run several subsidiaries, including a youth academy and catering facilities at their own grounds. Thus, administration of many activities in a larger club requires adequate skills and experience which as a consequence leads to higher managerial remuneration.

Third, larger firms usually have high absolute profits and therefore, high managerial remuneration may appear as an insignificant expenditure in published annual accounts. This happens in some clubs where there is a larger revenue foundation due to regular high attendance and lucrative sponsor deals. On top of this, many larger companies may have a diffused share ownership in which shareholders have no incentives to monitor excessive managerial pay. This is unsuitable in football firms because ownership is largely concentrated. In a nutshell, football corporations are not equal in terms of size. Some companies are bigger in terms of the number of employees, ground capacity and even fan base. For these three key reasons, I expect there to be a positive relationship between directors' remuneration and firm size. The formal research hypothesis is stipulated as follows:

*H2: There is a positive relationship between firm size and directors' remuneration.*

### **6.3.3 Remuneration and Governance Structure**

According to prior research, the firm-specific corporate governance characteristics refer, amongst others, to the ownership structure and composition of the board. Both kinds of attributes are able to influence directors' remuneration through ownership concentration and proportion of non-executive directors. The football sector has many family-controlled businesses that are actively managed by the first or second generation of the family. By family

control, this refers to firms where the directors and their families have considerable shareholding and voting power. La Porta et al. (1999) considered that high managerial ownership had important implications for corporate governance, firm performance and setting of directors' pay.

Berle and Means (1932) contended that separation of ownership and control in a corporation is the main source of agency problems. The vast majority of football clubs in the English Premiership are incorporated as public or private companies and most privately held football clubs have high managerial ownership. In theory, the management structure of firms with large managerial ownership is autocratic thus implying that some controlling shareholders might treat their company as a personal fiefdom for doing anything they wish (Cheng and Firth, 2005). It is noted that agency problems of firms with diffused ownership are different from firms with concentrated ownership. When managerial ownership is low, shareholders are concerned with managers shirking their duties. However, this problem is eliminated when there is high managerial ownership.

There is a different agency problem that arises when managerial share ownership is high. Previous research mentioned that majority shareholders may expropriate assets away from minority shareholders (Cheng and Firth, 2005). One way of expropriating is through considerable and unwarranted managerial compensation. In contrast to this view, Deckop (1988) and Ramaswamy et al. (2000) finds that directors with substantial shareholding tend to obtain reduced compensation. I build up my hypothesis through supporting this stream of literature. There are two reasons that I back up my hypothesis in this way.

First, the need for high remuneration is lessened when directors have substantial shareholding because they receive dividends and enjoy capital gains from the shares owned. Directors with large stakes in football companies demand modest remuneration because money saved will enhance growth through acquiring talented players and increase the potential for the success of the club. Second, taking reasonable remuneration gives directors a device by which to reduce wage demands of lower level managers, which assist in improving the firm's financial performance (Firth et al., 1996). From this understanding, I propose the following research hypothesis:

*H3: There is a negative relationship between managerial share ownership and directors' remuneration.*

The board of directors is the major internal corporate governance mechanism which stands for shareholders' interest through oversees management behaviour in the overall process of running a company's affairs (Ezzamel and Watson, 1998, Cosh and Hughes, 1997). Normally, the board is composed of executive and non-executive directors. Football clubs, like other companies contain a board of directors with the same structural composition. According to corporate governance codes in the UK, non-executive directors are expected to control unnecessary managerial compensation and encourage the use of performance related pay (Cadbury, 1992, Greenbury, 1995, Hampel, 1998). Fama and Jensen (1983) insisted that non-executive directors take their obligations seriously, if they wish to maintain and enhance their reputations.

Previous research considered the proportion of non-executive directors as a signal of a strong board that was able to control top management remuneration (Conyon and Peck, 1998, Cheng and Firth, 2005). In most cases, non-executive directors of one firm are executive directors in other firms, and they often know each other. According to this logic, much research finds that non-executive directors may inflate the pay of top management, and as a consequence, this may lead to an increase in remuneration in their own firms (Lorsch and MacIver, 1989, Ezzamel and Watson, 2002). In this study, I test if the proportion of non-executive directors exerts any impact on directors' remuneration. Based on the idea that non-executive directors act as a safeguard against unjustifiable managerial remuneration, I expect that directors' remuneration will be negatively affected by the proportion of non-executive directors.

*H4: The proportion of non-executive directors on the board has a negative impact on directors' remuneration.*

Figure 6-1 provides a summary of the hypotheses in this chapter and their related theories. The figure shows the direction of the relationship in each hypothesis and its respective theory.

### Figure 6-1: Summary of Theories and Hypotheses

This figure provides the summary of the theories used along with the hypotheses developed. The figure also reveals the direction of the relationship for each hypothesis and its corresponding theory.

	Agency Theory	Stewardship Theory	Stakeholder Theory
Hypothesis 1	+	N/A	+
Hypothesis 2	+	N/A	N/A
Hypothesis 3	-	N/A	N/A
Hypothesis 4	-	-	N/A

Source: Own Construction

## 6.4 Research Method and Sample

This chapter uses data from FA Premier League firms. All data is collected from 1998 to 2007; a total of ten years. The total sample size is 200 firm-year observations from 37 firms. Football clubs are mostly privately-owned firms that make voluntary disclosures about their corporate governance practices in their regulatory filings. As a result, not all firms disclose their directors' remuneration and other governance characteristics accordingly. There are a total of 192 observations for board remuneration, 150 observations for executive directors' remuneration and 183 observations for the CEO remuneration.

### 6.4.1 Dependent Variables

There are three dependent variables used in this chapter. They are; board remuneration, executive directors' remuneration and CEO remuneration. All three of these variables have been used in the literature. For example, Crespí-Cladera and Gispert (2003) adopted total board compensation, Doucouliagos et al. (2007) adopted both board remuneration and CEO remuneration, whereas Mehran (1995) studied executive compensation structure. To mitigate for the problem of heterogeneity as observed in the descriptive statistics, I follow the common practice of using logarithms of remuneration figures (e.g. Conyon and Peck, 1998, Cheng and Firth, 2005).

### 6.4.2 Independent Variables

#### 6.4.2.1 Performance and Size Variables

I included a number of performance and size variables that may have an impact on directors' remuneration. Unlike previous studies, firm performance has several metrics ranging from

financial measures to non- financial measures (i.e. industry-specific measures). I have adopted two measures of financial performance. First, I employed pre-tax profits as a measure of financial performance. I use pre-tax profits rather than operating profits for one important reason. There are 108 firm-year observations that reported losses during the sample period. This represents more than 50% of the observations analysed. That implies that figures of operating profits in these observations have a tax benefit effect. Therefore, it is realistic to use pre-tax profits rather than operating profits. The full sample reported there to be overall a pre-tax loss which suggests that many firms in the football industry reported losses during the sample period.

Second, I employed the ratio of turnover to total assets. This analysis uses this ratio for one important reason. This ratio measures how efficiently managers use available resources (i.e. total assets) to generate revenues for the company. A low ratio indicates that managers failed to utilise available resources to provide adequate revenues. For this reason, it is rational that one finds that firms with a higher turnover asset ratio pay larger directors' remuneration than firms with low turnover asset ratios.

I introduce different measures of productivity performance used in existing academic research. Of these studies, Szymanski and Kuypers (1999) used league position and wins, whilst Murphy (1999b) used league position, league points and goals scored. Gerrard (2001) adopted league points, while other scholars have adopted winning percentage as their measure of performance (Dawson et al., 2000, Boulier and Stekler, 2003, Marques, 2002). Following on from these studies, I therefore use three different metrics of productivity performance. These are; the percentage of league points, winning percentage and match attendance. I included attendance because the variable measures the entertainment aspect of performance which is preferred by many stakeholders of football firms. The correlation between attendance and percentage of league points is about 58%.

Firm size is measured by the number of employees. In the football context, the number of employees is a more appropriate measure of firm size than total assets and turnover for two reasons. First, total assets are highly influenced by wealthy investors who can inject interest free loans in their firms. For example, Chelsea had large intangible assets in 2005, which reflected recent expenditure on player transfer fees after the takeover by Roman Abramovich. Second, turnover is highly influenced by productivity performance. Normally, firms get significant

revenue during success in a particular tournament. Even discounting these reasons, many previous studies adopted the number of employees as their measure of firm size (e.g. Shaffer, 2002, Brunello et al., 2001, Nourayi and Daroca, 2008).

#### *6.4.2.2 Ownership and Board Composition Variables*

Board ownership is used to capture the impact of ownership structure on directors' remuneration. Many previous studies used directors' ownership among the independent variables in identifying determinants of managerial remuneration (e.g. Doucouliagos et al., 2007, Core et al., 1999, Crespí-Cladera and Gispert, 2003). Other studies used both directors' ownership and institutional ownership (e.g. Cheng and Firth, 2005, Firth et al., 1999b). The proportion of non-executive directors is another variable that is included in the regression specifications. I use this approach following recommendations from UK corporate governance codes (Cadbury, 1992, Greenbury, 1995). Additionally, the inclusion of this variable is common in practice (Doucouliagos et al., 2007, Conyon and Peck, 1998, Firth et al., 1999b).

#### *6.4.2.3 Control Variables*

Age and tenure are two factors that may influence directors' remuneration. Directors who have served for a long period of time in the firm are more likely to be skilled and to have acquired adequate experience. The additional skills and experience may contribute to firm performance and lead to more effective corporate control. Some previous studies have adopted age as the proxy for experience and find it to be an important factor for determining directors' remuneration (e.g. Doucouliagos et al., 2007).

It is reasonable to argue that older directors are more efficient in running the firm due to experience, and that it enhances their compensation. However in reality, the opposite may be true; they might be inefficient and less productive due to age and this may reduce their pay. Stathopoulos et al. (2004) finds that average managerial pay is negatively related to age, which implies that older directors are less effective and productive. In the present study, I included both age and tenure as seniority may allow for the capture of skills and experience that would have an influential impact on overall firm performance and as a consequence affect directors' remuneration.

### 6.4.3 Empirical Specifications

I adopt the standard empirical literature on managerial remuneration and use the following regression model to determine the impact of performance, size and governance attributes on directors' remuneration.

#### Equation 6-1

$$\log(Rem_{i,t}) = \beta_0 + \beta_1(Per_{i,t}) + \beta_2(Size_{i,t}) + \beta_3(Corgov_{i,t}) + \beta_4(Controls_{i,t}) + \gamma_t + \varepsilon_{i,t} \dots (6.1)$$

Where *Rem* = Directors' remuneration

*Per* = Firm performance

*Corgov* = Corporate governance

The regression specification assumes the contemporaneous relationship between directors' remuneration and its determinants. However, most prior studies assumed a lagged relationship, particularly on performance measures. In a separate specification, I use lagged performance measures to account for the possibility that remuneration paid in the current year is determined by the previous year's firm performance.

### 6.4.4 Analysis

The estimated regression uses panel data econometric techniques (Wooldridge, 2006, Baltagi, 1995) that model factors which influence directors' remuneration. In the initial stage, I estimated fixed effect models, which control for company-specific characteristics that affect managerial remuneration but are not observable or directly included in the models. I then follow the Hausman specification test to identify more efficient models between fixed and random effects. Brick et al. (2006) used the same approach in the analyses of directors' remuneration and firm performance.

Many econometricians recommend fixed effect estimation as a reasonable thing to do with panel data, but they may not be most efficient models to run (Wooldridge, 2006). I, therefore, estimated random effects models because it is statistically justifiable through the Hausman specification test. In some circumstances where data fails to meet the asymptotic assumptions, a generalisation of the Hausman test (Sargan-Hansen statistic) is used as suggested in econometrics (Arellano, 1993). Wooldridge (2006) recommends random effects models rather

than pooled ordinary least squares because random effects models are generally more efficient. In addition to that, I performed the joint significance test for year dummies for all models estimated. I included year dummies only when they were jointly significant, and otherwise not.

#### **6.4.5 Endogeneity**

In some regression specifications, I adopted lagged values of performance measures as explanatory variables. The inclusion of lagged performance lessens the extent of any possible endogeneity. Previous research such as Doucouliagos et al. (2007) and Duffhues and Kabir (2008) used only one lag because doing that reduces the problem of endogeneity in regression estimations. One earlier exception is the study by Boschen and Smith (1995) who adopted three lags in their models. Taking this statistical issue into consideration, I am confident that my approach on empirical specifications is a sound one.

#### **6.4.6 Multicollinearity**

To make sure my results are not affected by the problem of multicollinearity, two techniques were considered. The first technique is the correlation matrix analysed in chapter 5, which identified highly correlated variables. I did not include productivity performance measures in one regression estimation because these variables were highly correlated. This procedure alleviates the problem of multicollinearity among productivity performance measures. Secondly, I employed Variance Inflation Factor (VIF) to check multicollinearity among the explanatory variables after regression estimations. VIF measures the level of multicollinearity amongst independent variables in multiple regressions. This method measure the extent to which the variable contributes to the standard error in the regression.

A VIF coefficient of 1 implies no multicollinearity, while a coefficient of more than 10 indicates a serious multicollinearity problem (Gujarati, 2003). In my estimation, none of the explanatory variables in the regression equations revealed VIF coefficient above 3.36. This figure is far below the conventional rule of thumb of 10. This suggests there is no problem of multicollinearity in the whole analysis. For brevity purposes, I did not report VIF for each independent variable. It should be noted that panel data regressions in STATA software do not work with VIF as a post estimation command. It is recommended to estimate OLS regression using the same set of independent variables before introducing multicollinearity diagnostic tests of VIF. To summarise, I concluded that the results were not a function of multicollinearity.

## **6.5 Results**

Table 6-1 to 6-3 reports the regression results of this chapter. The estimated models assume both the contemporary and lagged relationship of firm's performance measures. My main interest was the sign and significance of performance, size and corporate governance variables. Another important aspect is to find out if there is any difference in the determinants between categories of directors' remuneration. In every table, column (1) to (3) represent contemporaneous models and column (4) to (6) represent models with lagged performance variables. The regression specifications are similar except that I replace one productivity performance measure in each model. Table 6-1 and 6-2 did not include year dummies because jointly they are not significant determinants of managerial remuneration. Table 6-3 include year dummies because they are jointly significant determinants of CEO compensation. For reasons of brevity, regression estimates on year dummies are not reported in the tables.

### **6.5.1 Remuneration, Performance and Size**

Table 6-1 reports the panel regression results where board remuneration is significantly related to several potential determinants of pay. I find that current attendance is the only measure of performance that has an impact on board remuneration. The finding shows that attendance is positive and statistically significant at the 1% level. The coefficient estimate however, indicates that attendance increases board remuneration by about 0.71. This means that the impact of attendance on board remuneration is economically noteworthy. Wald's test indicates Model (3) is the most preferred among the regression equations estimated ( $\chi^2 = 101.28$ ,  $\rho$ -value=0.00).

Table 6-2 details the regression results of executive remuneration. The results indicate that executive pay is wholly determined by productivity performance. The relationship between executive remuneration and percentage of league points is statistically significant at the 1% level. The coefficient estimate demonstrates that percentage of league points enhances executive compensation by about 1.10. In addition, the results show that winning percentage has a substantial impact on executive remuneration. These findings indicate statistical significance which starts from the 10% level or better. Importantly, the coefficients' estimates show that winning percentage increases executive remuneration by about 1.04 to 1.05. Overall, the influence of productivity performance measures on executive remuneration is economically important.

**Table 6-1: Board Remuneration Regressions for FA Premier League Firms**

This table presents the results of the regression which identifies determinants of board remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable, ln (board remuneration) is defined as the natural logarithm of total cash paid to board members during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) are proportions of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) are the proportion of non-executive directors in the board. Director age is the average age of a director. Director tenure is the average number of years a director served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients, p-value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.391*** (6.498)	4.387*** (6.416)	-2.257 (-0.955)	4.395*** (6.387)	4.329*** (6.270)	0.404 (0.155)
Ln (pre-tax profits)	-0.010 (-0.920)	-0.010 (-0.871)	-0.011 (-1.003)	-0.006 (-0.558)	-0.007 (-0.626)	-0.006 (-0.554)
Turnover/Total assets	0.067 (0.734)	0.068 (0.736)	0.065 (0.730)	-0.035 (-0.369)	-0.031 (-0.330)	-0.035 (-0.373)
League points (%)	0.468 (1.000)	-	-	0.303 (0.560)	-	-
Winning (%)	-	0.387 (0.825)	-	-	0.528 (0.978)	-
Ln (attendance)	-	-	0.709*** (2.982)	-	-	0.426 (1.613)
Firm size	0.613*** (5.601)	0.618*** (5.658)	0.554*** (5.101)	0.594*** (4.981)	0.586*** (4.931)	0.551*** (4.530)
Board ownership (%)	-0.011*** (-4.457)	-0.011*** (-4.458)	-0.010*** (-4.107)	-0.012*** (-4.548)	-0.012*** (-4.597)	-0.011*** (-4.374)
Non-executive directors (%)	-0.014*** (-3.887)	-0.014*** (-3.906)	-0.016*** (-4.415)	-0.012*** (-2.975)	-0.012*** (-3.002)	-0.012*** (-3.162)
Director age	-0.024*** (-3.346)	-0.024*** (-3.341)	-0.024*** (-3.371)	-0.020*** (-2.676)	-0.020*** (-2.705)	-0.018** (-2.442)
Director tenure	0.065*** (2.748)	0.065*** (2.750)	0.051** (2.179)	0.054** (2.058)	0.053** (2.039)	0.043 (1.601)
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	28	28	28	24	24	24
Observations	153	153	153	126	126	126
Wald $\chi^2$	88.47*** (0.000)	87.98*** (0.000)	101.28*** (0.000)	62.94*** (0.000)	63.92*** (0.000)	66.80*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

Table 6-3 reports the CEO remuneration regression results. The findings indicate that CEO remuneration is entirely determined by productivity performance measures. The evidence indicates that current attendance and all previous productivity performance measures are statistically significant determinants of CEO remuneration. The estimated coefficients for

attendance are positive and statistically significant at the 1% level. The percentage of league points and winning percentage are statistically significant at the 10% and 5% level respectively. Wald's test results confirm that Model (3) is superior to others ( $\chi^2 = 95.00$ ,  $p\text{-value}=0.00$ ). The findings on these models suggest that attendance is the key determinant of CEO remuneration rather than other measures of productivity performance.

The coefficient estimates show that attendance enhances CEO remuneration by about 0.63 to 0.69. Also, the coefficients' estimates for the percentage of league points and winning percentage are 0.94 and 1.01 respectively. Such coefficient estimates suggest that the impact of productivity performance measures on CEO remuneration is economically considerable. Overall, these findings are similar to many previous studies despite the use of different performance metrics. The available research on the remuneration and performance relationship is documented in two widely cited survey papers of Murphy et al. (1999) and Core et al. (2003). My result is consistent with the most accepted evidence that the relationship is positive. The positive pay-performance relationship confirms the role played by compensation in aligning interests of managers and those of stakeholders.

In contrast, there are few studies that do not find a positive relationship. For instance, Core et al. (1999), Brick et al. (2006) and Duffhues and Kabir (2008) find a significant negative pay-performance relationship. Other studies find very low pay-performance sensitivity. For example, see studies by Conyon and Murphy (2000) in the UK and Firth et al. (2006) in China. In every regression estimated, I find no evidence that financial performance influences directors' remuneration. My finding confirms the first hypothesis that productivity performance is stronger than financial performance in influencing directors' remuneration.

The logarithm of the number of employees (a proxy for firm size) is a consistently significant determinant of directors' remuneration. The results indicate that the size to pay relationship is strong and significant at the 1% level to all regression models estimated in the whole analysis. Across all the tables, the coefficient estimates for firm size range from 0.30 to 0.52. This indicates that firm size is an economically important determinant of directors' remuneration. Consistent with Core et al. (1999), these results justify that firm size and complexity are linked to higher managerial compensation. The positive association between pay and size is a well-established finding in director compensation studies.

The role of firm size on directors' remuneration is compatible with a diversity of explanations (Rosen, 1992, Kostiuk, 1990). For example, Rosen (1992) provides a theoretical validation for the positive link between firm size and pay. The logic is that as the company size increases, its operations become more complex and managers should thus be rewarded for the increased complexity. In this chapter, the estimates on firm size are similar to those found in the literature (Murphy et al., 1999, Giorgio and Arman, 2008).

### **6.5.2 Remuneration and Corporate Governance Attributes**

Managerial share ownership in the firm has a substantial impact on directors' remuneration. It is notable that board ownership is constantly indicative of a significant negative relationship in all estimated regressions. The relationship is strong in many models, indicating the 5% level or better statistical significance. This suggests that directors who own a higher percentage of their own firm's shares earn less remuneration compared to directors who own lower percentages of their own firm's shares. This finding is consistent with many previous studies. For example, Core et al. (1999) and Cyert et al. (2002) find that directors' ownership has significant negative coefficients on managerial remuneration regression. The essence of this finding is that directors with considerable share ownership in the firm are happy to receive dividends and enjoy capital gains instead of receiving excessive compensation.

Consistent with many recent prescriptions on governance, the proportion of non-executive directors is negative and statistically significantly related to board and executive remuneration. This finding holds alternative model specifications as well. In Table 6-1 and 6-2, the coefficients' estimates for the proportion of non-executive directors range from 0.01 to 0.02. This suggests that the proportion of non-executive directors tends to reduce board and executive remuneration, although it is not economically significant. The main implication here is that non-executive directors are independent and trustworthy when deciding on directors' compensation apart from CEO compensation. The negative coefficient on the presence of outside directors is consistent with empirical evidence on the monitoring value of additional non-executive directors. This provides support for the widespread contention that outside directors are better monitors of management than inside directors. This finding is similar to Kaplan and Minton (1994) as well as Basu et al. (2007) who suggest that non-executive directors perform vital corporate governance functions.

