



Article

Does the Persistence of Executive Pay Inhibit Optimal Firm Valuation?

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Abstract: This study examines whether the persistence of executive pay inhibits optimal firm valuation, with evidence from non-financial firms listed in the NIFTY 500 index over the period 2015–2025. Using firm-level data from the CMIE Prowess database, the analysis shifts the focus from static pay levels to the dynamic adjustment of executive compensation over time. Executive pay persistence is measured using firm-specific autoregressive estimates that capture compensation rigidity, while firm valuation is proxied by market-based measures, including Tobin’s Q and market-to-book ratios. Employing fixed-effects panel regressions and dynamic robustness tests, the study documents a significant negative relationship between executive pay persistence and firm valuation. The results indicate that firms in which executive compensation adjusts slowly to changing performance conditions experience valuation discounts, suggesting elevated agency costs and weakened incentive alignment. Further analysis reveals that strong corporate governance mechanisms—such as higher board independence and lower ownership concentration—significantly mitigate the adverse valuation effects of pay persistence. Additionally, evidence of asymmetric pay adjustment shows that executive compensation responds more strongly to positive performance than to negative outcomes, further amplifying valuation penalties.

Keywords: Executive compensation, pay persistence, firm valuation, corporate governance.

INTRODUCTION

Executive compensation has long been regarded as a critical governance mechanism intended to align managerial incentives with shareholder value creation. Rooted in agency theory, executive pay contracts are designed to mitigate conflicts between owners and managers by linking remuneration to firm performance and long-term value outcomes. Early empirical research provided support for this view, documenting positive associations between executive pay and firm performance, particularly through equity-based and incentive-linked compensation structures (Hall & Liebman, 1997; Mehran, 1994). However, as executive remuneration practices have evolved in scale and complexity, the effectiveness of compensation as a value-alignment

tool has increasingly been questioned.

A growing strand of the literature highlights that executive pay is often characterized by persistence—that is, compensation levels exhibit limited downward adjustment in response to poor performance while remaining highly responsive to favorable outcomes. This phenomenon, commonly referred to as pay stickiness or asymmetric pay-performance sensitivity, suggests that executives are rewarded more readily than they are penalized (Gregg et al., 2005; Yang, 2007; Lu et al., 2015). Such persistence challenges the optimal contracting view of executive compensation and lends support to the managerial power hypothesis, which argues that powerful executives may influence pay-setting processes to protect their private benefits (Core et al., 1997; Ntim et al., 2019).

The persistence of executive pay has important

implications for firm valuation. From a valuation perspective, executive compensation affects both expected future cash flows and firm risk. When pay remains elevated despite deteriorating performance, it may signal weak monitoring, governance failures, or managerial entrenchment, thereby increasing agency costs (Basu et al., 2007; Muzata & Marozva, 2022). Investors may interpret such compensation rigidity as evidence that internal governance mechanisms are ineffective, leading to lower market confidence and valuation discounts. Empirical evidence increasingly associates excessive or poorly aligned executive pay with reduced market-to-book ratios, higher volatility, and inferior long-term valuation outcomes, particularly in firms with weaker governance structures

Literature Review

Corporate governance plays a critical moderating role in shaping the valuation consequences of executive pay persistence. Prior studies demonstrate that governance mechanisms such as board independence, ownership concentration, and remuneration committees can strengthen pay-performance sensitivity and curb excessive compensation (Ntim et al., 2012; Schultz et al., 2010; Vetrivel et al., 2024). Conversely, weak governance—manifested through CEO duality, large or ineffective boards, and limited shareholder oversight—tends to exacerbate pay rigidity and weaken the disciplinary role of compensation contracts (Rashid, 2010). These governance failures may allow persistent pay arrangements to persist even when firm fundamentals no longer justify them, with adverse consequences for valuation efficiency.

Institutional context further amplifies these dynamics. Evidence from emerging markets indicates that executive pay persistence is often more pronounced in environments characterized by concentrated ownership, state involvement, or weak investor protection (Canyon & He, 2011; Iskandrani et al., 2018). In such settings, compensation contracts may serve political, relational, or retention objectives rather than value maximization, thereby distorting market signals. Even in developed economies, increasing compensation complexity and long-term incentive structures may inadvertently reduce transparency and weaken the responsiveness of pay to changing firm conditions (Burkert et al., 2023).