**Table 6-2: Executive Remuneration Regressions for FA Premier League Firms**

This table presents the results of the regression which identify determinants of executive directors' remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationships. All value variables are measured as of 1998. The dependent variable  $\ln$  (executive remuneration) is the natural logarithm of total cash paid to board executive members during the financial year.  $\ln$  (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) are proportions of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws is considered as half a win.  $\ln$  (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) are the proportion of non-executive directors in the board. Director age is the average age of an executive director. Director tenure is the average number of years an executive director served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $p$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.046*** (6.818)	3.987*** (6.594)	0.963 (0.410)	4.227*** (6.736)	4.158*** (6.622)	0.539 (0.200)
$\ln$ (pre-tax profits)	-0.006 (-0.610)	-0.005 (-0.529)	0.002 (0.256)	-0.014 (-1.390)	-0.015 (-1.432)	-0.012 (-1.158)
Turnover/Total assets	0.075 (1.050)	0.077 (1.070)	0.077 (1.042)	-0.004 (-0.053)	0.000 (0.004)	-0.004 (-0.050)
League points (%)	1.094*** (2.647)	-	-	0.862 (1.639)	-	-
Winning (%)	-	1.046** (2.511)	-	-	1.040* (1.920)	-
$\ln$ (attendance)	-	-	0.370 (1.536)	-	-	0.408 (1.459)
Firm size	0.502*** (5.254)	0.507*** (5.285)	0.478*** (4.641)	0.554*** (5.134)	0.547*** (5.098)	0.522*** (4.569)
Board ownership (%)	-0.006*** (-2.684)	-0.006*** (-2.744)	-0.005** (-2.274)	-0.006*** (-2.581)	-0.006*** (-2.646)	-0.006** (-2.440)
Non-executive directors (%)	-0.015*** (-3.979)	-0.015*** (-3.987)	-0.016*** (-4.151)	-0.017*** (-4.208)	-0.017*** (-4.258)	-0.017*** (-4.169)
Director age	-0.012* (-1.911)	-0.012* (-1.829)	-0.014** (-2.046)	-0.014* (-1.904)	-0.014** (-1.964)	-0.012* (-1.667)
Director tenure	0.023 (1.165)	0.023 (1.166)	0.025 (1.201)	0.032 (1.339)	0.031 (1.339)	0.023 (0.954)
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	23	23	23	19	19	19
Observations	120	120	120	99	99	99
Wald $\chi^2$	61.96*** (0.000)	60.91*** (0.000)	55.05*** (0.000)	56.72*** (0.000)	58.30*** (0.000)	55.78*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$

The proportional of non-executive directors has no significant impact on CEO remuneration. The coefficients are negative, as predicted but not statistically significant. This means that CEOs overshadow non-executive directors in making their own compensation decisions. It seems that most outside directors have been appointed or nominated by CEOs, thus becoming less independent and effective monitors of their own bosses. This reasoning is similar to Wade et al. (1990)'s conclusions on the ability of the CEO to influence compensation decisions

through his ability to influence outside directors. Also, CEOs may be authoritative either due to their talents and established long-term binding relationships to run the business or due to their larger stakes in the firm. The insignificance of the coefficient for outside directors in CEO remuneration is consistent with the findings of Hallock (1997).

### **6.5.3 Remuneration and Control Variables**

The coefficients for age have the negative sign and roughly similar magnitude in Table 6-1 and 6-3. In these tables, the relationship between age and remuneration is statistically significant at the 1% level. Table 6-2 indicates that age is consistently significant at the 10% level or better. The negative relationship is against labour economists' view that age is a proxy for experience and should be an important driver of pay. This finding implies that directors who are older are less effective and efficient and that lessens therefore their remuneration. In concise terms, younger directors are more productive thus receiving higher remuneration than old directors. This finding is consistent with Stathopoulos et al. (2004) and Doucouliagos et al. (2007) who found a negative relationship between directors' remuneration and age.

Table 6-1 and 6-3 demonstrate that tenure is positive and significant related to board and CEO remuneration respectively. In particular, CEO tenure is statistically significant at the 1% level across all regression models estimated. Table 6-1 indicates that director tenure appears strongly related to board remuneration from Model (1) to (5). There is no significant relationship between director tenure and executive remuneration. These results imply that CEO tenure has a major impact on the compensation of CEOs themselves, whereas the tenure for executive directors has nothing to do with their own compensation. Overall, these findings suggest that tenure is an important determinant of pay only for CEOs and not all executive directors.

**Table 6-3: CEO Remuneration Regressions for FA Premier League Firms**

This table presents the results of the regression which identified determinants of CEO remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable  $\ln(\text{CEO remuneration})$  is defined as the natural logarithm of total cash paid to the highest paid director during the financial year.  $\ln(\text{pre-tax profits})$  is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win.  $\ln(\text{attendance})$  is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) are the proportion of non-executive directors in the board. CEO tenure is the number of years a CEO served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects model. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $p$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	3.625*** (5.814)	3.591*** (5.701)	-2.238 (-1.035)	3.699*** (5.861)	3.636*** (5.741)	-2.721 (-1.164)
$\ln(\text{pre-tax profits})$	0.014 (1.355)	0.015 (1.374)	0.014 (1.339)	-0.004 (-0.352)	-0.004 (-0.339)	-0.002 (-0.187)
Turnover/Total assets	0.080 (0.929)	0.081 (0.940)	0.078 (0.931)	-0.097 (-1.100)	-0.093 (-1.060)	-0.095 (-1.089)
League points (%)	0.483 (1.097)	-	-	0.935* (1.858)	-	-
Winning (%)	-	0.482 (1.094)	-	-	1.011** (2.016)	-
$\ln(\text{attendance})$	-	-	0.628*** (2.884)	-	-	0.693*** (2.921)
Firm size	0.519*** (5.128)	0.522*** (5.164)	0.465*** (4.614)	0.515*** (4.702)	0.513*** (4.695)	0.458*** (4.148)
Board ownership (%)	-0.012*** (-5.417)	-0.012*** (-5.434)	-0.011*** (-5.123)	-0.011*** (-4.705)	-0.012*** (-4.804)	-0.010*** (-4.413)
Non-executive directors (%)	-0.002 (-0.617)	-0.002 (-0.632)	-0.003 (-1.001)	-0.003 (-0.748)	-0.003 (-0.732)	-0.004 (-0.984)
CEO age	-0.025*** (-3.609)	-0.024*** (-3.590)	-0.024*** (-3.678)	-0.028*** (-3.964)	-0.028*** (-3.980)	-0.025*** (-3.569)
CEO tenure	0.088*** (3.902)	0.088*** (3.892)	0.077*** (3.469)	0.089*** (3.606)	0.088*** (3.606)	0.072*** (2.903)
Year dummies	YES	YES	YES	YES	YES	YES
Number of Firms	26	26	26	23	23	23
Observations	148	148	148	123	123	123
Wald $\chi^2$	83.58*** (0.000)	83.52*** (0.000)	95.00*** (0.000)	67.11*** (0.000)	68.08*** (0.000)	74.53*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$

## 6.6 Additional Tests

So far, this chapter has evaluated determinants of directors' remuneration in the FA Premier League. This section addresses the determinants of managerial remuneration in the full sample. Table 6-4 to 6-6 reports results on the full sample. There are no new surprising results from the findings, only minor differences since the full sample comprises different sub-samples. The

models estimated include division dummies that control for major differences between subsamples. For purposes of clarity, regression estimates on division and year dummies are not reported in the tables.

**Table 6-4: Board Remuneration Regressions for Full Sample Firms**

This table presents the results of the regression which identifies determinants of board remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationships. All value variables are measured as of 1998. The dependent variable  $\ln$  (board remuneration) is defined as the natural logarithm of total cash paid to board members during the financial year.  $\ln$  (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) are proportions of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win.  $\ln$  (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors in the board. Director age is the average age of a director. Director tenure is the average number of years a director served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients, p-value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.663*** (6.635)	4.660*** (6.589)	-1.156 (-0.672)	4.620*** (6.169)	4.567*** (6.069)	-2.551 (-1.485)
$\ln$ (pre-tax profits)	0.003 (0.293)	0.003 (0.306)	-0.000 (-0.020)	0.015 (1.296)	0.015 (1.318)	0.004 (0.320)
Turnover/Total assets	-0.085 (-1.412)	-0.087 (-1.442)	-0.098 (-1.459)	-0.047 (-0.686)	-0.045 (-0.662)	-0.075 (-1.137)
League points (%)	0.569 (1.604)			0.622* (1.858)		
Winning (%)		0.500 (1.376)			0.671** (1.971)	
$\ln$ (attendance)			0.663*** (3.849)			0.785*** (4.745)
Firm size	0.389*** (3.985)	0.394*** (4.043)	0.297*** (2.964)	0.440*** (4.221)	0.441*** (4.235)	0.330*** (3.161)
Board ownership (%)	-0.002 (-1.343)	-0.002 (-1.364)	-0.002 (-1.315)	-0.002 (-1.152)	-0.002 (-1.175)	-0.001 (-0.715)
Non-executive directors (%)	-0.013*** (-4.844)	-0.013*** (-4.860)	-0.013*** (-4.948)	-0.014*** (-4.808)	-0.014*** (-4.816)	-0.013*** (-4.682)
Director age	-0.015** (-2.230)	-0.015** (-2.220)	-0.013* (-1.931)	-0.017** (-2.478)	-0.017** (-2.495)	-0.010 (-1.426)
Director tenure	0.056*** (2.663)	0.056*** (2.676)	0.041* (1.923)	0.048** (2.052)	0.048** (2.067)	0.014 (0.600)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	44	44	44	43	43	43
Observations	338	338	334	307	307	303
Wald $\chi^2$	128.67*** (0.000)	127.83*** (0.000)	146.27*** (0.000)	114.86*** (0.000)	115.45*** (0.000)	142.15*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

Table 6-4 shows the full sample results on board remuneration. The results suggest that board remuneration is wholly determined by productivity performance. As found previously, current attendance appeared to be a significant factor. Besides, all measures of productivity performance appeared significant in lagged relationship models. This is contrary to FA Premier League firms where current attendance is the only significant factor. Similar to previous analysis, firm size, proportion of non-executive directors, directors' age and tenure reveals similar relationships to board remuneration. Also, Wald's test show that Model (3) is the most preferable amongst the regression equations estimated ( $\chi^2 = 146.27$ ,  $p\text{-value}=0.00$ ). Unlike for FA Premier League firms, the variable that captures managerial ownership is not a statistically significant related to board remuneration.

Table 6-5 shows the full sample results on executive remuneration. The findings suggest that executive remuneration is determined by productivity performance measures. These results show there to be a stronger relationship in the lagged models than in the contemporary models. In addition, the coefficients on firm size, the proportion of non-executive directors and director age, exhibit the same trend of relationships in executive compensation regressions. These findings are qualitatively similar to the findings from the FA Premier League firms. The findings on board ownership and director tenure are not statistically significant. This is contrary to the findings from FA Premier League firms.

Table 6-6 shows the full sample results on CEO remuneration. The results suggest that CEO remuneration is entirely determined by productivity performance. Both contemporary and lagged models reveal that productivity performance is a significant determinant of CEO pay. This is comparable to FA Premier League firms where CEO remuneration is wholly determined by productivity performance measures. In addition, there is considerable evidence that CEO remuneration increases with firm size. The coefficients are positive with all models appearing statistically significant at the 5% level or better. There is very little evidence that the proportion of non-executive directors negatively affects CEO remuneration. The coefficients on board ownership, CEO age and tenure are statistically insignificant. This is inconsistent with the findings on FA Premier League firms where the proportion of non-executive directors, board ownership, CEO age and tenure were significantly positively related to CEO compensation.

**Table 6-5: Executive Remuneration Regressions for Full Sample Firms**

This table presents the results of the regression which identifies determinants of executive directors' remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable ln (executive remuneration) is the natural logarithm of total cash paid to board executive members during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, and in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) are the proportion of non-executive directors in the board. Director age is the average age of an executive director. Director tenure is the average number of years an executive director served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients, p-value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.768*** (6.044)	4.751*** (5.980)	1.043 (0.491)	4.368*** (5.478)	4.336*** (5.421)	-1.928 (-0.988)
Ln (pre-tax profits)	-0.002 (-0.157)	-0.001 (-0.112)	0.001 (0.077)	-0.001 (-0.063)	-0.001 (-0.050)	-0.004 (-0.339)
Turnover/Total assets	0.022 (0.233)	0.022 (0.229)	-0.005 (-0.049)	0.029 (0.305)	0.032 (0.340)	-0.090 (-0.952)
League points (%)	0.697* (1.799)	-	-	0.968*** (2.912)	-	-
Winning (%)	-	0.635 (1.595)	-	-	0.987*** (2.896)	-
Ln (attendance)	-	-	0.433** (2.021)	-	-	0.711*** (3.736)
Firm size	0.398*** (3.698)	0.404*** (3.753)	0.345*** (3.017)	0.489*** (4.353)	0.489*** (4.355)	0.393*** (3.403)
Board ownership (%)	0.001 (0.353)	0.001 (0.272)	0.000 (0.128)	0.001 (0.578)	0.001 (0.543)	0.002 (0.771)
Non-executive directors (%)	-0.016*** (-5.686)	-0.016*** (-5.705)	-0.016*** (-5.423)	-0.019*** (-6.069)	-0.020*** (-6.090)	-0.017*** (-5.219)
Director age	-0.018** (-2.314)	-0.017** (-2.280)	-0.016** (-2.075)	-0.019** (-2.317)	-0.019** (-2.346)	-0.014* (-1.690)
Director tenure	0.030 (1.312)	0.031 (1.343)	0.026 (1.125)	0.026 (0.995)	0.026 (1.005)	-0.001 (-0.038)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	33	33	33	31	31	31
Observations	219	219	216	195	195	192
Wald $\chi^2$	104.51*** (0.000)	103.77*** (0.000)	104.61*** (0.000)	115.73*** (0.000)	115.62*** (0.000)	122.72*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

**Table 6-6: CEO Remuneration Regressions for Full Sample Firms**

This table presents the results of the regression which identifies determinants of CEO remuneration for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationships. All value variables are measured as of 1998. The dependent variable  $\ln(\text{CEO remuneration})$  is defined as the natural logarithm of total cash paid to the highest paid director during the financial year.  $\ln(\text{pre-tax profits})$  is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of turnover to total assets. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win.  $\ln(\text{attendance})$  is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of a firm's directors. Non-executive directors (%) is the proportion of non-executive directors on the board. CEO tenure is the number of years a CEO served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects model. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $p$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.629*** (7.848)	4.574*** (7.694)	1.834 (1.183)	4.448*** (7.366)	4.380*** (7.211)	0.493 (0.308)
$\ln(\text{pre-tax profits})$	0.009 (0.967)	0.009 (0.974)	0.010 (1.038)	0.006 (0.666)	0.006 (0.679)	-0.002 (-0.231)
Turnover/Total assets	-0.072 (-0.920)	-0.073 (-0.925)	-0.082 (-1.037)	-0.029 (-0.347)	-0.025 (-0.298)	-0.151 (-1.449)
League points (%)	0.897*** (2.777)	-	-	0.979*** (3.457)	-	-
Winning (%)	-	0.912*** (2.755)	-	-	1.023*** (3.547)	-
$\ln(\text{attendance})$	-	-	0.332** (2.145)	-	-	0.458*** (2.978)
Firm size	0.207** (2.517)	0.210** (2.549)	0.208** (2.451)	0.253*** (3.068)	0.255*** (3.097)	0.213** (2.520)
Board ownership (%)	-0.001 (-0.750)	-0.001 (-0.781)	-0.002 (-1.005)	-0.000 (-0.189)	-0.000 (-0.213)	-0.000 (-0.021)
Non-executive directors (%)	-0.004 (-1.641)	-0.004* (-1.663)	-0.004* (-1.718)	-0.004 (-1.532)	-0.004 (-1.559)	-0.003 (-1.043)
CEO age	-0.004 (-0.600)	-0.004 (-0.566)	-0.005 (-0.723)	-0.010 (-1.607)	-0.010 (-1.592)	-0.007 (-1.098)
CEO tenure	-0.031 (-1.309)	-0.032 (-1.319)	-0.024 (-0.971)	-0.008 (-0.347)	-0.009 (-0.370)	-0.020 (-0.837)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	YES	YES	YES	YES	YES	YES
Number of Firms	35	35	35	34	34	34
Observations	268	268	265	242	242	239
Wald $\chi^2$	151.69*** (0.000)	151.50*** (0.000)	144.70*** (0.000)	155.82*** (0.000)	156.87*** (0.000)	146.38*** (0.019)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$

## 6.7 Results After Excluding Outliers

The goal of this section is to assess whether regression estimates that exclude outliers have different results from those discussed earlier. To that end, this approach verifies the robustness of the main results discussed in this chapter. In the previous chapter, I noticed that some

variables were very far away from the mean sample. The data with values far from the mean may distort the results. For this reason, I excluded some observations at 1% and 99% percentiles in the following variables; board remuneration, executive remuneration, CEO remuneration, pre-tax profit, attendance and number of employees. This technique eliminates the potential for the undue influence of outliers in the empirical results. Beiner et al. (2006) used the same approach of excluding obviously eccentric values in their data observations.

Table 6-7 to 6-12 show the results which exclude outliers for FA Premier League firms and the full sample. These results are reported in the appendix section. Overall, the main results remain qualitatively the same. The direction of the relationships remains similar throughout with minor differences in the coefficients and statistical significance levels. The trivial differences from the previous analysis are discussed for each table. In Table 6-7, every measure of productivity performance is shown to be a significant determinant of board remuneration. This is slightly different from earlier estimates where attendance was the only measure of productivity performance determining board remuneration.

Table 6-8 demonstrate that only contemporary measures of productivity performance are important determinants of executive remuneration. According to the previous analysis, there is evidence that a lagged winning percentage has a significant impact on executive compensation. Other variables follow the same trend, except for director age, which is insignificant in three models out of six. Table 6-9 show that levels of pre-tax profit influences CEO remuneration. The relationship is significant at the 5% level, but the coefficient's estimate is small. This is contrary to previous results in which there are no measure of financial performance which is a significant determinant of CEO remuneration.

Table 6-10 shows that director tenure is significant in the first two models only. This is different from previous results since this variable does seem to be significant in the first five models. While the earlier analysis showed that director tenure is an insignificant determinant of executive pay, Table 6-11 reveals evidence that director tenure is indeed a significant determinant of executive compensation. Table 6-12 demonstrates yet stronger evidence that the proportion of non-executive directors reduces even more substantially CEO remuneration than in previous estimations. In this estimation, five models appeared significant while in the preceding estimation only two models appeared significant.

## **6.8 Summary and Conclusion**

In this chapter, I studied the determinants of directors' remuneration in the FA Premier League. I find that there is a strong positive relationship between directors' pay and productivity performance. My results show that financial performance has no influence on board and executive remuneration. I also find little evidence of a link between CEO remuneration and profitability. These findings are consistent with stakeholder theory and are also in accordance with the first hypothesis of this chapter. In addition, the results indicate that firm size, and managerial ownership effects significantly compensation decisions. Firm size consistently has a positive impact on directors' remuneration. This means that larger firms pay greater director compensation than small firms. This is consistent with many previous studies.

I documented that managerial ownership negatively affects directors' compensation. This suggests that directors with large stockholdings receive high dividends and enjoy considerable capital gains and therefore, have less need for cash compensation. Comparable to studies in traditional corporations, the presence of non-executive directors curb directors' remuneration. However, its impact on CEO remuneration is not significant for a sample of FA Premier League firms. In this case, I have argued that outside directors seem to be appointed or nominated by the CEOs. Consequently, it is difficult for them to control the firm's decisions over CEO compensation effectively. Overall, the results on the additional tests and those reported after excluding outliers are generally the same as the initial findings. One exception is on the proportion of non-executive directors where there is evidence of affecting CEO remuneration in the full sample firms. The next chapter proceeds with the analysis on the determinants of executive directors' turnover.

## 6.9 Appendices

**Table 6-7: Board Remuneration Regressions Without Outliers for FA Premier League Firms**

This table presents the results of the regression which identifies determinants of board remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The disclosed models assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable  $\ln$  (board remuneration) is defined as the natural logarithm of total cash paid to board members during the financial year.  $\ln$  (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half wins.  $\ln$  (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors in the board. Director age is the average age of a director. Director tenure is the average number of years a director served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $p$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	3.989*** (6.847)	3.943*** (6.677)	0.418 (0.179)	3.998*** (6.696)	3.953*** (6.576)	-0.406 (-0.160)
$\ln$ (pre-tax profits)	-0.002 (-0.171)	-0.001 (-0.139)	0.005 (0.597)	-0.014 (-1.556)	-0.014 (-1.561)	-0.012 (-1.352)
Turnover/Total assets	0.090 (1.294)	0.092 (1.315)	0.103 (1.433)	-0.015 (-0.214)	-0.013 (-0.185)	-0.018 (-0.245)
League points (%)	0.814** (2.102)	-	-	0.652 (1.336)	-	-
Winning (%)	-	0.802** (2.063)	-	-	0.729 (1.441)	-
$\ln$ (attendance)	-	-	0.422* (1.731)	-	-	0.486* (1.830)
Firm size	0.519*** (5.170)	0.520*** (5.173)	0.460*** (4.150)	0.585*** (5.315)	0.584*** (5.300)	0.537*** (4.531)
Board ownership (%)	-0.010*** (-5.038)	-0.010*** (-5.084)	-0.009*** (-4.490)	-0.010*** (-4.520)	-0.010*** (-4.586)	-0.009*** (-4.231)
Non-executive directors (%)	-0.009*** (-2.698)	-0.009*** (-2.718)	-0.011*** (-3.049)	-0.011*** (-3.023)	-0.011*** (-3.040)	-0.012*** (-3.216)
Director age	-0.013** (-2.119)	-0.013** (-2.043)	-0.014** (-2.195)	-0.015** (-2.164)	-0.015** (-2.182)	-0.013* (-1.938)
Director tenure	0.047** (2.387)	0.046** (2.371)	0.046** (2.303)	0.052** (2.295)	0.052** (2.280)	0.044* (1.849)
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	23	23	23	19	19	19
Observations	113	113	113	93	93	93
Wald $\chi^2$	79.01*** (0.000)	78.60*** (0.000)	75.61*** (0.000)	69.22*** (0.000)	69.67*** (0.000)	71.42*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$

**Table 6-8: Executive Remuneration Regressions Without Outliers for FA Premier League Firms**

This table presents the results of the regression which identifies determinants of executive directors' remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable ln (executive remuneration) is the natural logarithm of total cash paid to board executive members during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is proportions of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) are the proportion of non-executive directors in the board. Director age is the average age of an executive director. Director tenure is the average number of years an executive director served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients, p-value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	4.143*** (6.621)	4.085*** (6.428)	0.040 (0.016)	4.299*** (6.363)	4.237*** (6.239)	0.796 (0.282)
Ln (pre-tax profits)	-0.006 (-0.601)	-0.005 (-0.546)	0.004 (0.392)	-0.015 (-1.402)	-0.015 (-1.433)	-0.012 (-1.178)
Turnover/Total assets	0.112 (1.471)	0.114 (1.492)	0.124 (1.573)	-0.000 (-0.003)	0.002 (0.030)	-0.000 (-0.001)
League points (%)	1.187*** (2.814)	-	-	0.723 (1.282)	-	-
Winning (%)	-	1.156*** (2.727)	-	-	0.872 (1.495)	-
Ln (attendance)	-	-	0.498* (1.884)	-	-	0.393 (1.331)
Firm size	0.467*** (4.306)	0.468*** (4.305)	0.398*** (3.282)	0.550*** (4.412)	0.545*** (4.380)	0.508*** (3.810)
Board ownership (%)	-0.006*** (-2.695)	-0.006*** (-2.772)	-0.005** (-2.223)	-0.006** (-2.501)	-0.006** (-2.561)	-0.006** (-2.385)
Non-executive directors (%)	-0.015*** (-3.890)	-0.015*** (-3.906)	-0.016*** (-4.184)	-0.018*** (-4.128)	-0.018*** (-4.154)	-0.018*** (-4.163)
Director age	-0.011 (-1.609)	-0.011 (-1.517)	-0.012* (-1.735)	-0.014* (-1.727)	-0.014* (-1.757)	-0.012 (-1.580)
Director tenure	0.021 (0.987)	0.021 (0.984)	0.023 (1.045)	0.033 (1.266)	0.033 (1.254)	0.028 (1.031)
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	23	23	23	19	19	19
Observations	113	113	113	93	93	93
Wald $\chi^2$	53.33*** (0.000)	52.63*** (0.000)	47.08*** (0.000)	46.76*** (0.000)	47.73*** (0.000)	47.01*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

**Table 6-9: CEO Remuneration Regressions Without Outliers for FA Premier League Firms**

This table presents the results of the regression which identifies determinants of CEO remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable ln (CEO remuneration) is defined as the natural logarithm of total cash paid to the highest paid director during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors on the board. CEO tenure is the number of years a CEO served on the board. Year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects model. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $\rho$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	2.606*** (3.735)	2.529*** (3.583)	-2.611 (-0.973)	2.862*** (4.310)	2.766*** (4.152)	-3.218 (-1.149)
Ln (pre-tax profits)	0.017 (1.479)	0.017 (1.479)	0.024** (2.287)	-0.004 (-0.412)	-0.004 (-0.394)	0.003 (0.284)
Turnover/Total assets	0.066 (0.757)	0.069 (0.790)	0.084 (0.947)	-0.098 (-1.216)	-0.091 (-1.132)	-0.100 (-1.210)
League points (%)	1.033** (2.140)	-	-	1.755*** (3.138)	-	-
Winning (%)	-	1.064** (2.205)	-	-	1.906*** (3.301)	-
Ln (attendance)	-	-	0.610** (2.171)	-	-	0.694** (2.370)
Firm size	0.549*** (4.539)	0.550*** (4.553)	0.457*** (3.471)	0.539*** (4.414)	0.535*** (4.393)	0.479*** (3.586)
Board ownership (%)	-0.014*** (-5.656)	-0.014*** (-5.712)	-0.013*** (-5.101)	-0.011*** (-4.630)	-0.012*** (-4.770)	-0.011*** (-4.448)
Non-executive directors (%)	0.001 (0.250)	0.001 (0.215)	-0.001 (-0.175)	-0.002 (-0.546)	-0.002 (-0.575)	-0.002 (-0.505)
CEO age	-0.018** (-2.198)	-0.017** (-2.112)	-0.018** (-2.290)	-0.024*** (-3.139)	-0.025*** (-3.189)	-0.022*** (-2.780)
CEO tenure	0.102*** (4.193)	0.101*** (4.156)	0.100*** (4.074)	0.108*** (4.178)	0.107*** (4.157)	0.101*** (3.721)
Year dummies	YES	YES	YES	YES	YES	YES
Number of Firms	23	23	23	19	19	19
Observations	113	113	113	93	93	93
Wald $\chi^2$	86.34*** (0.000)	86.52*** (0.000)	85.90*** (0.000)	73.04*** (0.000)	74.45*** (0.000)	66.18*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

**Table 6-10: Board Remuneration Regressions Without Outliers for Full Sample Firms**

This table presents the results of the regression which identifies determinants of board remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable  $\ln$  (board remuneration) is defined as the natural logarithm of total cash paid to board members during the financial year.  $\ln$  (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, and in this case draws are considered as half win.  $\ln$  (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors in the board. Director age is the average age of a director. Director tenure is the average number of years a director served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $p$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	5.024*** (5.077)	4.935*** (4.988)	2.113 (0.897)	4.559*** (4.344)	4.546*** (4.318)	-2.172 (-0.956)
$\ln$ (pre-tax profits)	-0.005 (-0.394)	-0.004 (-0.379)	-0.002 (-0.137)	0.007 (0.580)	0.008 (0.601)	0.003 (0.264)
Turnover/Total assets	0.059 (0.605)	0.059 (0.609)	0.041 (0.415)	0.040 (0.392)	0.042 (0.408)	-0.072 (-0.714)
League points (%)	0.911** (2.134)	-	-	0.719* (1.861)	-	-
Winning (%)	-	0.925** (2.106)	-	-	0.714* (1.817)	-
$\ln$ (attendance)	-	-	0.342 (1.456)	-	-	0.754*** (3.424)
Firm size	0.377** (2.505)	0.386** (2.569)	0.367** (2.328)	0.513*** (3.317)	0.512*** (3.313)	0.390** (2.508)
Board ownership (%)	0.001 (0.287)	0.001 (0.228)	0.000 (0.005)	0.000 (0.075)	0.000 (0.071)	-0.001 (-0.217)
Non-executive directors (%)	-0.016*** (-5.297)	-0.017*** (-5.339)	-0.016*** (-5.068)	-0.017*** (-4.750)	-0.017*** (-4.759)	-0.014*** (-3.932)
Director age	-0.021** (-2.401)	-0.021** (-2.353)	-0.019** (-2.169)	-0.022** (-2.271)	-0.022** (-2.277)	-0.015 (-1.594)
Director tenure	0.047* (1.694)	0.047* (1.690)	0.042 (1.495)	0.048 (1.490)	0.048 (1.488)	0.015 (0.485)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	32	32	32	31	31	31
Observations	188	188	188	167	167	164
Wald $\chi^2$	89.05*** (0.000)	89.39*** (0.000)	85.08*** (0.000)	86.18*** (0.000)	85.92*** (0.000)	100.28*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$

**Table 6-11: Executive Remuneration Regressions Without Outliers for Full Sample Firms**

This table presents the results of the regression which identifies determinants of executive directors' remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable ln (executive remuneration) is the natural logarithm of total cash paid to board executive members during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors in the board. Director age is the average age of an executive director. Director tenure is the average number of years an executive director served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects models. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients, p-value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	5.316*** (5.479)	5.249*** (5.411)	2.435 (1.060)	4.681*** (4.648)	4.651*** (4.608)	-1.085 (-0.490)
Ln (pre-tax profits)	-0.003 (-0.264)	-0.003 (-0.244)	-0.001 (-0.079)	0.005 (0.458)	0.006 (0.478)	0.003 (0.211)
Turnover/Total assets	0.062 (0.650)	0.062 (0.651)	0.044 (0.455)	0.047 (0.490)	0.051 (0.524)	-0.061 (-0.634)
League points (%)	0.725* (1.733)	-	-	0.838** (2.302)	-	-
Winning (%)	-	0.725* (1.684)	-	-	0.859** (2.323)	-
Ln (attendance)	-	-	0.333 (1.456)	-	-	0.654*** (3.061)
Firm size	0.364** (2.467)	0.371** (2.524)	0.343** (2.231)	0.492*** (3.336)	0.492*** (3.332)	0.393*** (2.620)
Board ownership (%)	0.002 (0.713)	0.001 (0.661)	0.001 (0.502)	0.002 (0.733)	0.002 (0.724)	0.001 (0.460)
Non-executive directors (%)	-0.017*** (-5.565)	-0.017*** (-5.594)	-0.016*** (-5.324)	-0.018*** (-5.396)	-0.018*** (-5.416)	-0.016*** (-4.414)
Director age	-0.026*** (-3.018)	-0.026*** (-2.978)	-0.024*** (-2.810)	-0.025*** (-2.779)	-0.026*** (-2.795)	-0.020** (-2.140)
Director tenure	0.045* (1.678)	0.046* (1.681)	0.041 (1.487)	0.039 (1.267)	0.039 (1.274)	0.011 (0.371)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	NO	NO	NO	NO	NO	NO
Number of Firms	31	31	31	30	30	30
Observations	187	187	187	166	166	163
Wald $\chi^2$	93.84*** (0.000)	93.91*** (0.000)	92.34*** (0.000)	96.70*** (0.000)	96.83*** (0.000)	101.07*** (0.000)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

**Table 6-12: CEO Remuneration Regressions Without Outliers for Full Sample Firms**

This table presents the results of the regression which identifies determinants of CEO remuneration after excluding outliers at 1% and 99% percentiles for the period 1998 to 2007. The models presented assume both contemporaneous and lagged relationship. All value variables are measured as of 1998. The dependent variable ln (CEO remuneration) is defined as the natural logarithm of total cash paid to the highest paid director during the financial year. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. League points (%) is the proportion of points accumulated by an individual club relative to total points that can be accumulated during the season. Winning (%) is the percentage of matches won by a club, in this case draws are considered as half win. Ln (attendance) is the natural logarithm of the average number of spectators watching football matches in a particular season. Firm size is the logarithm of the total number of employees in the club. Board ownership (%) is the aggregate equity ownership of firm's directors. Non-executive directors (%) is the proportion of non-executive directors on the board. CEO tenure is the number of years a CEO served on the board. Division and year dummies are included in the models when they are jointly significant, otherwise not. A Hausman specification test is able to reject fixed effects model. Wald is a test of goodness-of-fit, asymptotically distributed as  $\chi^2$  under the null of no joint significance of the coefficients,  $\rho$ -value in parentheses.

Variables	Contemporaneous relationship			Lagged relationship		
	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	3.468*** (3.899)	3.353*** (3.784)	-0.558 (-0.270)	3.525*** (3.632)	3.464*** (3.567)	-1.871 (-0.881)
Ln (pre-tax profits)	0.006 (0.437)	0.005 (0.412)	0.010 (0.782)	0.012 (0.975)	0.012 (0.984)	0.007 (0.553)
Turnover/Total assets	-0.035 (-0.343)	-0.035 (-0.340)	-0.054 (-0.510)	0.020 (0.204)	0.025 (0.260)	-0.086 (-0.877)
League points (%)	1.346*** (3.137)	-	-	0.828** (2.323)	-	-
Winning (%)	-	1.456*** (3.312)	-	-	0.891** (2.458)	-
Ln (attendance)	-	-	0.482** (2.246)	-	-	0.623*** (2.997)
Firm size	0.372*** (2.641)	0.371*** (2.659)	0.348** (2.284)	0.437*** (3.020)	0.438*** (3.033)	0.329** (2.207)
Board ownership (%)	-0.001 (-0.551)	-0.001 (-0.607)	-0.002 (-0.911)	0.001 (0.330)	0.001 (0.299)	0.000 (0.052)
Non-executive directors (%)	-0.007** (-2.335)	-0.008** (-2.389)	-0.007** (-2.152)	-0.007** (-2.055)	-0.007** (-2.091)	-0.005 (-1.435)
CEO age	0.000 (0.004)	0.000 (0.050)	0.002 (0.153)	-0.007 (-0.746)	-0.007 (-0.739)	-0.004 (-0.387)
CEO tenure	-0.028 (-0.771)	-0.029 (-0.792)	-0.027 (-0.739)	-0.007 (-0.191)	-0.008 (-0.206)	-0.020 (-0.544)
Division dummies	YES	YES	YES	YES	YES	YES
Year dummies	YES	YES	YES	YES	YES	YES
Number of Firms	31	31	31	30	30	30
Observations	187	187	187	166	166	163
Wald $\chi^2$	93.81*** (0.000)	95.85*** (0.000)	87.17*** (0.000)	87.86*** (0.000)	88.86*** (0.000)	87.55*** (0.019)

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

# 7 PERFORMANCE, PRODUCTIVITY AND DIRECTORS' TURNOVER

## 7.1 Introduction

This chapter extends the previous empirical analysis by reconsidering factors that drive executive directors' turnover. The two topics lie at the heart of corporate governance research and to a large extent are interrelated. Despite the vast literature that examines the association between CEO turnover and firm performance, researchers in academic finance know relatively little about directors' turnover patterns within firms. There are some issues that have been overlooked and the analyses have been sparse in small firms and specific industries. These issues have greatly motivated the decision to explore this relationship. This chapter is motivated by four main issues.

The first motivation originates from the theories used to describe performance-turnover relationships. According to previous research, it appears that there is no general theory for describing performance-turnover relationships. The existing studies in this area have mostly adopted principal-agent theory (Jensen and Meckling, 1976). Studies using this theory find contradictory results for the link between firm performance and CEO turnover (e.g. Warner et al., 1988). Although agency theory is the main foundation of turnover-performance relationship, other theories such as stakeholder theory, human capital theory and social network theory may offer possible explanations of the relationship. This chapter aims to perform an empirical evaluation using these theories simultaneously and determine their efficacies in explaining directors' turnover and firm performance relationships.

The second motivation relies on the importance and benefits that research on turnover-performance relationships offer to academics and practitioners. The threat of dismissal for corporate managers is an important research area because it is the major factor used to discipline managers following a firm's poor performance. Kim (1996) argued that executive turnover is one of the most important instruments of corporate governance. Companies can enhance

performance through replacing incompetent directors and can provide a strong incentive for performance through linking director turnover to firm performance.

The third motivation is based on increasing pressure from shareholders on the stock market regulatory agencies to redress the governance question of who disciplines management in public corporations (Phan and Lee, 1995). Some studies propounded that corporate directors represent the top stratum of a corporation to its shareowners, and are regarded by the marketplace as answerable for the firm's performance (Jensen and Meckling, 1976). Directors have a significant impact on corporate value, and thus understanding the causes and consequences of their departure would appear to be an important issue of investigation. In addition, Fee and Hadlock (2004) recommend further studies of directors' turnover as an important area of exploration. The removal of directors in the firm is a form of internal control mechanism which is one of the key functions of corporate governance.

The fourth motivation is focused on industry-specific factors. The availability of data in the UK soccer industry has facilitated the undertaking of this research. The industry offers abundant productivity performance data that has not been used to evaluate managerial turnover decisions. Importantly, the availability of firms' financial and corporate governance information has motivated this research. The possibility of analysing productivity performance data together with corporate governance variables are the main driving factors behind this study. Another important issue that motivated this research is the scandal of financial troubles in the football sector. Specifically, this has motivated the investigation of whether executive directors in this sector are punished for their corporate performance.

The principal aim of this chapter is to examine whether there is a relationship between executive turnover and measures of corporate performance.<sup>35</sup> In this chapter, I have tested five hypotheses. The first and most important hypothesis considers whether the probability of directors' turnover is inversely related to productivity and financial performance. I have compared the strength of productivity performance over financial performance in determining the probability of turnover. The findings indicate that productivity performance is more important than financial performance in determining the probability of turnover. This productivity performance-turnover relationship is much stronger in listed football firms than in FA Premier League firms. After

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<sup>35</sup> In this chapter the term executive turnover represents the departure of executive directors in the firm.

excluding outliers in the full sample firms, I find little evidence that financial performance is a significant determinant of the probability of director turnover. These findings are consistent with the first hypothesis and supports stakeholder theory rather than agency theory.

For other hypotheses tested, the findings indicate that ownership structure significantly affect the probability of turnover in different ways. For listed firms, CEO ownership considerably reduces the likelihood of managerial turnover but does not override the role of productivity performance on directors' turnover decisions. The relationship between the probability of executive turnover and productivity performance remained significant after the inclusion of CEO ownership in the regression equation. For Premier League firms, board ownership is not significant but distracts the role of productivity performance on directors' turnover decisions. The incorporation of board ownership variables into the regression equation makes the turnover-performance relationship insignificant.

The additional tests using the full sample firms reveal that board and CEO ownership significantly reduces the probability of turnover but does not override the role of productivity performance in turnover decisions. These findings support agency theory in the context that directors with company equity stakes exploit minority shareholders through entrenching themselves in their firms. In addition, the findings in the FA Premier League and the full sample indicate that directors' industry experience drastically reduces the probability of turnover. This demonstrates that my findings support human capital theory. In general, this chapter provides consistent evidence that managerial ownership has a substantial impact on executive turnover decisions.

This chapter contributes to the finance literature in the following ways. First, it provides new evidence on the negative link between productivity performance and probability of turnover and presents evidence of its practical applicability. This establishes that productivity performance is a key factor in managerial turnover decisions. To my knowledge, this has not been done elsewhere in other performance-turnover studies. Most existing studies adopted stock market returns (e.g. Kaplan, 1994b, Murphy and Zimmerman, 1993) and accounting measures (e.g. Conyon and Florou, 2002, Denis and Denis, 1995) to analyse performance-turnover relationships. Thus, the adoption of industry-specific measure of performance is the greatest contribution of this analysis.

Second, this chapter offers new evidence on the determinants of directors' turnover in the situation where stakeholder theory, human capital theory and social network theory are considered simultaneously in the analysis. Existing research in this area has primarily focused on principal-agent theory (e.g. Conyon and Florou, 2002, Dahya et al., 2002). This chapter extends this research by incorporating other theories that may offer alternative potential explanations. The findings on these theories confirm that stakeholder theory, agency theory and human capital theory all matter considerably in managerial turnover studies. I also corroborate the idea that stakeholder theory is more important than agency theory in the context of soccer corporations.

Lastly, this chapter contributes to the debate on the effectiveness of boardroom governance, particularly by considering issues on board and ownership structure. The findings of this chapter suggest ownership structure has a significant impact on corporate decision making. That is managerial ownership matters greatly for corporate turnover decisions. From this finding, the study has provided confirmatory evidence on the findings of Denis et al. (1997) and Goyal and Park (2002). The finding that CEO duality significantly affects the probability of executive turnover is comparable to previous findings by Goyal and Park (2002) and Hillier et al. (2005). The positive and significant coefficients on CEO duality for listed firms and full sample firms confirm that firms with separated CEO-chairman positions are more likely to remove their directors than firms with combined CEO-chairman positions.

The structure of the chapter is as follows. Section 7.2 discusses the theoretical foundation and develops the hypotheses. Section 7.3 explains the measurement of variables used in the empirical analysis. Section 7.4 describes data sets and empirical methods adopted. Section 7.5 discusses the results from the determinants of directors' turnover. Section 7.6 describes the predicted probabilities of directors' turnover on productivity performance. Section 7.7 discusses the results from the full sample firms. Section 7.8 conducts robustness checks by estimating the results without outliers. The summary and conclusion are in Section 7.9. Finally, section 7.10 contains appendices with predicted probability figures and the results that exclude outliers.

## **7.2 Theoretical Underpinnings and Hypotheses**

### **7.2.1 Agency Theory**

Agency theory has been the dominant foundation for corporate governance practice and policy. The theory recommends that directors should be evaluated according to their firm performance. The theory also recommends appropriate corporate governance practices that help to reduce agency costs and enhance the firm value. The following subsections discuss the concepts of agency theory in relation to directors' turnover in two categories. The first part describes the link between directors' turnover and firm performance. The second part explains the relationship between directors' turnover and corporate governance mechanisms.

#### *7.2.1.1 Directors' Turnover and Firm Performance*

According to agency theory postulates, directors should be assessed based on their corporate performance. If that is the case, a board of directors should choose between alternative performance metrics to evaluate its directors' performance (Brickley, 2003). A dismissal from the board is a mechanism for controlling directors' actions and aligning the interest of both directors and shareholders. This mechanism serves to reduce a firm's agency costs and maximise shareholders' wealth (Jensen and Meckling, 1976, Fama, 1980, Puffer and Weintrop, 1991). The criterion used on dismissal decisions differ from one firm to another in accordance with the company objectives. In the football industry, it is sensible to judge directors' performance using productivity measures as well as financial measures.

Stakeholders in football firms include people such as owners, directors, fans and creditors, amongst others. A larger number of these stakeholders prefer more success in productivity performance than in financial performance. Here, there is a conflict of interest between the firm's objectives under agency theory and stakeholder theory. The former objective is the maximisation of shareholders' wealth while the latter objective is the maximisation of balance interests of various stakeholders where shareholders are just one of them. In order to fulfil the interests of many stakeholders and in accordance with stakeholder theory recommendations, directors are largely assessed using productivity performance rather than financial performance. This leads to the following formal hypothesis.

*H1: There is a strong negative relationship between productivity performance and the probability of directors' turnover rather than financial performance.*

### 7.2.1.2 *Directors' Turnover and Corporate Governance Mechanism*

Studies linking turnover decisions and governance structure date back to the 1970s (Helmich, 1976). Later studies have incorporated governance structures in their analyses. For example, Weisbach (1988), finds that more independent boards are more likely to fire poorly performing CEOs. Fazel and Louie (1990) find that internal governance structures such as CEO duality and board setup have a larger impact on turnover decisions than firm performance. The significance of corporate governance prescriptions in turnover decisions has been confirmed by Dahya et al. (2002) who find there to be an improvement in the previously negative link between CEO turnover and performance, after the 1992 Cadbury Report on corporate governance in the UK. This finding implies that firms with more non-executives on the board have a stronger negative performance-turnover relationship than firms with few non-executives on the board.