Despite extensive research on executive compensation and firm performance, relatively little attention has been paid to the dynamic persistence of executive pay and its implications for firm valuation. Most prior studies focus on pay levels or contemporaneous pay-performance sensitivity, overlooking how compensation adjusts over time and how such adjustment—or lack thereof—affects

investor perceptions and market valuation. This omission is notable given heightened regulatory scrutiny, the rise of say-on-pay mechanisms, and growing investor concern over governance quality and sustainable value creation.

Against this backdrop, this study examines whether the persistence of executive pay inhibits optimal firm valuation. By shifting the focus from static compensation outcomes to dynamic pay behavior, the study contributes to the literature by linking executive pay rigidity to valuation efficiency. In doing so, it offers insights into how compensation design, governance quality, and institutional context jointly shape the ability of firms to achieve valuations that accurately reflect their underlying economic fundamentals.

Executive Compensation and Agency Considerations

The executive compensation literature is fundamentally anchored in agency theory, which conceptualizes pay contracts as mechanisms to align managerial incentives with shareholder interests. Early theoretical and empirical studies argue that performance-contingent compensation mitigates agency conflicts by motivating executives to maximize firm value (Mehran, 1994; Hall & Liebman, 1997). Equity-based incentives and long-term compensation components, in particular, are viewed as effective tools for encouraging value-enhancing decisions and reducing managerial opportunism.

However, subsequent research has challenged the assumption that executive compensation is optimally designed. Empirical evidence increasingly reveals that pay-performance sensitivity is often weak, asymmetric, or inconsistent across firms and institutional contexts (Gregg et al., 2005; Yang, 2007). These findings have given rise to the managerial power perspective, which posits that executives with substantial influence over boards and compensation committees can extract rents in the form of excessive or poorly aligned pay (Core et al., 1997; Ntim et al., 2019). This strand of literature emphasizes that compensation outcomes reflect not only incentive alignment but also bargaining power and governance quality.

Pay Persistence and Compensation Stickiness

An important development in the executive compensation literature concerns the dynamic behavior of pay over time. Several studies document that executive pay exhibits substantial persistence, meaning that compensation levels adjust slowly to changes in firm performance and are often insulated from poor outcomes (Lu et al., 2015; Olaniyi & Olayeni, 2020). This persistence is frequently asymmetric: executives benefit disproportionately

from positive performance shocks but experience limited pay reductions following negative shocks (Gregg et al., 2005; Yang, 2007).

Such pay stickiness has been attributed to multiple factors, including retention concerns, benchmarking practices, implicit contracts, and executive influence over pay-setting processes. While proponents argue that stable compensation structures may help retain managerial talent and promote long-term orientation, critics contend that persistent pay weakens incentive effects and exacerbates agency problems, particularly when performance deteriorates (Muzata & Marozva, 2022). The literature thus suggests that pay persistence is not a neutral feature of compensation design but a potentially consequential governance outcome.

Corporate Governance as a Moderating Mechanism

Corporate governance mechanisms play a central role in shaping both executive pay levels and their persistence. Prior research demonstrates that board independence, ownership concentration, and effective remuneration committees enhance pay-performance alignment and reduce excessive compensation (Ntim et al., 2012; Schultz et al., 2013; Vetrivel et al., 2024). Strong governance structures limit managerial discretion and facilitate timely adjustment of compensation in response to firm performance.

Conversely, weak governance is consistently associated with persistent and excessive executive pay. Studies document that CEO duality, large or ineffective boards, and weak shareholder monitoring allow executives to maintain high compensation even during periods of underperformance (Core et al., 1997). In such settings, pay persistence reflects entrenchment rather than incentive alignment, increasing agency costs and undermining firm value. The governance literature therefore positions compensation persistence as an outcome that is endogenous to monitoring quality and power distribution within the firm.