*H2: The proportion of non-executive directors and separation of CEO/Chairman positions are positively related to the probability of directors' turnover.*

Another recommendation from agency theory is that firm's managers should own stocks of the company so as to minimise the divergent motivations between managers and owners of the firm. Morck et al. (1988) find that managers who own company shares above a certain threshold will have power to defend themselves from being fired. Confirming the considerable impact of managerial ownership on turnover decisions, Denis et al. (1997) finds that managers with relatively small equity stakes in their firms lessen considerably the probability of being sacked. Dahya et al. (1998) find similar results in the analysis of ownership structure, performance and top executive change for UK firms. These results imply that shareholders with low levels of ownership in the firm will find it too expensive to monitor the firm's managers. The literature identifies this phenomenon as the "free rider problem" (e.g. Shivdasani, 1993, Ertan et al., 2009, André, 2009).

Studies indicate that blockholder or institutional ownership of the firm can mitigate the free rider problem because they have a strong incentive to monitor management (e.g. Denis et al., 1997, Goyal and Park, 2002). This means that blockholders have greater equity stakes in the firm, and thus effective monitoring of the managers' performance enhances their own wealth. These kinds of ownership are important corporate governance mechanisms that improve manager turnover decisions for poorly performing firms. In plain terms, the higher ownership

by blockholders or institutions makes the board more effective and reduces managerial entrenchment in the firm. Goyal and Park (2002) insisted that these ownership structures mitigate agency problems and align the divergent motivations between managers and owners.

*H3 (a): The probability of directors' turnover is negatively related to the percentage of board and CEO ownership.*

*H3 (b): The probability of directors' turnover is positively related to the percentage of blockholder ownership.*

### **7.2.2 Human Capital Theory**

Becker (1984) classified human capital as either a firm-specific investment or non-firm-specific investment. Firm-specific investments involve on-the-job training that ensures that employees remain longer with the firm by increasing the firm specificity of an employee's human capital. Ideally, such firm-specific investments bring greater productivity because of the relevance fit between the firm's needs and unique capabilities of the labour (Becker, 1984). However, depending on the degree of specialisation of the firm, the level of productivity cannot be achieved outside the particular firm. According to Phan and Lee (1995), directors have no incentives to engage in firm-specific trainings since these limit their mobility outside the firm and increase their opportunity costs in staying with the firm.

It is argued that, if the director has high firm-skill specificity, his or her dismissal from the firm will represent a loss of firm-specific human capital investments that will lead to erosion of competency in productivity (Phan and Lee, 1995). Boards must carefully consider directors' firm-specific human capital investments when making firing decisions. One of the previous studies discussed factors that contribute to the building and accumulation of human capital investments (Dierkes and Coppock, 1975). The authors mentioned factors such as costs of recruitment and training, capability development and investment building experience that contribute to firm-specific knowledge.

Non-firm-specific investments include general education and previous work experience. Becker (1984) insisted that people with a good generalised educational background and prior industry experience have more opportunities to be retained in the firm because they are general human capital investments that are useful in the firm's development. A long tenure in one firm may

reflect accumulation of firm-specific knowledge, which is a valuable asset in the firm. Based on these arguments and information available, I propose the following hypothesis.

*H4: There is a negative relationship between industry experience and the probability of directors' turnover.*

### **7.2.3 Social Network Theory**

Social network theory explains a situation where CEOs use their position to accumulate power in order to reduce the relative monitoring power of the board (Phan and Lee, 1995). The theory predicts that CEOs with strong social networks will be punished less for poor performance because they have the power to influence other board members in their corporate decisions. Recent research indicates that social ties have a potentially large impact on a director's monitoring and disciplinary capacity (Hwang and Kim, 2009). A social relationship leads one to interpret favourably another's intentions and actions (Uzzi, 1996). If a CEO has a personal relationship with a director, a director's resulting concern for the CEO will be impaired. Therefore, directors with personal ties with a CEO lack independence in objective monitoring and disciplining of the CEO.

An environment of close and long personal relationships in the board makes it harder to dislodge entrenched directors because such systems favour stability over change. Also, familiar members in the board will prefer not to have new members as these would prevent them in maintaining coherence in a disagreement (Phan and Lee, 1995). This implies that what maintains solidarity in board are the ties between the directors themselves. Zucker (1977) claimed that stronger connections between the people in the firm lead to a more stable social environment in the organisation. In the later study, Wade et al. (1990) find that CEOs are able to manipulate board distribution by appointing directors who are favourably inclined towards the CEO's personal agenda. This means that if the firm performs poorly, the board will lack influence to punish the CEO because the board consists of directors who were appointed by the CEO.

Social network theory suggests that it is difficult for a director to be entrenched if there is no strong social network. This is simply because the director has to satisfy the competing claims of many stakeholders (Freeman, 1984). Thus, if social networks are diverse then it is easier to remove a director from the board if he or she performs poorly. Ocasio (1994) finds that larger

networks tend to be more diverse, thus reducing the power of the CEO to influence the board on managerial turnover decisions. Larger boards have larger networks, thus limiting a CEO's influence, since his or her efforts are directed to a larger group of individuals thus weakening his or her power over turnover decisions (Phan and Lee, 1995). Therefore, larger boards tend to have higher levels of directors turnover than small boards because their social networks are more diverse. This leads to the following formal hypothesis.

*H5: There is a positive relationship between board size and the probability of directors' turnover.*

Figure 7-1 provides the summary of hypotheses developed and their corresponding theories. The figure shows the direction of the relationship for each hypothesis and its respective theory.

**Figure 7-1: Summary of Theories and Hypotheses**

This figure provides the summary of theories employed, along with hypotheses developed. The figure demonstrates the direction of the relationship for each hypothesis and its corresponding theory.

	<b>Agency Theory</b>	<b>Stakeholder Theory</b>	<b>Human Capital Theory</b>	<b>Social Network Theory</b>
Hypothesis 1	-	-	N/A	N/A
Hypothesis 2	+	N/A	N/A	N/A
Hypothesis 3(a)	-	N/A	N/A	N/A
Hypothesis 3(b)	+	N/A	N/A	N/A
Hypothesis 4	N/A	N/A	-	N/A
Hypothesis 5	N/A	N/A	N/A	+

Source: Own Construction

## **7.3 Measurement of Variables**

### **7.3.1 Dependent Variable**

Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Much previous research used the same variable in their analysis (e.g. Brunello et al., 2003, Garay and Gonzalez, 2005). Other papers that analysed the turnover of many directors include Blackwell et al. (1994) and Fee and Hadlock (2000). Another paper by Fee and Hadlock (2004) provides some evidence of directors' departures by examining management turnover across the corporate hierarchy. Most of these papers are fairly informative and their empirical strategies are specific to particular industries under investigation. These studies relate to this chapter in the sense that it takes into account the turnover of any executive director in the firm regardless of his or her position.

## **7.3.2 Independent Variables**

### *7.3.2.1 Performance Measurements*

Holmstrom (1979) recommends that directors should be evaluated using performance measures that provide information concerning their efforts or abilities. This recommendation is based on the agency theory framework. According to Puffer and Weintrop (1991) care should be taken in defining performance metrics which scrutinize. Metrics of firm performance should act as proxies for stakeholders' perceptions. Normally, performance measures are commonly articulated in directors' compensation contracts. These measures might differ from one firm to another or from one industry to another. The measures are fundamentally associated with the principal objectives of the company. It is expected that a firm's managers should concentrate on the company's primary objectives. In that context, performance measures for football firms involve success in productivity and financial performance.

As in previous studies, alternate measures of performance are used. Productivity performance is captured by winning percentages. This measure was previously used in empirical research (Boulier and Stekler, 2003, Dawson et al., 2000). Consistent with chapter 6, financial performance is measured in two ways. These measures are pre-tax profits and the ratio of turnover to total assets. The reasons for using these measures have been explained in chapter 6. There is, however, one additional reason for adopting the ratio of turnover to total assets. In the context of football firms, directors are more likely to be fired when the firm has adequate resources (e.g. talented players) and fails to generate the sufficient level of revenues. For this reason, I find the turnover asset ratio to be a sound measure of financial performance in using the framework of executive turnover research.

### *7.3.2.2 Corporate Governance and Other Variables*

The non-executive director is a dummy variable recorded as one if the board consists of three or more non-executive directors, and zero otherwise. This definition is based on UK Combined Code (2003)'s recommendation, that companies should have at least half the board comprised of non-executive directors. For smaller companies, a board should have at least two non-executive directors. For the sub-samples examined, each board has an average of six directors. I find that a cut-off of 50% will be appropriate for these firms. Weisbach (1988) and Denis et al

(1997) use a cut-off of 60%, which was consistent with outsider-dominated board classification. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. For similar definitions see Hillier and McColgan (2009) and Phan and Lee (1995).

To assess the impact of ownership structure on the probability of director turnover, I have included board, CEO and blockholder ownership. These variables have been defined in chapter 5. Industry experience is captured by the average directors' tenure in the firm. Goyal and Park (2002) have used the same variable. I adopted board size to measure social network among the directors. Phan and Lee (1995) used board size as one of the variables that measures the board's social networks. This variable is defined as the total number of directors in the firm's board at the end of the financial year. Most previous studies used the same definition (e.g. Dahya et al., 2002).

### *7.3.2.3 Control Variables*

According to the standard literature, several factors are to be controlled for in determining the relationship between corporate performance and managerial turnover. In this chapter, I controlled for firm size and directors' age. Most prior studies adopted the same technique in the empirical analysis (e.g. Puffer and Weintrop, 1991, Cosh and Hughes, 1997, Lausten, 2002). Studies from Parrino (1997) to Chen et al. (2007) adopted directors' age as a control variable in their regression equations. The variable has proven to be significant in several papers. Brickley (2003) in a discussion of CEO turnover studies suggested that researchers should further investigate the relationship between turnover and age. Thus, I use an average of director age and number of employees as a measure of firm size. I have explained the reasons to use number of employees as a proxy for firm size in chapter 6.

## **7.4 Data and Empirical Strategy**

### **7.4.1 Data**

The data used in this analysis comes from two separate sub-samples. The first sub-sample consists of FA Premier League firms, and the second consists of UK listed football firms. The entirety of this data set is the unbalanced panel containing information at the firm level. For listed firms, data is collected during the listing period provided that it is within the sample

period. Normally, companies may restructure their boards prior to flotation and change board structures only gradually after delisting. This means that for those firms listed or delisted during the sample period, data also includes the year listed and the year delisted. Data sources and descriptive statistics have been explained in chapter 5.

One important issue in the study of firm performance and probability of turnover is the distinction between voluntary and involuntary departures for directors (Hermalin and Weisbach, 2003). Ideally, there are several reasons for director change, such as retirement age, illness, death, dismissal or voluntary resignation, etc. Distinguishing between these different reasons, however, is certainly problematic, but many studies so far have ignored this fact in their empirical analysis due to the unavailability of relevant records. In this context, the performance-turnover relationship can be biased for reasons such as ordinary retirement or sudden death of a director which have nothing to do with firm performance. Also, due to insider information, a director may voluntarily quit because of poor performance before the board decides to fire him (Lausten, 2002).

In this chapter, I have no technique of identifying whether the departure of a director is voluntary or involuntary. I therefore estimated regression equations where the dependent variable is recorded as one if there is any executive director departure from the company, and zero otherwise. It does not matter if the departure is of a CEO or an ordinary director. This approach has ignored the reasons for potential departure and is consistent with some previous studies in the literature (e.g. Blackwell et al., 1994, Lausten, 2002). However, the focus of this chapter is on the link between firm performance and directors' turnover, so the classification of turnover cases is far from being an important objective.

#### **7.4.2 Empirical Strategy**

I have adopted an empirical strategy that follows the existing literature and suits the data available for analysis. The adoption of fixed or random effects logit regressions depend entirely on the objective of the analysis. The main objective of this chapter is to estimate performance-turnover relationships while controlling for the unmeasured characteristic of individual firms. For that reason, I have used fixed effects logit regressions. According to econometric literature, the use of fixed effects specification allows taking explicitly into consideration the unobserved heterogeneity that exists among the firms in the sub-samples analysed (Wooldridge, 2006).

Importantly, fixed effects models are preferable to random effects models because they allow unobservable effects to be correlated with explanatory variables (Greene, 2001). As a consequence, many econometricians recommend the use of the fixed effects method in estimating *ceteris paribus* effects (e.g. Wooldridge, 2006, Greene, 2001). The application of fixed effects and inclusion of control variables in the models reduces the possible endogeneity between directors' turnover and firm performance (Coles et al., 2007). One paper that shares a similar empirical strategy is the study by Hillier and McColgan (2009), which examined firm performance and managerial succession in family-managed firms. However, the focus of their work is somewhat different.

## **7.5 Results**

Table 7-1 shows the logit regression results for FA Premier League firms and Table 7-2, logit regression results for UK quoted firms. Table 7-2 contains more estimated models than Table 7-1 because listed firms have more corporate governance data than FA Premier League firms. My main interest is to find out how firm performance and other variables influence the probability of directors' turnover. Another motivation is to observe how my findings relate to tested theories and how they can be applied in policy development. The estimated regressions have similar specifications except that I replace some variables in each model. For clarity purposes, the coefficient estimates on year and division dummies are not reported. In this chapter, reported models are contemporaneous. Models with lagged performance measures are not reported because they are not consistently significant and do not offer any explanation. The main findings are discussed below in sub headings.

### **7.5.1 Does Firm Performance Influence Directors' Turnover Decisions?**

This section presents the key findings of the chapter. For the whole analysis, the findings indicate that productivity performance is a major factor that influences director turnover decisions. The results demonstrate a significant negative relationship between productivity performance and the probability of director turnover. For FA Premier League firms, productivity performance is statistically significant at the 10% level or better in the first three models out of the four estimated. The coefficients' estimates show that winning percentage reduces the probability of turnover by about 4.27 to 5.60. These coefficients suggest that the turnover-performance relationship is economically meaningful. Winning percentage is not

significant in Model (4) where board ownership is included in the regression equation. This implies that the firm's managerial ownership distracts the role of productivity performance in influencing the probability of turnover.

**Table 7-1: Logit Regression Estimates for FA Premier League Firms**

This table reports logit regression estimates for FA Premier League firms for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total asset is the ratio of total revenue collected for the period over total assets of the company. Winning percentage is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of the number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model
Ln (Pre-tax profits)	-0.048 (-0.829)	-0.064 (-1.141)	-0.066 (-1.178)	-0.069 (-1.191)
Turnover/Total assets	-0.124 (-0.261)	-0.081 (-0.173)	-0.113 (-0.245)	-0.080 (-0.175)
Winning percentage	-4.273* (-1.649)	-5.602** (-2.191)	-5.299** (-2.040)	-3.367 (-1.244)
CEO duality	0.513 (0.843)	-	-	-
Non-executive directors	-	-0.177 (-0.291)	-	-
Board size	-	-	0.044 (0.297)	-
Board ownership	-	-	-	-0.021 (-1.459)
Director tenure	-0.246** (-2.013)	-0.237** (-1.996)	-0.233** (-1.961)	-0.208** (-1.686)
Firm size	0.173 (0.325)	0.264 (0.498)	0.253 (0.479)	-0.044 (-0.077)
Director age	-0.010 (-0.266)	-0.016 (-0.420)	-0.013 (-0.322)	-0.011 (-0.263)
Year dummies	No	No	No	No
Observations	161	174	174	167
Number of firms	22	25	25	25
Log likelihood (Probability)	-68.682 (0.095)	-72.124 (0.029)	-72.122 (0.029)	-68.095 (0.082)

For listed firms, productivity performance is significant at the 5% level or better in all models estimated. The coefficients' estimates on winning percentage start from 4.07 to 4.86 revealing that its impact on the probability of turnover is economically important. This presents evidence that in listed firms, factors such as board or ownership structure does not override the role of

productivity performance on managerial turnover decisions. This finding suggests that regardless of board structure or ownership type, executive directors leave their positions during a period of poor productivity performance. This finding differs from that of FA Premier League firms where board ownership distracts the function of productivity performance on managerial turnover decisions. This would suggest that listed firms adhere to corporate governance directives more than FA Premier League firms. The log likelihood indicates Model (4) in Table 7-1 and Model (5) in Table 7-2 are superior to others.

For all of the previous analysis, no measure of financial performance is a statistically significant determinant of directors' turnover. On the whole, the findings on performance metrics are consistent with the first hypothesis that productivity performance is a stronger determinant of directors' turnover than financial performance. This agrees with the framework of stakeholder theory rather than agency theory. My results are similar to most previous studies in the sense that firm performance is negatively related to directors' turnover (e.g. Conyon and Nicolitsas, 1998, Coughlan and Schmidt, 1985, Hillier and McColgan, 2009). However, the performance metrics analysed here differ from other managerial turnover studies.

### **7.5.2 Does Board Structure Affect Directors' Turnover Decisions?**

The results give evidence that CEO duality affects the probability of directors' turnover in a sample of quoted firms. The coefficient on CEO duality is positive and statistically significant at the 10% level. The coefficient estimate demonstrates that CEO duality enhances the probability of turnover by about 1.13. This would suggest that the sensitivity of the performance-turnover relationship is greater for firms with separate CEO-chairman positions than for firms with combined CEO-chairman positions. This finding is similar to Goyal and Park (2002) as well as Hillier et al. (2005). I find no significant relationship between the proportion of non-executive directors on the board and the probability of turnover. This suggests that the role of non-executive directors in the sub-samples analysed is more advisory than monitoring.

### **7.5.3 Does Ownership Structure Affect Directors' Turnover Decisions?**

Table 7-1 contains ownership structure variables in Model (4) and Table 7-2 contains ownership structure variables from Model (4) to (6). For listed firms, I find that CEO ownership is statistically significantly negatively related to the probability of directors' turnover. The relationship becomes significant at the 10% level. The coefficient estimate reveals that CEO

ownership reduces the probability of turnover by about 0.04. This finding tells us that high ownership by the CEO considerably reduces the chances of executive directors' departure from the firm. This is consistent with the findings by Denis et al. (1997) and Goyal and Park (2002).

**Table 7-2: Logit Regression Estimates for UK Listed Football Firms**

This table reports logit regression estimates for UK listed firms for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/total asset is the ratio of total revenue collected for the period over total assets of the company. Winning (%) is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. CEO ownership is the percentage of equity stakes owned by the CEO. Blockholder ownership is the aggregate percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firms' share capital. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of the number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Ln (Pre-tax profits)	-0.023 (-0.389)	-0.037 (-0.660)	-0.042 (-0.755)	-0.037 (-0.664)	-0.035 (-0.583)	-0.039 (-0.651)
Turnover/Total assets	-0.232 (-0.455)	0.153 (0.316)	0.063 (0.132)	0.033 (0.069)	0.007 (0.014)	0.003 (0.005)
Winning percentage	-4.673*** (-2.606)	-4.282** (-2.478)	-4.237** (-2.467)	-4.071** (-2.380)	-4.861*** (-2.627)	-4.136** (-2.307)
CEO duality	1.126* (1.688)	-	-	-	-	-
Non-executive directors	-	-0.887 (-1.554)	-	-	-	-
Board size	-	-	-0.016 (-0.096)	-	-	-
Board ownership	-	-	-	-0.009 (-0.911)	-	-
CEO ownership	-	-	-	-	-0.038* (-1.841)	-
Blockholder ownership	-	-	-	-	-	0.020 (1.397)
Director tenure	-0.214 (-1.514)	-0.193 (-1.490)	-0.197 (-1.543)	-0.165 (-1.249)	-0.194 (-1.351)	-0.215 (-1.527)
Firm size	0.146 (0.172)	-0.279 (-0.386)	-0.329 (-0.463)	-0.249 (-0.345)	0.198 (0.227)	-0.599 (-0.684)
Director age	-0.023 (-0.586)	0.004 (0.094)	-0.013 (-0.332)	-0.019 (-0.485)	-0.034 (-0.806)	0.009 (0.193)
Year dummies	No	No	No	No	No	No
Division dummies	No	No	No	No	No	No
Observations	146	158	158	155	137	142
Number of firms	24	24	24	24	24	24
Log likelihood (Probability)	-74.158 (0.045)	-81.402 (0.051)	-82.668 (0.119)	-80.795 (0.122)	-66.922 (0.036)	-72.146 (0.097)

The logic behind the negative link between managerial ownership and probability of turnover can be associated for two reasons. First, directors with higher equity ownership in the firm get more power, since they have increased voting control obtained through their equity ownership (Morck et al., 1988). Their power may deeply entrench directors in the firm. Second, equity ownership by management prevents external control mechanisms, which harms the internal monitoring systems in the company (Hirshleifer and Thakor, 1994). This also reduces the probability of turnover for poorly performing managers. The findings on CEO ownership are consistent with the prediction of agency theory and largely related with the reasons above.

#### **7.5.4 Does Industry Experience Matter on Directors' Turnover Decisions?**

The results indicate that a director's industry experience is a significant determinant of the probability of turnover in a sample of FA Premier League firms. Table 7-1 shows that despite the alternate variables employed in the regression models, the coefficients on director tenure show significant negative signs in all models estimated. The relationship is statistically significant at the 10% level or better across all models. The coefficients' estimates reveal that director tenure reduces the probability of turnover by 0.21 to 0.25. This demonstrates that directors with large industry experience tend to be entrenched in their firms. This finding is consistent with many studies in the literature. For example, Goyal and Park (2002) find that CEO tenure is negative and significant related to CEO turnover. This has similar implications to the insight that the reduced probability of the turnover of directors is associated with longer tenure.

This finding is consistent with the fourth hypothesis of this chapter. It confirms that human capital theory matters substantially in directors' turnover decisions. From this finding, I assert that the most prominent directors in a given industry are always entrenched in their firms. One previous study has found a conflicting result to mine, however. Lausten (2002) finds significant positive coefficients on CEO tenure, suggesting that longer serving CEOs are more likely to be discharged from their firms. However, she did not use CEO tenure as a measure of industry experience and the result was not in line with her own conjecture.

### **7.6 Predicted Probabilities**

I evaluated further the implications of these results by using the graphical presentation of the predicted probabilities of directors' turnover over productivity performance. The 95%

confidence intervals for the predicted probability are shown with shaded regions in the figures. Figure 7-2 and 7-3 represents the predicted probabilities of turnover compared to productivity performance. Both figures are attached in the appendices' section. The graphics are reasonably clear that the relationship is always negative and significant for both sub-samples analysed. For instance, using Figure 7-2, and for a firm that falls from the winning percentage of 40% to 20%, the probability of directors' turnover would rise from 50% to 80%. This means a 50% decrease in productivity performance leads to a 60% increase in the probability of turnover. These figures confirm the results from the regressions in this chapter that the lower the productivity performance, the higher the risk of dismissal for directors.

## **7.7 Additional Tests**

Consistent with chapter 6, the additional tests performed in this section took into account the full sample firms. The estimations use the same set of variables employed in the main analysis above. Overall, the findings are qualitatively similar to earlier analysis above. The productivity performance is the foremost determinant of the probability of executive turnover. In all estimations, the results demonstrate that productivity performance is stronger than financial performance in determining the likelihood of executive turnover. In fact, none of the financial performance measures is a statistically significant determinant of directors' turnover.

The findings indicate that managerial ownership reduces the probability of executive turnover. Table 7-4 demonstrate that board and CEO ownership significantly lessens the probability of turnover. In the previous analysis, board ownership was not significant in either sub-sample analysed. In addition, the results show that directors' industry experience substantially reduces the probability of executive turnover. This is consistent with earlier findings on the FA Premier League firms. The results from these additional tests enhance the reliability of the main findings analysed above.

**Table 7-3: Logit Regression Estimates for Full Sample Firms**

This table reports logit regression estimates for full sample firms for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/total asset is the ratio of total revenue collected for the period over total assets of the company. Winning (%) is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. CEO ownership is the percentage of equity stakes owned by the CEO. Blockholder ownership is the aggregate percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firms' share capital. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of the number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Ln (Pre-tax profits)	-0.017 (-0.452)	-0.043 (-1.432)	-0.044 (-1.447)	-0.034 (-1.082)	-0.022 (-0.614)	-0.061 (-1.162)
Turnover/Total assets	0.033 (0.175)	0.006 (0.054)	0.005 (0.046)	0.001 (0.009)	-0.078 (-0.460)	0.107 (0.509)
Winning percentage	-3.094*** (-2.813)	-2.631*** (-2.989)	-2.620*** (-2.976)	-2.307** (-2.515)	-2.958*** (-2.716)	-4.461*** (-2.996)
CEO duality	0.888** (2.191)	-	-	-	-	-
Non-executive directors	-	-0.102 (-0.298)	-	-	-	-
Board size	-	-	-0.003 (-0.057)	-	-	-
Board ownership	-	-	-	-0.009** (-1.966)	-	-
CEO ownership	-	-	-	-	-0.019* (-1.946)	-
Blockholder ownership	-	-	-	-	-	0.013 (1.349)
Director tenure	-0.169*** (-2.623)	-0.116** (-2.322)	-0.115** (-2.279)	-0.132** (-2.421)	-0.140** (-2.143)	-0.248** (-2.547)
Firm size	0.078 (0.248)	-0.188 (-0.834)	-0.185 (-0.819)	-0.135 (-0.563)	0.171 (0.524)	-0.532 (-0.783)
Director age	-0.010 (-0.467)	-0.021 (-1.262)	-0.021 (-1.287)	-0.010 (-0.570)	-0.005 (-0.239)	0.007 (0.225)
Year dummies	NO	NO	NO	NO	NO	NO
Division dummies	NO	NO	NO	NO	NO	NO
Observations	449	739	739	688	444	289
Number of firms	53	89	89	86	54	42
Log likelihood	-200.728	-335.834	-335.877	-306.192	-196.709	-118.530
Probability	(0.002)	(0.001)	(0.001)	(0.001)	(0.013)	(0.004)

## 7.8 Results After Excluding Outliers

As in chapter 6, I have repeated regression estimations using the same set of variables but excluded outliers. The eccentric values of pre-tax profits and number of employees are excluded at the 1% and 99% percentiles. These two variables contain strange figures that are considered

too far from the sample mean. The logic behind this approach is described in the previous chapter. Table 7-4 to 7-6 which are attached in the appendices, report these supplementary results. Overall, the findings from these tables are qualitatively similar to initial findings. The minor discrepancies from the former results are described briefly as follows.

While results in Table 7-1 show that winning percentage is significant from Model (1) to (3), Table 7-4 indicate that winning percentage is only significant in Model (2) and (3). Furthermore, the earlier findings reveal that director tenure is significant across all models estimated; whilst Table 7-4 demonstrate that this variable is significant in the first three models. Although Table 7-5 reports similar relationships and levels of significance to the former analysis, the coefficients' estimates on significant variables are slightly larger than the previous results. Table 7-6 indicate evidence that pre-tax profit is negatively related to the probability of director turnover. The results reveal that Model (2) and (3) are statistically significant at the 10% level but the coefficients' estimates are small. This finding is inconsistent with previous findings where profitability is an unimportant determinant of probability of turnover.

## **7.9 Summary and Conclusion**

The intuition for these findings is fairly clear. The most important finding suggests that productivity performance is a superior determinant of directors' turnover than financial performance. This relationship is contemporaneous for the whole analysis and robust in alternative model specifications. For listed firms, the sensitivity of negative relationship has remained stable despite the incorporation of different variables in the original model specification. This confirms that the role of productivity performance in managerial turnover decisions is not hampered by either board or ownership structure of the firm. After excluding outliers in the full sample firms, the findings show little evidence that financial performance is a significant determinant of directors' turnover. Overall, the findings on performance metrics support the application of stakeholder rather than agency theory.

This chapter documents that ownership structure does indeed affect the probability of turnover. The findings indicate that firms largely owned by their CEOs or board members have a lower probability of turnover than firms that are not largely owned by their CEOs or board members. This finding is consistent to Denis et al. (1997) and Goyal and Park (2002) and is accordance with the agency theory framework. Thus, directors with high equity ownership get more power

through voting control and this influences their entrenchment decisions within firms. I also find evidence that CEO duality enhances the probability of turnover. This implies that firms with separated CEO-chairman positions are more likely to remove their directors than firms with combined CEO-chairman positions.

Moreover, this chapter provides evidence that directors' industry experience determines the probability of turnover. In the FA Premier League and the full sample firms, the findings on industry experience are robust in alternative model specifications. The coefficients' estimates on director tenure are statistically significant in all models estimated. This justifies the assertion that human capital theory is important in analysing the determinants of executive turnover. Finally, this study provides evidence that social network theory is not effective in explaining managerial turnover decisions. The coefficient estimates on board size that proxy for social networks among directors have never been significant. The next chapter investigates the impact of directors' features on productivity and financial performance measures.

## 7.10 Appendices

Predicted Probability of Directors' Turnover Changing Over Productivity Performance

Figure 7-2: FA Premier League Firms

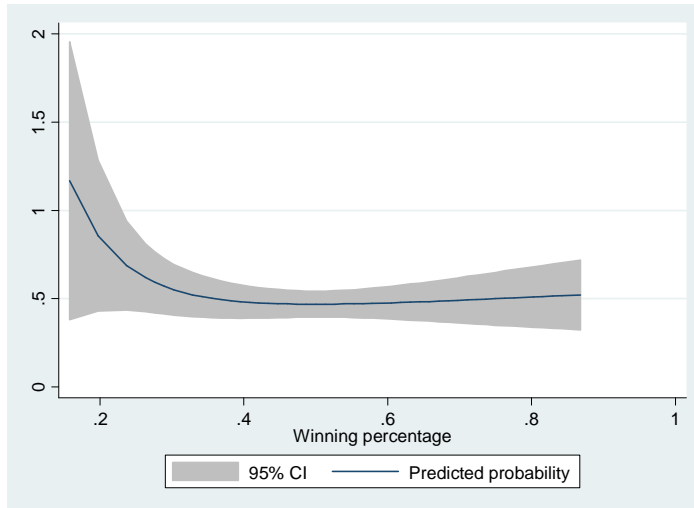
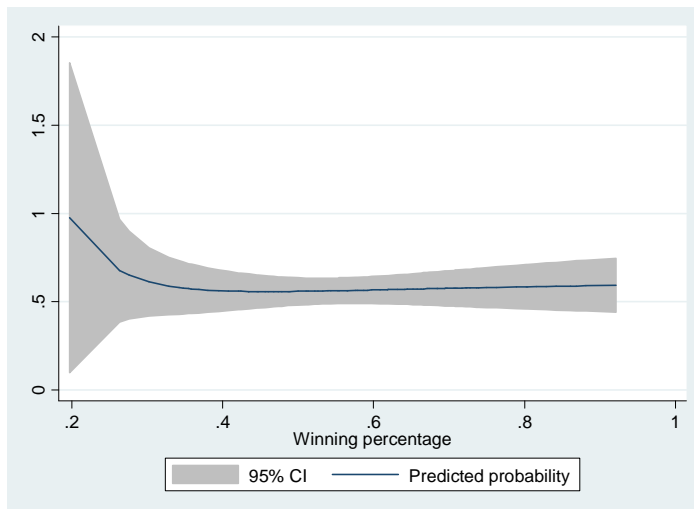


Figure 7-3: Listed Football Firms



**Table 7-4: Logit Regression Estimates Without Outliers for FA Premier League Firms**

This table reports logit regression estimates for FA Premier League firms after excluding the outliers for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (Pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total assets is the ratio of total revenue collected for the period over total assets of the company. Winning percentage is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model
Ln (Pre-tax profits)	-0.060 (-1.028)	-0.076 (-1.344)	-0.078 (-1.381)	-0.078 (-1.311)
Turnover/Total assets	-0.150 (-0.314)	-0.096 (-0.203)	-0.140 (-0.299)	-0.122 (-0.260)
Winning percentage	-3.926 (-1.457)	-5.381** (-2.014)	-5.180* (-1.902)	-3.653 (-1.304)
CEO duality	0.618 (1.014)	-	-	-
Non-executive directors	-	-0.314 (-0.508)	-	-
Board size	-	-	0.009 (0.063)	-
Board ownership	-	-	-	-0.022 (-1.494)
Director tenure	-0.262** (-2.123)	-0.245** (-2.035)	-0.243** (-2.015)	-0.203 (-1.632)
Firm size	0.076 (0.140)	0.158 (0.295)	0.142 (0.266)	-0.174 (-0.298)
Director age	-0.003 (-0.083)	-0.011 (-0.290)	-0.009 (-0.233)	-0.007 (-0.163)
Year dummies	No	No	No	No
Observations	158	170	170	164
Number of firms	22	25	25	25
Log likelihood	-66.814	-70.304	-70.432	-66.947
Probability	(0.081)	(0.028)	(0.031)	(0.068)

**Table 7-5: Logit Regression Estimates Without Outliers for UK Listed Football Firms**

This table reports logit regression estimates for UK listed firms after excluding the outliers for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (Pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/Total assets is the ratio of total revenue collected for the period over total assets of the company. Winning percentage is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. Blockholder ownership is the aggregate percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firms' share capital. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Ln (Pre-tax profits)	-0.032 (-0.537)	-0.047 (-0.828)	-0.052 (-0.919)	-0.047 (-0.820)	-0.045 (-0.755)	-0.048 (-0.795)
Turnover/Total assets	-0.248 (-0.487)	0.112 (0.227)	0.032 (0.065)	-0.001 (-0.002)	-0.020 (-0.041)	-0.006 (-0.012)
Winning percentage	-5.061*** (-2.734)	-4.655*** (-2.605)	-4.613*** (-2.597)	-4.416** (-2.496)	-5.231*** (-2.734)	-4.527** (-2.448)
CEO duality	1.140* (1.695)	-	-	-	-	-
Non-executive directors	-	-0.901 (-1.572)	-	-	-	-
Board size	-	-	-0.030 (-0.181)	-	-	-
Board ownership	-	-	-	-0.008 (-0.877)	-	-
CEO ownership	-	-	-	-	-0.039* (-1.873)	-
Blockholder ownership	-	-	-	-	-	0.019 (1.343)
Director tenure	-0.223 (-1.544)	-0.194 (-1.458)	-0.200 (-1.538)	-0.170 (-1.254)	-0.202 (-1.372)	-0.219 (-1.520)
Firm size	-0.083 (-0.095)	-0.509 (-0.689)	-0.556 (-0.766)	-0.453 (-0.613)	-0.064 (-0.072)	-0.875 (-0.975)
Director age	-0.022 (-0.573)	0.003 (0.071)	-0.014 (-0.351)	-0.020 (-0.509)	-0.034 (-0.784)	0.009 (0.192)
Year dummies	No	No	No	No	No	No
Division dummies	No	No	No	No	No	No
Observations	173	186	186	183	162	167
Number of firms	24	24	24	24	24	24
Log likelihood	-72.043	-79.213	-80.498	-78.801	-64.853	-69.977
Probability	(0.024)	(0.029)	(0.071)	(0.076)	(0.020)	(0.064)

**Table 7-6: Logit Regression Estimates Without Outliers for Full Sample Firms**

This table reports logit regression estimates for full sample firms after excluding the outliers for the period 1998 to 2007. Directors' turnover is a binary variable represented by one if there is any executive director turnover in a particular year, zero otherwise. Ln (Pre-tax profits) is the natural logarithm of pre-tax profits. Turnover/total assets is the ratio of total revenue collected for the period over total assets of the company. Winning (%) is the percentage of matches won by a club in every season, in this case draws are considered as half win. CEO duality is a dummy variable recorded as one if there is a separation of duties between CEO and chairman of the board, and zero otherwise. Non-executive director is a dummy variable recorded as one if the board consists of three or more non-executives, zero otherwise. Board size is the total number of directors serving on the board at the end of the financial year. Board ownership is the aggregate percentage of shares owned by all directors either directly or indirectly through other companies or their families. CEO ownership is the percentage of equity stakes owned by the CEO. Blockholder ownership is the aggregate percentage of shares owned by larger organisations or individuals with substantial shareholding amounting to or exceeding three percent of the firms' share capital. Director tenure is the average number of years a director served on the board. Firm size is measured by the logarithm of number of employees. Director age is the average age of a director. Z-statistics for two-tailed tests are reported in parenthesis. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Ln (Pre-tax profits)	-0.024 (-0.624)	-0.052* (-1.667)	-0.052* (-1.674)	-0.041 (-1.272)	-0.026 (-0.686)	-0.071 (-1.294)
Turnover/Total assets	0.054 (0.283)	0.015 (0.135)	0.012 (0.114)	0.011 (0.096)	-0.079 (-0.462)	0.120 (0.562)
Winning percentage	-2.516** (-2.230)	-2.208** (-2.460)	-2.195** (-2.445)	-2.056** (-2.206)	-2.688** (-2.421)	-4.360*** (-2.854)
CEO duality	1.026** (2.317)	-	-	-	-	-
Non-executive directors	-	-0.222 (-0.605)	-	-	-	-
Board size	-	-	-0.016 (-0.262)	-	-	-
Board ownership	-	-	-	-0.007 (-1.626)	-	-
CEO ownership	-	-	-	-	-0.014 (-1.526)	-
Blockholder ownership	-	-	-	-	-	0.010 (0.965)
Director tenure	-0.177*** (-2.685)	-0.125** (-2.461)	-0.126** (-2.439)	-0.146*** (-2.602)	-0.145** (-2.166)	-0.266*** (-2.629)
Firm size	0.388 (1.121)	0.181 (0.626)	0.193 (0.668)	0.268 (0.839)	0.487 (1.335)	0.313 (0.369)
Director age	-0.006 (-0.280)	-0.019 (-1.128)	-0.020 (-1.171)	-0.008 (-0.474)	-0.001 (-0.060)	0.007 (0.239)
Year dummies	NO	NO	NO	NO	NO	NO
Division dummies	NO	NO	NO	NO	NO	NO
Observations	414	695	695	647	410	258
Number of firms	51	86	86	83	52	39
Log likelihood	-184.370	-315.683	-315.833	-289.190	-183.503	-108.749
Probability	(0.006)	(0.002)	(0.003)	(0.002)	(0.029)	(0.012)

## 8 PERFORMANCE, PRODUCTIVITY AND MULTIPLE DIRECTORSHIPS

### 8.1 Introduction

This chapter examines the impact of directors' attributes on productivity and financial performance. Most of the corporate governance literature has focused on traditional features of the board of directors such as board composition and board size. Recent research has increased attention on the link between multiple directorships and firm performance (e.g Fich and Shivdasani, 2006, Perry and Peyer, 2005, Sarkar and Sarkar, 2009). Despite the increased attention on this topic, findings from previous studies are mixed and therefore inconclusive. For instance, earlier research by Core et al. (1999) finds that busy directors (i.e. directors with three or more directorships) set excessively high levels of CEO compensation, which leads to poor firm performance, whereas Perry and Peyer (2005) find that directors accumulating multiple board seats improve firm performance. Also, Ferris et al. (2003) find no relationship between the average number of directorships held by outside directors and firm performance. Thus, whether holding multiple directorships impairs the individual director's ability to work effectively is a questionable issue that has generated proposals for governance reform and is certainly worth further investigation.

Motivations for this chapter are derived from three theoretical areas. First, the motivation of linking multiple directorships and firm performance evolved from resource dependency theory which to-date has been rarely examined in finance research. Nicholson and Kiel (2007) and Sarkar and Sarkar (2009) are among the few studies that have incorporated this theory in the corporate governance literature. The theory considers boards of directors to be an essential link between the firm and the essential resources that it needs in order to maximise performance (Pfeffer and Salancik, 1978). Researchers view the board as a potentially important resource for the firm, especially in its links with external organisations (Hillman et al., 2000, Nicholson and Kiel, 2007). While resources obtained from third parties are seen as important, the exact character of the resources is variable. The appropriate value of a particular resource depends on

the necessity of the need. Thus, resource dependency theory provides guidance on whether directors holding multiple board seats are beneficial or detrimental to firm performance.

The literature on multiple directorships and firm performance has been mixed. Two streams of empirical evidence differ from each other regarding this relationship. The first stream supports the “reputation hypothesis” that multiple directorships have a positive impact on firm performance. Fama and Jensen (1983) asserted that multiple board appointments is the signal of superior directorial quality. Several other studies have supported this view and argued that the number of board seats that outside directors hold is tied to the firm performance in which these directors are incumbents, either as CEOs or outside directors. These findings were documented for firms that cut dividends (Kaplan and Reishus, 1990), for financially distressed firms (Gilson, 1990), for firms that fire their CEOs (Farrell and Whidbee, 2000) and for a broad sample of firms (Yermack, 2004). In these studies, directors lose their directorships following a firm’s poor performance.

The second stream supports the “busyness hypothesis” that multiple directorships have a negative impact on firm performance. Directors with multiple directorships are considered to be overcommitted thus become ineffective in carrying out their obligations. This means that, directors may seek more directorships in other companies, at the expense of shareholders, because it improves their public prominence and status. Several papers have shown evidence that multiple directorships affect firm performance negatively. Beasley (1996) finds that directors with multiple directorships increase the probability of committing accounting fraud in the firm. Shivdasani and Yermack (1999) as well as Core et al. (1999) finds a positive correlation between directors holding multiple directorships and CEO compensation. These findings provide evidence that implies a negative effect on shareholders’ wealth. Also, Fich and Shivdasani (2006) find evidence that busy directors (i.e. directors holding multiple board seats) harm firm performance.

My second motivation is originated from agency theory. This chapter focuses on the conflicts between majority and minority shareholders. There are two main concerns on the agency issue. First, it is argued that majority shareholders use their controlling position in the corporation to a expropriate firm’s wealth at the expense of minority shareholders (Ali et al., 2007). The main methods of wealth expropriation include investment in fruitless projects, consuming perquisites and tunnelling. Alternatively, if majority shareholders are institutions like banks or pension

funds, the advantage of controlling shareholders to expropriate firm's wealth is channelled to several individuals who own these institutions (Villalonga and Amit, 2006). As a result, controlling shareholders have little incentive to take away a firm's wealth at the cost of minority shareholders. This implies that blockholder investors supervise effectively a firm's operations and enhance firm performance.

My third motivation is derived from human capital theory. This theory describes the way the experience of managers may contribute to a firm's productivity. The relationship between human capital attributes and firm performance is analysed in more depth in management research (e.g. Simsek, 2007, Henderson et al., 2006) and less in finance research (e.g. Christoffersen and Sarkissian, 2009). The literature in economics suggests that human capital attributes have a substantial impact on a firm's productivity through numerous mechanisms (Ballot et al., 2001). For instance, firms efficiently structured with managers who have considerable experience can make better decisions than its rivals with managers who have lower experience. This means that firms endowed with managerial experience have the ability to imitate other firms and take advantage of cheap spill-overs coming from other firms' technical knowledge. It is important to understand the impact of human capital on firm performance since it is one of the inputs used in the production process.

The main objectives of this chapter are twofold. First is to investigate the impact of multiple directorships on firm performance. Second is to investigate the impact of ownership structure and managerial industry experience on firm performance. To do this successfully, I have used listed soccer corporations in the UK as a laboratory for two important reasons. First, these firms have a very clear distinction between productivity and financial performance measures. This provides the opportunity to conduct an in-depth analysis on how directors' features affect each of the performance measures. Second, football firms offer plentiful production data that is recorded frequently in a meaningful way. In addition, there is high level of disclosure of corporate governance information for quoted corporations. Overall, listed football firms are data-rich thus facilitating detailed empirical research in finance and economics.

My main findings and contributions are as follows. Firstly, multiple directorships demonstrate two major impacts on firm performance. A system of simultaneous equations shows that multiple directorships considerably enhance net spending whilst at the same time substantially reducing pre-tax profits. In the same system of equations the results reveal that net spending

substantially increases the winning percentage. This implies multiple directorships have an indirectly positive impact on productivity performance by means of increasing investment in playing assets. My finding suggests skills gained by directors through multiple board appointments help them to enhance productivity performance.

It is important to recognise that success in productivity performance requires distinctive skills that conform to the firm's investment schemes. In the analysed sample, the establishment of business affiliations through multiple directorships promotes productivity performance, while at the same time reducing financial performance. This tells us that directors holding several directorships use a firm's financial resources to strengthen the playing squad. As a consequence, this improves the winning percentage but reduces the firm's profitability. This finding concurs with the "performance trade-off hypothesis", that multiple directorships tend to improve productivity performance at the expense of poorer financial performance. The intuition of this hypothesis is that it is difficult to maximise both productivity and financial performance at one time. This suggests that the trade-off between performance measures is contemporary taking into account that improved productivity performance in the current period is likely to generate better financial performance in the future.

This finding enriches the finance literature through extending prior studies and offers benefits to practitioners. The positive relationship between multiple directorships and productivity performance is comparable to the findings by Yermack (2004) and Perry and Peyer (2005). The proposition of this positive relationship is that multiple directorships bring firm-specific skills that promote productivity performance. This finding supports resource dependency theory in the sense that directors acquire skills through external workloads that enable them to improve productivity performance. The negative relationship between multiple directorships and financial performance is similar to the findings by Shivdasani and Yermack (1999) and Fich and Shivdasani (2006). The implication of this negative relationship is that multiple directorships persuade directors to focus on players' investment which lessens a firm's profitability.

The extension of multiple directorship and firm performance literature is advantageous in the following ways. First, my analysis can offer guidelines to firms and their boards as to the conditions under which the nomination of a director to hold multiple board seats is likely to enhance or weaken firm performance. The value of resources that can be gained through multiple board seats depends on its urgency to the firm. In this context, firms should consider

carefully before giving multiple board seats to its directors. Second, I expect that any discussion regarding the demand for multiple board seats and proposed limitations on the number of directorships an individual can hold should consider potential benefits and costs that may arise to the firm.

Secondly, my investigation is conducted in firms that show a clear distinction between productivity and financial performance. This adds to the literature by providing an in-depth analysis between multiple directorships and firm performance. I examined simultaneously the impact of multiple directorships on both productivity and financial performance measures. I have employed logarithms of pre-tax profits and winning percentage as measures of financial and productivity performance respectively. The use of industry-specific measures of performance provides new evidence for multiple directorships studies. Furthermore, the use of pre-tax profits as a measure of financial performance is different from the long tradition of using the market-to-book ratio (e.g. Ferris et al., 2003, Fich and Shivdasani, 2006). This leads to relatively original estimates, the comparison of the results being merely on the relationship direction rather than performance measures employed.

Thirdly, I reconsider the impact of ownership structure on productivity and financial performance. In the previous literature, this relationship has been complex and its direction is unclear. My study adds to this line of research by providing new evidence on each type of ownership investigated. One view is that board ownership negatively affects productivity performance but does not enhance financial performance. I interpret this finding as showing that directors with equity ownership aim to maximise their personal welfare at the expense of shareholders' wealth. This finding is comparable to Short and Keasey (1999) and Davies et al. (2005) who find a negative relationship between managerial ownership and firm performance at intermediate levels of ownerships. The inference of these studies is that managers tend to exert inadequate effort, accumulate private benefits and entrench themselves at higher levels of managerial ownership, leading to a negative relationship between managerial ownership and firm performance. My results contribute to the literature by providing evidence on the presence of the "Type II agency problem" where majority shareholders exploit minority shareholders.

Another view is that blockholder investors tend to enhance financial performance at the expense of poorer productivity performance. This implies that blockholder shareholders monitor a firm's activities with the focus on enhancing financial performance. Again, this is consistent with the

“performance trade-off hypothesis” because it is difficult for blockholder investors to maximise both performance metrics at one time. As discussed in chapter 6, many stakeholders prefer productivity performance to financial performance. Accordingly, blockholder investors are concerned with few stakeholders who favour financial performance and thus ignore many stakeholders who favour productivity performance. This finding adds to the literature by confirming that blockholder investors are merely worried about shareholders’ wealth. The findings on this relationship are consistent with standard literature and explain the role of blockholders in the firm (Woitdtk, 2002).

Fourthly, I investigated how managerial industry experience affects productivity and financial performance. Previous finance research rarely used human capital theory in evaluating determinants of firm performance. In this chapter, I find evidence that managerial industry experience improves productivity performance which in turn reduces financial performance. This suggests that directors with experience focus on players’ acquisitions which enhance winning percentage but lessen a firm’s profitability. This finding contributes to previous research by providing evidence on “expertise hypothesis” explained by Vafeas (1993). The hypothesis suggests that long tenure is associated with greater experience, commitment and competency because serving long-term in the firm provides directors with firm-specific knowledge that is relevant in the business environment. Therefore, directors with industry experience utilise their firm-specific skills to improve productivity performance, which is the foundation for future overall firm performance.

Finally, I find that productivity and financial performance depend on each other. There is evidence that productivity performance enhances financial performance and vice-versa. This finding provides confirmatory evidence on the results found by Pinnuck and Potter (2006) using firms from the Australian Football League over the period from 1993 to 2002. The remainder of the chapter is structured as follows. Section 8.2 describes the theoretical foundation, previous studies and develops hypotheses of this chapter. Section 8.3 discusses data, variables and explains the methods used in empirical analyses. Section 8.4 explains empirical results. Robustness checks are explained in Section 8.5. Section 8.6 report results after excluding the outliers. Section 8.7 contains a summary and conclusion of the chapter. Section 8.8 contains the appendices with results that exclude outliers.

## **8.2 Theoretical Foundation and Hypotheses**

### **8.2.1 Resource Dependency Theory**

Pfeffer and Salancik (1978) propose that a firm's continued survival depends on its capability to access and control external environmental resources. They described this phenomenon as the resource dependency theory. According to the management literature, the board of directors is an important resource for companies mainly in terms of the connection with the external environment (e.g. Hillman et al., 2000). In the corporate governance literature, Nicholson and Kiel (2007) used resource dependency theory as it provides links between external resources gained by directors and firm performance. These authors advocated the idea that directors with broad links to the external environment would improve the firm's access to various resources which in turn would improve governance systems and performance of the firm.

According to resource dependency theory, there are two resources that can be obtained by directors who have affiliations with external organisations (Hillman and Dalziel, 2003). The first resource is the board capital which includes experience, expertise and reputation. The second resource is the relational capital which includes networks to other firms and external contingencies. Previous research has shown evidence of the relationship between board capital and firm performance (e.g. Pfeffer, 1972, Dalton et al., 1999, Boyd, 1990). These studies have revealed the way board capital leads to the provision of resources to the firm. The board capital explained here is comparable to what Becker (1964) described as human capital attributes.

Other studies have shown a relationship between relational capital and firm performance. Mizruchi and Stearns (1994) and Booth and Deli (1996) have revealed that directors with multiple board appointments have better networks with external organisations thereby bringing benefits by helping to bring much-needed resources to the company. These studies have shown how relational capital is important through bringing in relevant resources that are beneficial to the firm. Directors with multiple board appointments are in a position to access useful resources in other firms that add value to their own firms.

The logic underlying resource dependency theory suggests that provisions of resources by directors to the firm are directly associated to firm performance. Several previous sets of research argued differently on the impact of these resources to the firm performance. Pfeffer (1972) argued that resources tend to reduce uncertainty for the firm, whereas Pfeffer and

Salancik (1978) argued that resources assist to lessen dependency between the firm and external organisations. In a later study, Williamson (1984) finds that resources help to lower transaction costs, whilst Singh et al. (1986) finds that resources are useful in the survival of the firm. These findings demonstrate that resources attained from external organisations may assist the directors of the incumbent firm in enhancing the performance of their own firms.

Multiple directorships have been linked with resource dependency theory as there appears to be a theoretical argument that directors with external environment affiliations obtain access to numerous resources that improve firm performance. It is worth noting that directors with multiple directorships help the firm to link with important stakeholders, facilitate access to capital and assist in strategy formulation (Hillman and Dalziel, 2003). These arguments focus on the way directors can be helpful through bringing resources to the firm through their multiple board seats. This scenario has been explained as the “reputation hypothesis” where directors are able to acquire several board seats in relation to the performance of their incumbent firms. It is important to note that multiple directorships are beneficial if they bring relevant resources to the company. Overall, this discussion leads to the following formal hypothesis.

*H1: There is a positive relationship between multiple directorships and firm performance.*

An alternative view is that multiple directorships can make directors overcommitted which reduce their ability to monitor effectively a company’s activities and harmfully affects the firm performance. This scenario has been discussed as the “busyness hypothesis” where directors become overwhelmed by workloads in other firms. Since each firm has its own mission and objective, directors’ external workloads can be completely unrelated to the incumbent firm activities. Ideally, directors are required to do their homework in terms of the organisation and its industry. Directors’ involvement in nonspecific business activities affects firm performance negatively. The literature in strategic finance suggests that multiple directorships can be invaluable if it provides access to relevant strategic insights and diverse perspectives. This implies that directors’ participation in unrelated firm activities ruin firm performance.

Strategies in football firms require directors to focus on productivity performance as well as financial performance (Gerrard, 2005). There is a potential trade-off between these performance dimensions. The focus on financial performance mainly involves monitoring revenues generated through merchandising, sponsorship, broadcasting, gate receipts and players’ trading. Directors

are accountable for overseeing all contracts that involve financial transactions with the firm. In particular, directors are important personnel for the administering of player investment in the firm. There is a huge demand for high-calibre players and reputable managers (i.e. the head coach). It is the responsibility of directors to recruit the quality players and reputable manager that aid the production process. The coach should be able to utilise efficiently the available playing resources to achieve superior productivity performance. O'Neal and Thomas (1996) insisted that the key roles of directors are in advising, controlling and implementing strategies that conform to the principal objectives of the firm.

The premise of the performance trade-off is that value-maximising firms achieve better productivity performance at the expense of poorer financial performance. This means that productivity success requires massive investment on playing talents and recruitment of a good manager. Corporate investment in playing resources is vital in the production process. The larger net spending means that the cost used to purchase players is greater than the proceeds received from sales of players. This is an indication that the firm has strengthened its playing squad through purchasing more and selling less. It is rational to observe firms that spend more on playing resources achieving better productivity performance (Callejo and Forcadell, 2006). It is also noticed that players are resources that are the basis of building capabilities. Ideally, well organised players' investment schemes leads to better productivity performance. Based on this discussion, the following hypothesis is formulated.

*H2: There is a positive relationship between firm's net spending and productivity performance.*

### **8.2.2 Agency Theory**

This theory has been explained in the previous chapters of this thesis. However, some further discussion is required in this section for the development of a well-grounded hypothesis. The literature on ownership structure and corporate performance has been mixed. For instance, early studies by Demsetz and Lehn (1985) finds there to be a linear relationship, while later studies such as those by Morck et al. (1988), McConnell and Servaes (1995), Short and Keasey (1999) and Davies et al. (2005) finds a non-linear relationships. Short and Keasey (1999) emphasised that the non-linear relationship stems from the influence of alignment and entrenchment under the agency theory perspective. The belief that managerial ownership helps to lessen the divergent interests between shareholders and managers is well explained by agency theory

literature (Jensen and Meckling, 1976). Ideally, firms that align interests of managers to that of shareholders have minimal agency problems and larger corporate value.

Majority shareholders use their controlling positions in the firms to expropriate the firm's wealth at the expense of minority shareholders. This implies that firms with majority shareholders who are also corporate managers perform poorly because these managers expropriate private benefits at the expense of minority shareholders. However, if the majority shareholder is a widely held corporation or other institution such as a pension fund, an insurance company or a bank, the benefits of controlling the firm are diluted to several individual owners (Villalonga and Amit, 2006). As a consequence, majority shareholders have few incentives to take away a firm's wealth from minority shareholders. These kinds of institutions oversee effectively firms' activities and increase firm performance.

Majority shareholders of most football clubs are also directors in their own firms. The percentage of managerial ownership in these firms is however, larger. For a sample of listed clubs, the average managerial ownership is slightly larger than 33%. The average ownership for the CEO himself is slightly larger than 7%. This may indicate that directors in these firms tend to be majority shareholders if the remaining shares are owned by various individual shareholders. These companies have also demonstrated large average blockholder ownership, which is slightly larger than 43%. The detail information on these figures is discussed in chapter 5.

In the previous literature, Morck et al. (1988) found a positive relationship between Tobin's Q and managerial ownership for the 0% to 5% board ownership range, and a negative relationship in the 5% to 25% board ownership range. They also find that managers are entrenched in the firm when managerial ownership ranges from 5% to 25%. These authors find a positive relationship for board ownership exceeding 25%. However, other studies such as Davies et al. (2005) find different ranges of managerial ownership that are positively and negatively related to corporate value.

I develop the hypothesis under the premise that directors in football firms are major shareholders. This implies that firms with directors who have a higher equity ownership perform poorly because these directors expropriate the firm's wealth at the expense of minority

shareholders. The main methods of expropriating wealth from these minority shareholders involves awarding themselves excessive salaries and entrenching themselves in the firm regardless of individual performance. Other methods include the tendency of investing in unproductive players, consuming perquisites and tunnelling. On the other hand, firms whose majority shareholders are from widely held firms or other institutions such as a supporters' trust, pension funds or banks tend to monitor management effectively and achieve a higher level of firm performance. This leads to the following formal hypothesis.

*H3 (a): There is a negative relationship between the percentage of board ownership and firm performance.*

*H3 (b): There is a positive relationship between the percentage of blockholder ownership and firm performance.*

### **8.2.3 Human Capital Theory**

Human capital theory developed from the field of macroeconomic development theory (Schultz, 1993, Becker, 1993). Most research grounded in human capital theory provides a foundation of the association between management experience and firm performance (e.g. Finkelstein and Hambrick, 1996, Huselid, 1995). Human capital attributes such as experience, skills and education have long been viewed as important resources that affect firm outcomes (Hitt et al., 2001, Pfeffer, 1994). For instance, Hitt et al. (2001) finds that intangible resources have a competitive advantage over tangible resources as they can add value to the incoming factors of production. Other studies suggested that intangible resource such as knowledge is the most crucial competitive asset that the firm possesses (Grant, 1996, Spender, 1996).

Much of the firm's knowledge exists through its people (human capital attributes). Managers can gain knowledge through formal education or through job execution. The knowledge or proficiency gained is transferable in the field of specialisation. People working in one firm for a long period acquire firm-specific knowledge through learning on the daily activities of the company. Some previous studies have revealed the way firm-specific knowledge can be acquired through practicing on the job (Grant, 1996, Hitt et al., 2001). That means people working in one firm get familiarity with the firm's activities which in turn increases their competence and expertise in that particular firm. Ideally, managers with a higher level of competency will improve the competitiveness and performance of the firm.

A recent study by Seleim et al. (2007) finds there to be a positive relationship between human capital indicators and corporate performance. Many other studies provide evidence of the way human capital plays a crucial role in the strategic planning into how to create competitive advantages (Agarwala, 2003, Barney, 1995, Nordhaug, 1998). Specifically, Barney (1995) and Agarwala (2003) find that human capital attributes play a significant role in promoting a firm's competitiveness and performance. The football industry consists of firms that are competitive in nature, their production processes requiring by definition competition between two rivals. Thus, firms that consist of directors with sufficient relevant experience are more likely to achieve a higher performance than firms that consist of directors with less relevant experience. In this way, I propose that directors who have longer tenures in the firm acquired a great deal of relevant knowledge and proficiency which should contribute to a significant increase in firm performance.

*H4: There is a positive relationship between directors' industry experience and firm performance.*

Figure 8-1 below provides the summary of the hypotheses developed and their corresponding theories.

**Figure 8-1: Summary of Theories and Hypotheses**

This figure represents the summary of theories used, and hypotheses developed. The figure provides direction of the relationship for each hypothesis and its corresponding theory.

	<b>Resource Dependency Theory</b>	<b>Agency Theory</b>	<b>Human Capital Theory</b>
Hypothesis 1	+	N/A	N/A
Hypothesis 2	+	N/A	N/A
Hypothesis 3 (a)	N/A	-	N/A
Hypothesis 3 (b)	N/A	+	N/A
Hypothesis 4	N/A	N/A	+

Source: Own Construction

## **8.3 Data and Methods**

### **8.3.1 Sample Description**

The sample consists of the listed football firms during the ten-year period from 1998 to 2007. For these firms, data is collected during the listing period provided it falls within the sample period. I consider that companies may restructure their boards prior to flotation and change

board structures only gradually after delisting. This means that for those firms listed or delisted during the sample period, data included the year listed and the year delisted. This criterion yields a final sample of 198 observations for 26 firms across the ten-year period. Data sources and descriptive statistics have been explained in detail in chapter 5 of this thesis.

### **8.3.2 Empirical Modelling**

To account for plausible interdependence between multiple directorships, net spending and firm performance variables, I estimate using three-stage least squares (3SLS) regressions. Three-stage least squares is a system of structural equations, where some equations contain endogenous variables among the explanatory variables. Normally, the endogenous explanatory variables are dependent variables on other equations in the system. Kennedy (2003) recommends the use 3SLS as it is more efficient than 2SL. The method exploits all available information and simultaneously estimates all equations in the system but 2SLS use limited information in its estimation. For that reason, 3SLS method permits multiple directorships, net spending, productivity performance and financial performance to be endogenously determined in an efficient way. For each endogenously determined variable, I include instrumental variables that are correlated with the variable of interest. However, in 3SLS procedure it is assumed that instrumental variables are uncorrelated with the error term.

#### *8.3.2.1 Order Condition for Identification*

There is an identification procedure in systems with three or more equations. I followed the order condition for complicated simultaneous equation models as recommended in many econometrics books. Wooldridge (2006) advocated that any equation in structural equation models will satisfy the order condition for identification, only if the number of excluded exogenous variables from the equation is large or equal to the number of right-hand side endogenous variables included. To meet this criterion, equation (8.3) does not include division dummies as they are not important in influencing multiple directorships. Each equation in the system anyway contains exogenous variables that really describe the endogenous variable either through a theoretical foundation or intuition. The econometric literature suggests that in any model specification, researchers should rely on good economic theory, richly laced with good reasoning (e.g. Wannacott and Wannacott, 1979, Larcker and Rusticus, 2010). The equation order and the rank conditions were fulfilled, and the system was identified.

**Equation 8-1**

$$\begin{aligned}
 \text{Net Spending}_i &= \alpha_0 + \beta_1 \text{Multiple Directorships}_{i,t-1} + \beta_2 \text{Director Tenure}_i + \beta_3 \text{Firm Size}_i \\
 &+ \beta_4 \text{Promotion}_i + \beta_5 \text{Relegation}_i + \beta_6 \text{Pretax profits}_i \\
 &+ \sum_{k=1}^{10} \gamma_k \text{Year Dummies}_i \\
 &+ \sum_{k=1}^4 \gamma_k \text{Division Dummies}_i + \varepsilon_i \dots \dots \dots (8.1)
 \end{aligned}$$

**Equation 8-2**

$$\begin{aligned}
 \text{Winning \%}_i &= \alpha_0 + \beta_1 \text{Net Spending}_{i,t-1} + \beta_2 \text{Board Ownership}_i + \beta_3 \text{Director Tenure}_i \\
 &+ \beta_4 \text{Firm Size}_i + \beta_5 \text{Director Age}_i + \beta_6 \text{Promotion}_i + \beta_7 \text{Relegation}_i \\
 &+ \beta_8 \text{PNBV}_i + \sum_{k=1}^{10} \gamma_k \text{Year Dummies}_i + \sum_{k=1}^4 \gamma_k \text{Division Dummies}_i \\
 &+ \varepsilon_i \dots \dots \dots (8.2)
 \end{aligned}$$

**Equation 8-3**

$$\begin{aligned}
 \text{Multiple Directorships}_i &= \alpha_0 + \beta_1 \text{Director Tenure}_i + \beta_2 \text{Firm Size}_i + \beta_3 \text{Director Age}_i \\
 &+ \beta_4 \text{Promotion}_i + \beta_5 \text{Relegation}_i + \beta_6 \text{Pretax profits}_i + \beta_7 \text{Winning \%}_i \\
 &+ \sum_{k=1}^{10} \gamma_k \text{Year Dummies}_i \\
 &+ \varepsilon_i \dots \dots \dots (8.3)
 \end{aligned}$$

**Equation 8-4**

$$\begin{aligned}
 &\text{Pretax profits}_i \\
 &= \alpha_0 + \beta_1 \text{Multiple Directorships}_{i,t-1} + \beta_2 \text{Board Ownership}_i + \beta_3 \text{Director Tenure}_i \\
 &+ \beta_4 \text{Firm Size}_i + \beta_5 \text{Director Age}_i + \beta_6 \text{Promotion}_i + \beta_7 \text{Relegation}_i + \beta_8 \text{Winning \%}_i \\
 &+ \beta_9 \text{Board Size}_i + \sum_{k=1}^{10} \gamma_k \text{Year Dummies}_i \\
 &+ \sum_{k=1}^4 \gamma_k \text{Division Dummies}_i + \varepsilon_i \dots \dots \dots (8.4)
 \end{aligned}$$

### 8.3.2.2 *Endogenous Variables*

There are four main dependent variables used in this analysis. Net spending is defined as the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. I have scaled this variable with total assets because firms in the sample differ considerably in their sizes. Other endogenous variables include the winning percentage, multiple directorships and pre-tax profits. The definitions of these variables are provided in chapter 5. As stated previously, winning percentage measures productivity performance and pre-tax profit measures financial performance. The reason for choosing pre-tax profits rather than operating profits has been explained in chapter 6.

### 8.3.2.3 *Exogenous Variables*

The important exogenous variables in the system are ownership structure and industry experience variables. Board and blockholder ownership captures the impact of ownership structure on firm performance. These variables are defined in chapter 5. Existing studies on multiple directorships and firm performance have examined ownership variables in their regression equations (e.g. Ferris et al., 2003, Fich and Shivdasani, 2006). Managerial industry experience is captured by the average directors' tenure in the firm. Tenure has been used to proxy for experience in previous studies (e.g. Goyal and Park, 2002).

I have controlled for several variables that have an impact on a given dependent variable. As in previous empirical chapters, firm size is measured by the logarithm of full-time employees of the firms. Several papers studying firm performance issues controlled for firm size (e.g. Fich and Shivdasani, 2006). Director age is the average age of all directors in the board. I have included this variable because individuals close to retirement age might be willing to increase their current incomes through accepting excessive commitments that are detrimental to firm performance. Also, directors close to the retirement age might think that having multiple board seats is a lucrative part-time job during their retirement years. In this context, any of the reasons above indicate that advanced age is associated with poor firm performance. Ferris et al. (2003) controlled for this variable in their regression models.

Board size is the total number of directors in the firm's board at the financial year end. Previous research indicates that board size has an impact on firm performance.<sup>36</sup> Yermack (1996) documents a significant inverse relationship between board size and firm value. Besides this, other previous studies have controlled for this variable (e.g. Ferris et al., 2003, Fich and Shivdasani, 2006). Wherever the dependent variable is the winning percentage, I have controlled for the quality of players because playing talent contributes to the possibility of winning games. This is measured by the net book value of a players' registration. Normally, the net book value of an individual player declines every year because the company amortises the cost of a player's registration on the annual basis using the straight-line method over the contract period.

Promotion is a dummy variable recorded as one if the firm was promoted from the lower-level division to the higher-level division. Intuition suggests that promotion may require huge spending because the firm competes in the higher-level league than before. It is hard to achieve superior winning percentage for a newly promoted firm, but promotion increases their revenues through extended sponsorships contracts, merchandising, broadcasting and gate tickets. Relegation is a dummy variable recorded as one if the firm was relegated from the higher-level division to the lower-level division. It is logical to find relegated firms cut their players' spending and sometimes sell their players because the lower-level league has inferior playing talent, lower revenues and lower gate attendances. Firms that have been relegated may increase their winning percentage because they are competing in a less competitive environment. However, competing in a lower-level league reduces revenues because deals like sponsorship, merchandising and broadcasting lose their value.

## **8.4 Empirical Results**

The empirical analysis proceeds in three important steps. First, I use ordinary least squares (OLS) regressions using equation (8.4) of the system where financial performance depends on multiple directorships and productivity performance in separate models. Similar approaches have been common in the literature, but they ignore the influence of other variables on financial performance and potential endogeneity. Second, I estimate equation (8.4) using OLS to examine the effects of interactions between multiple directorships and productivity performance on financial performance. Finally, I estimate a system of simultaneous equations using 3SLS. A

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<sup>36</sup> In this chapter, board size is included as a control variable that has influence on firm performance. In chapter 7, the variable is included as a measure of social networking between the directors.

direct inspection of possible endogeneity may be observed by comparing 3SLS estimates with OLS estimates of equation (8.4).

#### **8.4.1 Ordinary Least Squares Results**

Table 8-1 reports the results from OLS regressions of pre-tax profits on multiple directorships and winning percentage along with the exogenous control variables included in equation (8.4) of the system. Model (1) and (2) show that previous multiple directorships have a statistically significant negative effect on financial performance. I examine if the crucial impact of multiple directorships is affected by productivity performance. Model (5) to (6) include an interaction term between previous multiple directorships and productivity performance. In both models, the interaction term is negative and significant at the 10% level or better, indicating that when a firm has higher productivity performance, its financial performance has a stronger negative association with multiple directorships. Model (3) and (4) indicate that productivity performance is positively related to financial performance at the 1% level. This supports the perception that winning firms attract more customers to watch their games which increases demand for gate tickets and enhances media and sponsorship opportunities.

It is particularly interesting to observe that board ownership is negatively related to financial performance. The coefficient of board ownership is significant in Model (1) at the 10% level. As in Fich and Shivdasani (2006), I find some evidence that firm size is positively associated with financial performance. Most models are statistically significant at the 5% level or better. There is evidence that financial performance is positively affected by promotion but negatively affected by relegation. This is consistent with expectations and intuition which supports the finding. The adjusted  $R^2$  indicates that Model (3) is superior among the regression models estimated.

**Table 8-1: Determinants of Financial Performance**

The table reports the results from OLS regression of financial performance on individual endogenous variables as well as with the exogenous control variables included in equation (8.4) of the system equations for the period 1998 to 2007. Model (1) and (2) include the board ownership variable while Model (3) and (4) include the blockholder ownership variable in their regressions. Model (5) uses an interaction variable but includes the board ownership variable in the regression. Model (6) use an interaction variable but includes the blockholder ownership variable in the regression. All other variables are self-explanatory or are described in the main text.

Variables	(1) Model	(2) Model	(3) Model	(4) Model	(5) Model	(6) Model
Constant	-8.656*** (-2.976)	-7.297** (-2.229)	-6.449** (-2.245)	-6.552* (-1.750)	-9.943*** (-3.461)	-8.945*** (-2.835)
Multiple directorships <sub>1</sub>	-0.720** (-2.447)	-0.746** (-2.482)	-	-	-	-
Winning %	-	-	7.254*** (3.739)	6.933*** (3.356)	-	-
Multiple directorships <sub>1</sub> * Winning %	-	-	-	-	-0.598* (-1.823)	-0.669** (-2.024)
Board ownership %	-0.023* (-1.834)	-	0.012 (1.278)	-	-0.020 (-1.613)	
Blockholder ownership %	-	0.004 (0.308)	-	0.002 (0.175)	-	0.003 (0.220)
Director tenure	0.062 (0.451)	-0.034 (-0.254)	-0.023 (-0.164)	-0.087 (-0.564)	0.038 (0.278)	-0.043 (-0.310)
Firm size	1.453*** (3.206)	1.224*** (2.641)	-0.300 (-0.633)	-0.338 (-0.646)	1.413*** (2.925)	1.257** (2.557)
Promotion	2.606** (2.405)	1.768 (1.470)	1.916** (2.282)	1.495 (1.425)	2.398** (2.276)	1.550 (1.355)
Relegation	-2.265*** (-4.397)	-2.461*** (-4.162)	-1.003 (-1.141)	-1.858*** (-2.608)	-2.138*** (-4.191)	-2.270*** (-3.844)
Ln (Board size)	1.279 (1.135)	1.038 (0.832)	0.244 (0.255)	1.088 (1.094)	1.503 (1.318)	1.290 (1.020)
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Time Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	135	130	192	175	135	130
Adjusted. R <sup>2</sup>	0.119	0.101	0.241	0.223	0.097	0.080

White heteroscedasticity-consistent standard errors are in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.10

### 8.4.2 Three-Stage Least Squares Results

As a first step, to make sure that 3SLS is a suitable methodology, I test for the endogeneity of net spending, winning percentage, multiple directorships and pre-tax profits using a Durbin-Wu-Hausman test (Hausman, 1978). For the test I follow the standard procedure in the econometrics literature (Gujarati, 2003).<sup>37</sup> The predicted value of winning percentage was applied to the multiple directorships' equation and the predicted value of multiple directorships applied to the pre-tax profits equation. The predicted value of net spending was applied to the winning

<sup>37</sup> Firstly, each dependent variable is regressed on all exogenous variables in the system. The predicted values for the dependent variables are computed using estimated coefficients from these first stage regressions. Secondly, each dependent variable is regressed on the exogenous variables in the respective equation, the right-hand-side dependent variables and the predicted values of the right-hand-side dependant variables. If a predicted dependent variable is significant in the model, then the dependent variable is presumed to be endogenous.

percentage equation and the predicted value of pre-tax profits was applied to the net spending equation. I tested each equation using the standard t-statistic to confirm whether the coefficient of the predicted right-hand-side dependent variable is statistically significant or not. Table 8-2 to 8-7 included the Durbin-Wu-Hausman test for endogeneity for each dependent variable. For most phenomena, the predicted dependent variable is significant indicating that the variable is endogenous. I conclude that OLS estimation may lead to inconsistent and biased results.

Table 8-2 reports the results obtained from estimating simultaneous equations of the system where equations (8.2) and (8.4) include the board ownership variable. Table 8-3 reports the results obtained from estimating simultaneously equations of the system where equations (8.2) and (8.4) include the blockholder ownership variable. I have separated models with board and blockholder ownership to get the clear picture of their impact on firm performance. For clarity purposes, regressions reported do not show coefficients on year and division dummies. In both tables, the adjusted  $R^2$  demonstrate that Model (2) is superior to other models in the system.

#### *8.4.2.1 Multiple Directorships, Net Spending and Firm Performance*

The results confirm expectations based on theory, but also provide interesting new insights. Table 8-2 and 8-3 indicates that previous multiple directorships are positively related to a firm's net spending. The relationship is statistically significant at the 5% level or better. This tells us that directors holding several board seats in the previous year considerably increases the current year firm's net spending. My estimates suggest that the impact of multiple directorships on net spending is not economically trivial. The coefficients' estimates show that multiple directorships enhance net spending by about 0.03 to 0.04. Also, the findings indicate that previous net spending is positive and statistically significant relating to winning percentage. The models estimated are statistically significant at the 10% level, and the estimates suggest that the impact of net spending on the winning percentage is economically meaningful. Coefficient estimates indicate that net spending increases the productivity performance by about 0.1.

The significant positive relationship between net spending and winning percentage provides evidence that multiple directorships improve productivity performance by encouraging acquisition of players. It is rational to find that investment in playing talent leads to success in productivity performance. My result suggests that skills obtained through multiple board seats stimulate the investment of players. This indirect positive relationship between multiple

directorships and productivity performance is consistent with some previous studies (Perry and Peyer, 2005, Loderer and Peyer, 2002). Loderer and Peyer (2002) find a positive association between performance, measured by Tobin's Q, and the number of directorships a chairman holds for a sample of Swiss firms. Likewise, Perry and Peyer (2005) find that multiple directorships enhance the firm performance. One important caution is that performance measures examined here differ from previous multiple directorships' studies.

This positive relationship concurs with the "reputation hypothesis" with the logic that multiple board appointments act as a signal of superior quality, and enhance firm value. It is argued that directors that accept a directorship enhance the firm value of the primary employer if sitting on other boards assist them in learning different management styles or strategies used by other firms (Booth and Deli, 1996, Carpenter and Westphal., 2001). In addition, firms can benefit from its directors using the directorship to establish affiliations or to manage business relationships (Loderer and Peyer, 2002, Rosenstein and Wyatt., 1994). Several other studies report evidence consistent with a positive association between the multiple directorships and director quality (e.g. Gilson, 1990, Kaplan and Reishus, 1990, Shivdasani, 1993, Ferris et al., 2003, Brickley et al., 1999).

Model (4) of Table 8-2 and 8-3 provide evidence that previous multiple directorships is negative and statistically significantly related to pre-tax profits at the 1% level. This implies that as the directors acquire more board seats, the firm performs worse financially. My estimates suggest that the impact of multiple directorships on firm's profitability is economically significant. The coefficients' estimates indicate that multiple directorships reduce pre-tax profits by about 1.70 to 1.73. The negative relationship between multiple directorship and financial performance is consistent with some previous studies (e.g. Fich and Shivdasani, 2006, Core et al., 1999, Shivdasani and Yermack, 1999).

Core et al. (1999) and Shivdasani and Yermack (1999) established that directors holding multiple board seats are busy and might not monitor firm's main activities effectively. Also, Fich and Shivdasani (2006) reported that directors holding three or more directorships ruin firm performance. One important difference of my finding from previous studies is that in my study, resources gained by the firm through multiple board appointments conform to productivity performance rather than financial performance. Overall, the relationships between multiple directorships and firm performance suggest that directors with multiple board seats bring

distinctive resources to the firm that enhance productivity performance while weakening financial performance.

**Table 8-2: Multiple Directorships, Managerial Ownership and Firm Performance**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and multiple directorships for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include multiple directorships, director tenure, board ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. Durbin-Wu-Hausman test for endogeneity represents coefficients of predicted values with their t-statistic. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Multiple directorships	(4) Ln (Pre-tax profits)
Multiple directorships <sub>1</sub>	0.034** (2.301)	-	-	-1.697*** (-6.999)
Net spending <sub>1</sub>	-	0.137* (1.822)	-	-
Board ownership %	-	-0.001** (-2.514)	-	0.011 (1.266)
Director tenure	0.001 (0.159)	0.010* (1.889)	0.006 (0.093)	-0.265 (-1.477)
Firm size	-0.046* (-1.929)	0.056*** (3.395)	0.251 (1.231)	-0.254 (-0.428)
Ln (Director age)	-	-0.119 (-1.473)	2.195** (2.346)	4.123* (1.852)
Promotion	-0.040 (-0.837)	-0.013 (-0.445)	1.004*** (2.680)	3.157*** (3.304)
Relegation	0.110* (1.782)	-0.042 (-1.081)	-1.025** (-2.221)	-3.130*** (-2.667)
Ln (Pre-tax profits)	0.028* (1.666)	-	-0.194** (-2.342)	-
Winning %	-	-	4.676*** (4.200)	15.591*** (3.758)
Ln (PNBV)	-	0.113*** (6.554)	-	-
Ln (Board size)	-	-	-	1.790** (2.102)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	130	130	130	130
Durbin-Wu-Hausman test	0.016 (1.209)	-1.324** (-2.379)	19.097*** (12.675)	7.494*** (2.633)
Adjusted. R <sup>2</sup>	-0.210	0.630	0.080	0.242
p-value of F-test	<0.00	<0.00	<0.00	<0.00

These results on multiple directorships could be explained by the potential trade-off between performance metrics prevailing in football firms. Winning games requires investment in playing

squads that in turn involves significant financial expenditure. Firms doing well in productivity performance have spent massively. The “performance trade-off hypothesis” suggests that firms achieve better productivity performance at the expense of poorer financial performance or vice versa. In plain terms, it is difficult to maximise both productivity and financial performance at one time. My findings reveal that firms accept that their directors hold multiple directorships for the purpose of improving productivity performance, but that weakens their financial performance. However, it worth noting that the current improvement of productivity performance is likely to generate better financial performance in the future.

#### *8.4.2.2 Ownership Structure and Firm Performance*

Table 8-2 shows that board ownership is negatively associated to winning percentage. The relationship is significant at the 5% level. This demonstrates that directors with equity ownership do not focus on the firm’s productivity performance. This suggests that directors with equity ownership aim to maximise their personal interests rather than stakeholders’ interests. The negative relationship between board ownership and productivity performance is consistent with entrenchment effects found in the intermediate levels of managerial ownership (Morck et al., 1988, McConnell and Servaes, 1990, Short and Keasey, 1999). This implies that directors with substantial shareholdings are entrenched in their firms regardless of their individual contribution to that firm’s performance. This is an indication of “Type II agency problem” where directors with majority shares expropriate minority shareholders at the expense of shareholders’ wealth. Davies et al. (2005) also reported a negative association between the managerial ownership and corporate value between the ownership range of 7% to 26% and 51% to 76%.

Table 8-3 indicates that blockholder ownership is positively related to pre-tax profits. The relationship is significant at the 5% level, though the regression estimates suggests that its impact is economically small. The coefficient estimate reveals that blockholder ownership increases pre-tax profits by about 0.02. The finding is consistent with agency theory which asserts that higher blockholder shareholding is associated with better financial performance. The main proposition is that blockholder investors are more concerned with shareholders’ interests rather than stakeholders’ interests. This finding is consistent with my conjecture in the sense that blockholder shareowners have been shown to maximise shareholders’ wealth. My result confirms the findings in the standard literature that explains the role of blockholder investors in the firm (e.g. Woidtke, 2002, Cornett et al., 2007).

**Table 8-3: Multiple Directorships, Blockholder Ownership and Firm Performance**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and multiple directorships for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include multiple directorships, director tenure, blockholder ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. Durbin-Wu-Hausman test for endogeneity represents coefficients of predicted values with their t-statistic. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Multiple directorships	(4) Ln (Pre-tax profits)
Multiple directorships <sub>1</sub>	0.036** (2.215)	-	-	-1.739*** (-7.275)
Net spending <sub>1</sub>	-	0.146* (1.870)	-	-
Blockholder ownership %	-	-0.000 (-1.012)	-	0.023** (2.248)
Director tenure	0.004 (0.608)	0.003 (0.548)	-0.007 (-0.110)	-0.224 (-1.238)
Firm size	-0.041* (-1.691)	0.051*** (2.990)	0.241 (1.084)	-0.222 (-0.370)
Ln (Director age)	-	-0.097 (-1.083)	1.409 (1.372)	3.064 (1.304)
Promotion	-0.010 (-0.199)	-0.028 (-0.839)	0.860** (2.132)	2.210** (2.106)
Relegation	0.128** (1.967)	-0.003 (-0.070)	-1.199** (-2.507)	-4.539*** (-3.703)
Ln (Pre-tax profits)	0.029 (1.569)	-	-0.194** (-2.257)	-
Winning %	-	-	4.651*** (3.666)	14.895*** (3.566)
Ln (PNBV)	-	0.103*** (6.014)	-	-
Ln (Board size)	-	-	-	2.913*** (3.150)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	126	126	126	126
Durbin-Wu-Hausman test	0.049*** (3.450)	-0.873** (-2.148)	15.801*** (10.740)	6.254** (2.274)
Adjusted. R <sup>2</sup>	-0.215	0.604	0.091	0.267
p-value of F-test	<0.00	<0.00	<0.00	<0.00

#### 8.4.2.3 Managerial Industry Experience and Firm Performance

There is evidence that managerial experience is positively related to winning percentage. Table 8-2 indicates that the relationship is statistically significant at the 10% level. The coefficient shows that director tenure enhances winning percentage by about 0.01. This finding suggests that directors with industry experience focus on productivity performance rather than financial

performance. This finding is comparable to the concept of the “expertise hypothesis” explained by Vafeas (1993). The hypothesis suggests that a long-term director is associated with greater experience, commitment and proficiency, because it provides him with essential firm-specific knowledge and his business environment. On top of this, earlier research supports the idea that managerial extended tenure enhances firm commitment and will contribute to the expending of effort towards company goals (Buchanan, 1974).

My finding suggests that veteran directors take risk by approving substantial financial expenditure on players and coaching staff. Theirs is an important role in creating a competitive advantage over other firms. It is important to note that managerial experience is a valuable asset to a firm in terms of generating new knowledge and capabilities that are positively associated with business performance. Overall, the findings on director tenure shows clearly that directors with industry experience prefer to achieve better productivity performance as it is more accepted by many stakeholders than financial performance. In fact, the improvement of productivity performance creates more robust future overall firm performance.

#### *8.4.2.4 Control Variables and Firm Performance*

I find that firm size is positively associated with productivity performance. Table 8-2 and 8-3 both show that the relationship is statistically significant at the 1% level. This positive relationship is consistent with Fich and Shivdasani (2006). Other findings show that firm size is negatively related to net spending, and the relationship is only statistically significant at the 10% level. I find evidence that director age is positively associated to multiple directorships and financial performance. Table 8-2 shows that their relationships are statistically significant at the 5% and 10% level respectively. These findings are consistent with Ferris et al. (2003) in the sense that directors close to retirement age might be willing to increase their current incomes through accepting multiple directorships.

I find evidence that winning percentage and promotion are positively related to financial performance. The relationships are statistically significant at the 5% level or better, and the coefficients’ estimates are economically important. This implies that firms with better productivity performance boost their financial performance through increased gate tickets, merchandising and sponsorship deals. There is also evidence that winning percentages and promotion are positively and significantly statistically associated with multiple directorships.

The coefficients' estimates of the effects of winning percentage and promotion on multiple directorships are economically substantial. This means that directors in firms with superior productivity performance achieve extra board appointments as a signal of their reputation and quality. This is consistent with reputational hypothesis advocated by Fama and Jensen (1983). Other previous studies find similar results that superior firm performance leads to further multiple board seats (Kaplan and Reishus, 1990, Farrell and Whidbee, 2000, Yermack, 2004).

I also find evidence that relegation is negatively associated to multiple directorships and financial performance. Table 8-2 and 8-3 show that the relationships are statistically significant at the 5% and 1% level respectively. The coefficient estimates indicate that the relationships are economically important. The relationship with multiple directorships suggest that directors in relegated firms lose their existing board seats as a result of poor performance. The relationship with financial performance suggests that profits in relegated firms declines due to decreased demand in gate tickets, memorabilia and sponsorship deals. Surprisingly, there is evidence that relegation and net spending are positively related.

I find that pre-tax profits are positively and negatively related to net spending and multiple directorships respectively. This positive relationship suggests that firms with higher profitability spend more on players' investments than firms with lower profitability. This tells us that a firm's profitability influences its spending capability. The negative relationship reveals that profitability tends to lessen directors having existing board seats. That means in football firms, directors lose their directorships whilst improving financial performance. My results suggest that the quality and reputation of directors in the football context is measured by productivity performance rather than financial performance. I also find that players' net book value is positive and statistically significant related to winning percentage. This suggests that the firm's playing quality resource is a noteworthy factor that enhances productivity performance. Notably, the relationship between board size and financial performance is positive, which contradicts previous findings by Yermack (1996). The positive relationship is equivalent to one recent study by Beiner et al. (2006).

## **8.5 Robustness Checks**

For substantiating the reliability of these results, I have repeated the simultaneous equations regressions by including the busy board variable rather than a multiple directorships variable.

The board is categorised as busy if on average its directors serve on three or more directorships. The three directorships criterion might be considered anecdotal, but I choose this cut-off point for several reasons. First, this approach is consistent to previous studies such as Ferris et al. (2003) and Fich and Shivdasani (2006). Second, this approach follows the recommendations by the Council of Institutional Investors (1998). This council has proposed that directors with full-time jobs should not serve on more than two other boards. Third, the mean and median number of multiple directorships is close to three. This suggests a roughly equal split between busy and less-busy boards.

The main results remain in essence the same, although there are minor changes in statistical significance levels. Table 8-4 and 8-5 show that a busy board significantly enhances a firm's net spending. As previously, the positive relationship between previous net spending and winning percentage remained significant at the 10% level. I noticed that a busy board affects pre-tax profits negatively and the relationship is statistically significant at the 1% level. The implication of these findings tells us the same story; that busy boards enhance productivity performance at the expense of poorer financial performance.

The finding on board ownership remains the same, but it considerably weakens the firm's winning percentage. The relationship has strengthened the statistical significance from the 5% level to the 1% level. The finding on blockholder ownership remained in the same direction but the coefficient on pre-tax profits was not as statistically significant as before. The finding shows that blockholder ownership is negative and significantly statistically related to winning percentage. This result provides evidence of the "performance trade-off theory" as blockholder investors cannot maximise both productivity and financial performance at one time. Managerial industry experience is positively and negatively related to winning percentage and pre-tax profits respectively. This suggests that directors with huge experience tend to maximise productivity performance at the expense of poorer financial performance. Most results for the control variables remain qualitatively the same with slight changes in significance levels. As in the previous section, the adjusted  $R^2$  reveal that Model (2) remained superior to others in both tables.

**Table 8-4: Busy Boards, Managerial Ownership and Firm Performance**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and busy boards for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include busy board, director tenure, board ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Busy board	(4) Ln (Pre-tax profits)
Busy board <sub>1</sub>	0.080* (1.813)	-	-	-3.924*** (-4.557)
Net spending <sub>1</sub>	-	0.119* (1.686)	-	-
Board ownership %	-	-0.001*** (-3.178)	-	0.013 (1.428)
Director tenure	0.001 (0.074)	0.010* (1.859)	0.007 (0.327)	-0.348* (-1.913)
Firm size	-0.042* (-1.680)	0.050*** (3.053)	0.075 (1.138)	-0.995 (-1.632)
Ln (Director age)	-	-0.101 (-1.264)	0.666** (2.165)	5.949*** (2.742)
Promotion	-0.036 (-0.717)	-0.015 (-0.528)	0.309*** (2.624)	3.381*** (3.462)
Relegation	0.100 (1.573)	-0.029 (-0.760)	-0.385*** (-2.640)	-2.869** (-2.401)
Ln (Pre-tax profits)	0.027 (1.586)	-	-0.043 (-1.580)	-
Winning %	-	-	1.877*** (5.174)	20.118*** (4.593)
Ln (PNBV)	-	0.115*** (6.789)	-	-
Ln (Board size)	-	-	-	2.092** (2.250)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	130	130	130	130
Durbin-Wu-Hausman test	0.021 (1.646)	-1.472*** (-2.647)	13.547*** (7.552)	57.592*** (2.904)
Adjusted. R <sup>2</sup>	-0.143	0.626	0.180	0.262
p-value of F-test	<0.00	<0.00	<0.00	<0.00

**Table 8-5: Busy Boards, Blockholder Ownership and Firm Performance**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and busy boards for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include busy board, director tenure, blockholder ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Busy board	(4) Ln (Pre-tax profits)
Busy board <sub>1</sub>	0.095** (2.038)	-	-	-4.275*** (-4.655)
Net spending <sub>1</sub>	-	0.133* (1.817)	-	-
Blockholder ownership %	-	-0.001* (-1.741)	-	0.019 (1.599)
Director tenure	0.003 (0.403)	0.001 (0.091)	0.008 (0.356)	-0.336* (-1.799)
Firm size	-0.036 (-1.467)	0.041** (2.417)	0.065 (0.883)	-1.133* (-1.818)
Ln (Director age)	-	-0.077 (-0.865)	0.630* (1.844)	6.120*** (2.617)
Promotion	-0.008 (-0.166)	-0.033 (-0.996)	0.336*** (2.623)	2.721** (2.485)
Relegation	0.120* (1.812)	0.015 (0.376)	-0.375** (-2.447)	-4.334*** (-3.435)
Ln (Pre-tax profits)	0.027 (1.546)	-	-0.042 (-1.430)	-
Winning %	-	-	2.001*** (4.711)	20.341*** (4.458)
Ln (PNBV)	-	0.104*** (6.155)	-	-
Ln (Board size)	-	-	-	3.342*** (3.187)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	126	126	126	126
Durbin-Wu-Hausman test	0.049*** (3.793)	-0.980*** (-2.433)	11.754*** (7.330)	-9.272 (-0.663)
Adjusted. R <sup>2</sup>	-0.146	0.600	0.168	0.276
p-value of F-test	<0.00	<0.00	<0.02	<0.00

## 8.6 Results After Excluding Outliers

Similar to previous empirical chapters, this section repeated the same set of the simultaneous equations system but excluded outliers. This procedure is an alternative method of testing robustness of the main findings reported above. I have excluded outliers of pre-tax profits and number of employees at the 1% and 99% percentiles. This is consistent with the preceding two empirical chapters of this dissertation. As explained in chapter 7, these two variables comprise

of unusual figures that are too far from the sample mean. Table 8-6 and 8-7 attached in the appendices reports these supplementary results. Overall, the results presented in this section are qualitatively similar to former results. There are, however, minor differences in coefficient estimates and significance levels, which are explained in more detail in the following.

Table 8-6 reveals a much stronger relationship between multiple directorships and net spending. In this finding, the relationship is significant at the 1% level, while in the previous analysis the relationship is significant at the 5% level. Besides, Table 8-6 indicates that pre-tax profit is not a significant determinant of net spending. This is inconsistent with earlier results, which showed that pre-tax profit is a significant determinant of net spending. Table 8-7 demonstrates stronger relationships between multiple directorships and net spending as well as between net spending and winning percentage. These relationships are statistically significant at the 1% and 5% level respectively. In contrast, previous results revealed that these relationships are statistically significant at the 5% and 10% level respectively. Finally, Table 8-7 show that director age is positively related to profitability. This is different from former results where director age is an unimportant determinant of profitability. Overall, the results in this section justify the main findings discussed earlier.

## **8.7 Summary and Conclusion**

The primary purpose of this chapter is to enhance our understanding of the multiple directorships-performance relationship. I have addressed the question of whether multiple directorships have an impact on firm performance. In doing so, I have investigated how and why multiple directorships affect both productivity and financial performance. The main findings indicate that multiple directorships positively influence productivity performance but negatively affect financial performance. The main suggestion of this finding is that directors holding multiple directorships gain skills that enhance productivity performance at the expense of poorer financial performance. The skills gained by directors through multiple directorships induce players' investments that improve firm's productivity performance but weaken financial performance. This finding offers an important lesson that practitioners and policy makers can apply when setting multiple directorships' limits. Additionally, I observed that productivity and financial performance depend on each other.

The secondary objective of this chapter is to reconsider the impact of ownership structure and managerial experience on firm performance. I have found that board ownership worsens productivity performance but does not enhance financial performance substantially. I interpreted this finding that directors focus on their personal interests rather than stakeholders' interests. That suggests directors own shares in the firm in order to maximise their personal welfare. Another important lesson is that blockholder investors improve financial performance while weakening productivity performance. This finding demonstrates that the focus of blockholder investors is on shareholders' wealth and not on the interests of other stakeholders. Finally, I have documented evidence that managerial industry experience leads to better productivity performance but poorer financial performance. The next chapter concludes with a summary of the main findings and contributions of the thesis. The chapter also discusses limitations and suggests ideas for future research.

## 8.8 Appendices

**Table 8-6: Multiple Directorships, Managerial Ownership and Firm Performance Without Outliers**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and multiple directorships after excluding outliers for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include multiple directorships, director tenure, board ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. Durbin-Wu-Hausman test for endogeneity represents coefficients of predicted values with their t-statistic. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Multiple directorships	(4) Ln (Pre-tax profits)
Multiple directorships <sub>1</sub>	0.039*** (2.733)	-	-	-1.589*** (-5.635)
Net spending <sub>1</sub>	-	0.138* (1.868)	-	-
Board ownership %	-	-0.001*** (-2.945)	-	0.009 (0.976)
Director tenure	-0.002 (-0.284)	0.009* (1.688)	0.019 (0.314)	-0.281 (-1.519)
Firm size	-0.041* (-1.850)	0.051*** (3.043)	0.217 (1.199)	-0.695 (-1.113)
Ln (Director age)	-	-0.105 (-1.297)	2.097** (2.409)	4.689** (2.052)
Promotion	-0.040 (-0.879)	-0.013 (-0.464)	0.978*** (2.852)	3.326*** (3.425)
Relegation	0.100* (1.708)	-0.041 (-1.050)	-0.947** (-2.228)	-3.130*** (-2.630)
Ln (Pre-tax profits)	0.022 (1.419)	-	-0.148* (-1.928)	-
Winning %	-	-	5.072*** (5.032)	17.633*** (4.153)
Ln (PNBV)	-	0.116*** (6.765)	-	-
Ln (Board size)	-	-	-	2.145** (2.286)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	127	127	127	127
Durbin-Wu-Hausman test	0.017 (1.324)	-2.044* (-1.823)	15.350*** (13.369)	7.171** (2.617)
Adjusted. R <sup>2</sup>	-0.052	0.636	0.170	0.237
p-value of F-test	<0.00	<0.00	<0.00	<0.00

**Table 8-7: Multiple Directorships, Blockholder Ownership and Firm Performance Without Outliers**

This table reports simultaneous equations (Three-stage least squares) regression results for various variables on firm performance and multiple directorships after excluding outliers for the period 1998 to 2007. Net spending is the difference between payments used to acquire players' registration and proceeds received from sales of players' registration. This variable is scaled by total assets of the firm. Key variables of interest include multiple directorships, director tenure, blockholder ownership and firm performance variables. I included several control variables that may have an impact on a given dependent variable. Director tenure is a proxy for managerial industry experience. Firm size is measured by the logarithm of the number of employees. PNBV is the abbreviation for players' net book value. This variable measures quality of playing resource in the firm. All other variables are self-explanatory or are described in the main text. Durbin-Wu-Hausman test for endogeneity represents coefficients of predicted values with their t-statistic. I report t-statistics in parentheses below each coefficient estimate. \*\*\*, \*\*, \* Denotes statistical significance at the 1%, 5% and 10% level respectively.

Variables	(1) Net spending	(2) Winning %	(3) Multiple directorships	(4) Ln (Pre-tax profits)
Multiple directorships <sub>1</sub>	0.048*** (3.010)	-	-	-1.665*** (-5.907)
Net spending <sub>1</sub>	-	0.151** (1.970)	-	-
Blockholder ownership %	-	-0.001 (-1.419)	-	0.022** (1.998)
Director tenure	0.001 (0.108)	0.000 (0.081)	0.004 (0.064)	-0.270 (-1.463)
Firm size	-0.040* (-1.669)	0.042** (2.379)	0.188 (0.979)	-0.798 (-1.291)
Ln (Director age)	-	-0.076 (-0.853)	1.344 (1.440)	4.199* (1.834)
Promotion	-0.021 (-0.430)	-0.028 (-0.823)	0.890** (2.453)	2.468** (2.330)
Relegation	0.128* (1.950)	-0.007 (-0.170)	-1.097** (-2.524)	-4.582*** (-3.683)
Ln (Pre-tax profits)	0.026 (1.523)	-	-0.142* (-1.823)	-
Winning %	-	-	5.222*** (4.701)	17.679*** (4.318)
Ln (PNBV)	-	0.110*** (6.421)	-	-
Ln (Board size)	-	-	-	3.315*** (3.282)
Year dummies	Yes	Yes	Yes	Yes
Division dummies	Yes	Yes	No	Yes
Observations	123	123	123	123
Durbin-Wu-Hausman test	0.049*** (3.711)	-0.655 (-1.132)	14.285*** (12.146)	6.104** (2.324)
Adjusted. R <sup>2</sup>	-0.170	0.612	0.178	0.253
p-value of F-test	<0.00	<0.00	<0.00	<0.00

# **9 CONCLUSIONS AND IMPLICATIONS FOR FUTURE RESEARCH**

## **9.1 Introduction**

The objective of this thesis was to analyse systematically the relationship between directors' attributes and firm performance. This objective has been accomplished. This concluding chapter intends to present a summary and overview of the main findings of the empirical analysis that was undertaken in the preceding chapters. Also this chapter aims to discuss the strengths and weaknesses of the present study as well as suggesting ideas for future research. The rest of this chapter is structured as follows. Section 9.2 presents and discusses the summary findings of the analysis. Section 9.3 restates the main contributions of this thesis by considering its significance in theory and practice. Section 9.4 discusses the limitations and also proposes a number of ideas for future research.

## **9.2 Summary of Main Findings**

In developing a detailed analysis of the relationship between directors' characteristics and firm performance, nine different chapters are included in this thesis. The first chapter introduced the subject by describing the objectives, significance and contributions of the thesis. Chapter 2 surveys the finance literature conducted in the sporting sector. Chapter 3 reviewed the literature in corporate governance. Chapter 4 discussed the industry background and institutional framework of the study. Chapter 5 presented and summarised the data and descriptive statistics that would be used in the following empirical analysis. The chapter also discussed issues related to data collection and definitions of variables used in subsequent empirical chapters. Chapter 6 analysed empirically factors that determines directors' remuneration. Chapter 7 presented an empirical investigation of the factors that drive executive directors' turnover. Chapter 8 analysed the impact of multiple directorships, ownership structure and managerial industry experience on firm performance. The following sections of this chapter highlight the main findings from each empirical chapter.

### **9.2.1 Performance, Productivity and Directors' Remuneration**

In chapter 6, I analysed the determinants of directors' remuneration by dividing them into three groups namely; board remuneration, executive remuneration and CEO remuneration. My analysis has considered agency theory, stewardship theory and stakeholder theory. My results can be summarised as follows. I find that all categories of directors pay are significantly determined by productivity performance. My findings show that financial performance has no impact on board and executive remuneration. Furthermore, I find little evidence of a relationship between CEO pay and financial performance. I present evidence that firm size substantially affects directors' remuneration. I document evidence that managerial ownership significantly reduces directors' remuneration. Finally, I find evidence that the proportion of non-executive directors on the board reduce the amount of directors' pay. This relationship is significant for both board and executive remuneration but not for CEO remuneration.

### **9.2.2 Performance, Productivity and Directors' Turnover**

In chapter 7, I investigated factors that really drive executive director turnover by considering agency theory along with stakeholder theory, human capital theory and social network theory. In doing so, I analysed the strength of the relationship between productivity and financial performance on wielding executive turnover decisions. I also analysed the impact of several corporate governance features on the probability of executive turnover. My findings can be summarised as follows. First, I find that productivity performance dominates financial performance in driving executive turnover. There is a strong negative relationship between productivity performance and the likelihood of executive turnover in most models estimated. The findings, after excluding outliers in the full sample firms, reveal little evidence that financial performance is a significant determinant of director turnover.

Secondly, I find evidence that managerial ownership substantially reduces the probability of executive turnover. Lastly, my results provide evidence that managerial industry experience significantly reduces the likelihood of executive turnover. Overall, my findings show a stronger sensitivity of the performance-turnover relationship in a sample of listed corporations than in a sample of FA Premier League corporations. This provides evidence that a sample of fully quoted companies adheres more closely to corporate governance recommendations than a sample of mixed companies.

### **9.2.3 Performance, Productivity and Multiple Directorships**

In chapter 8, I analysed the impact of multiple directorships, ownership structure and managerial industry experience on firm performance measures. First, I use resource dependency theory to analyse the relationship between multiple directorships and firm performance. Second, I employed agency theory to analyse the effect of ownership structure on firm performance. Finally, I adopted human capital theory to analyse the impact of managerial industry experience on firm performance. To avoid endogeneity problems my estimates are obtained using the three-stage least squares method. My findings are interesting and can be summarised as follows.

First, I find that directors with multiple directorships improve productivity performance by enhancing a firm's net spending, while weakening profitability. This suggests that directors with multiple board seats promote productivity performance through acquiring talented players. It is logical that large spending on playing resources enhance productivity performance because it involves the acquisition of high-calibre players. Second, I find that managerial ownership worsens productivity performance, whereas blockholder ownership enhances financial performance. Finally, I find evidence that managerial industry experience boosts productivity performance at the expense of poorer financial performance. This suggests that football firms are characterised by a trade-off between financial performance and productivity performance. This trade-off is only in the short-term as improved productivity performance in the current period is likely to generate better financial performance in the future.

### **9.3 Contributions to the Theory and Practice**

This thesis contributes to both academic theory and in practice. In terms of theoretical contributions this research has analysed six theories of corporate governance. The first research area offers support for agency theory and stakeholder theory. Several existing studies use agency theory to explain the factors that affect directors' remuneration. This thesis develops a more comprehensive analysis by analysing other finance theories, which describe directors' remuneration. For instance, the finding that productivity performance is one of the factors that determines managerial remuneration is new evidence that supports stakeholder theory. Also, the finding that managerial ownership reduces directors' remuneration is an indication of self-serving behaviour as explained by agency theory (Jensen and Meckling, 1976). Ideally, agency theory recommends that managerial rewards should be linked to corporate performance (Fama

and Jensen, 1983). For this reason, the positive link between CEO pay and financial performance reveals support for agency theory.

The second research area provides support for agency theory, stakeholder theory and human capital theory. Most previous studies used agency theory to explain performance-turnover relationships (e.g. Dahya et al., 2002, Conyon and Florou, 2002). The inclusion of other theories in the analysis offers an essential extension in the literature of executive turnover decisions. Empirical evidence shows that productivity performance seems to dominate financial performance in the explanation of the probability of executive turnover. This implies that stakeholder theory is more effective than agency theory in explaining the impact of firm performance on executive turnover. The finding that managerial ownership substantially reduces the likelihood of executive turnover presents support for agency theory. This entrenchment effect is the sign of managerial selfish behaviour as explained in agency theory. In addition, the evidence that managerial industry experience reduces the probability of executive turnover provides support for human capital theory. In this context, this study contributes to the finance literature by analysing determinants of executive turnover in the context of multiple theories.

In the final research area, my empirical findings offer only partial support for resource dependency theory, agency theory and human capital theory due to the performance substitution character of the firms analysed. Each factor analysed shows opposing effects between productivity and financial performance. For example, directors holding multiple directorships enhance productivity performance while weakening financial performance. This suggests that directors with multiple board seats enhance the winning percentage at the expense of less profitability. This finding provides partial support for resource dependency theory in the sense that directors bring resources to the firms that are beneficial in productivity strategy while being detrimental in financial strategy.

Other factors analysed which include ownership structure and managerial industry experience exhibit a similar fashion of relationship on productivity and financial performance measures. For instance, managerial experience enhances productivity performance while worsening financial performance. This means that in the contemporary relationship, the improvement of productivity performance leads to poor financial performance and vice-versa. I called this phenomenon “performance trade-off theory”. However, the trade-off between these

performance measures exists again only in the short-term since the improved productivity performance in the current period is likely to generate better financial performance in the future.

In terms of practical contributions, this research highlights the benefits of its empirical findings. The findings on directors' remuneration suggest the main factors that regulators and practitioners can recommend during setting of directors' pay. Importantly, the extension of directors' compensation research assists people to understand the way agency problems of a firm can be minimised through the linking of pay to corporate performance. Practically, this thesis offers new insights to the public that companies reward their executive directors using productivity performance rather than financial performance.

The research on executive turnover helps corporations to take appropriate actions during the period of poor performance. Specifically, managerial turnover research assists firms to identify factors that they are required to use during decisions over the replacement of incompetent directors. The findings from my analysis support the use of productivity performance as the main criteria to evaluate performance of executive directors. In addition, the research of directors' turnover assists experts in corporate governance in the reform of firms' internal control mechanisms.

The analysis of multiple directorships, ownership structure, managerial industry experience and firm performance offers several practical benefits. First, the finding on multiple directorships offers a guiding principle to corporations to understand when it is favourable or unfavourable for a director to hold multiple board appointments. The impact of multiple directorships to financial and productivity performance is very clear. Thus, the decision to accept or reject multiple directorships depends on the priority of the company in question. Second, the finding on multiple directorships assists companies to suggest limits on multiple board seats for an individual director by considering its potential benefits and costs. Lastly, the impacts of ownership structure and managerial experience on productivity and financial performance have practical implications which can help firms to construct a suitable ownership structure and managerial experience that is consistent with the firm's main objective.

## **9.4 Limitations and Further Research Ideas**

Similar to other studies in corporate finance, this thesis is subject to four main limitations. For this reason, my results should be interpreted in consideration of the following issues. First, the analysis on directors' remuneration did not consider non-cash compensation such as stock options or awards. There are very few firms in the sample that disclosed stock options for its directors. Accordingly, I did not include stock options as a component of directors' pay. Second, the analysis on directors' remuneration and executive turnover only looks at a unidirectional relationship. Chapter 6 and 7 focused on how firm performance and other corporate governance variables affect directors' remuneration and executive turnover respectively. But it is possible that directors' pay and executive turnover may have an impact on firm performance measures.

Third, the analysis in chapter 7 did not consider reasons for executive directors' turnover. The data available does not provide reasons for directors' departure. In fact, there are several reasons for director change such as retirement age, illness, death, dismissal and voluntary resignation among others. However, this chapter focused on the link between firm performance and directors' turnover rather than the classification of turnover cases. Finally, the empirical chapters in this thesis did not analyse separately firms in lower divisions of the FA Football League and the Scottish Premier League. These firms did not disclose sufficient corporate governance information, and some were insolvent. Consequently, it becomes difficult to undertake an empirical evaluation of each division individually. Nevertheless, the selection of the sample is an observation rather than a limitation.

This research can be extended in the future along the following dimensions. In the first empirical topic, one could extend the present study by considering stock options or awards on the analysis of directors' remuneration. With time most football firms start to disclose non-cash compensation, which motivates a further extension of this research. Besides, it would be interesting for future research to explore the link between non-executive directors' remuneration and corporate performance. Most research on boards and compensation has primarily focused on the pay for executive directors rather than non-executive directors. Opportunities also exist to study the dispersion of directors' compensation among the board members. Extending the current research by analysing directors' pay differentials in relation to firm performance should lead to a more comprehensive managerial remuneration study. Such research would help us

understand not only the determinants of directors' compensation, but also the disparity of pay among the corporate directors.

In the second empirical topic, there are some avenues for future research. While scholars have applied significant effort in exploring the relationship between executive turnover and firm performance, other potentially fruitful topics for research have been ignored. First, it would be interesting to explore the impact of directors' entrenchment on firm performance. More empirical work is needed to understand the benefits and drawbacks of the impact of managerial entrenchment on corporate performance. Second, another potential area of future research is the determining of whether directors' ownership and entrenchment enhances workers' pay. The research that focuses on managerial ownership and tenure in association with players' salary is a promising area that should lead to a great academic contribution. Finally, the age of the executives is frequently a more important variable than performance in explaining directors' turnover. Most studies have simply employed age as a control variable in the regressions. The inclusion of age as the key variable has the potential to provide important insights on executive turnover research.

In the final empirical topic, there are two important avenues for future research. First, is to explore the existence of politicians on the board of directors. It would be interesting to investigate whether politicians have the actual impact on corporate performance. Second, the findings from this research could also be used to develop a new construct, which can be tested in qualitative and quantitative settings. For instance, the concept of "performance trade-off theory" could be tested further by considering alternative measures of performance in different corporations. This would be a useful area of future exploration.

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