Institutional Context and Cross-Country Evidence

The persistence of executive pay is further conditioned by institutional and regulatory environments. Cross-country studies reveal significant variation in pay-performance sensitivity and compensation adjustment across legal regimes and ownership structures (Essen et al., 2012; Conyon & He, 2011). Emerging markets, in particular, tend to exhibit weaker governance enforcement, higher ownership concentration, and stronger political or relational influences on executive pay, all of which contribute to greater compensation rigidity (Iskandrani et al., 2018).

In such contexts, executive pay persistence may reflect institutional constraints rather than firm-level optimization. State ownership, regulatory intervention, and labor market frictions can limit downward pay flexibility, weakening the informational role of compensation for investors. Even in developed markets, regulatory reforms and peer benchmarking practices may unintentionally reinforce compensation inertia by anchoring pay to historical or industry norms rather than firm-specific performance (Bayer & Burhop, 2008).

Executive Pay Persistence and Firm Valuation

Despite extensive research on executive compensation and firm performance, the implications of pay persistence for firm valuation remain underexplored. From a valuation standpoint, executive compensation influences both expected cash flows and perceived governance risk. Persistent pay that is weakly linked to performance may signal ineffective monitoring and higher agency costs, leading investors to discount firm value (Basu et al., 2007; Muzata & Marozva, 2023).

Empirical studies increasingly associate excessive or rigid executive compensation with lower market-to-book ratios, higher stock return volatility, and increased downside risk. These valuation effects are particularly pronounced in firms where governance mechanisms fail to discipline pay-setting behavior. Moreover, compensation persistence may distort managerial incentives by encouraging risk aversion or rent preservation, thereby affecting long-term growth prospects and investment efficiency. The literature thus suggests that executive pay persistence has the potential to inhibit optimal firm valuation by weakening both incentive alignment and market confidence.

Hypothesis Development

Persistent executive pay reduces the responsiveness of compensation to firm performance, weakening its incentive and signaling functions. When executive pay remains elevated despite declining performance, investors may interpret this rigidity as evidence of managerial entrenchment or governance failure, increasing perceived agency costs and lowering firm valuation. Accordingly, the following hypothesis is proposed:

H1: Executive pay persistence is negatively associated with firm valuation.

Strong corporate governance can mitigate the adverse valuation effects of executive pay persistence by enhancing monitoring and ensuring that compensation adjustments reflect firm fundamentals. In contrast, weak governance is likely to amplify the negative consequences of pay rigidity.

Therefore:

H2: The negative relationship between executive pay persistence and firm valuation is weaker in firms with stronger corporate governance.

Asymmetric compensation structures that reward positive performance more than they penalize poor

outcomes exacerbate pay persistence and weaken incentive alignment. Such asymmetry may increase firm risk and valuation discounts. Hence:

H3: Firms exhibiting greater asymmetry in executive pay adjustment experience lower firm valuation.

METHODOLOGY

Data and Sample

This study employs a quantitative panel data research design to examine whether the persistence of executive pay inhibits optimal firm valuation in the Indian corporate context. The empirical analysis is based on a balanced and unbalanced panel of firms drawn from the NIFTY 500 index over the period 2015–2025. The NIFTY 500 represents approximately 96% of the free-float market capitalization of the Indian equity market and provides a comprehensive cross-section of large, mid-cap, and select small-cap firms, making it well suited for examining executive compensation dynamics and valuation outcomes.

Firm-level financial, ownership, and market data are sourced from the CMIE Prowess database, which provides standardized and audited financial information for Indian listed companies. Data on executive compensation—including salary, bonuses, perquisites, and long-term incentive payments—are extracted from remuneration disclosures available in CMIE Prowess and firms’ annual reports.

Consistent with prior literature, financial firms are excluded due to their distinct regulatory environment, capital structure, and compensation practices. Firms with incomplete compensation or market data are also excluded from the final sample.

Table 1 Descriptive Statistics

Variables	Mean	Median	Std. Dev.	Min	Max
Tobin’s Q (TQ)	1.47	1.32	0.68	0.54	4.96
Market-to-Book (MTB)	2.11	1.74	1.25	0.61	7.83
Executive Pay (ln PAY)	5.92	5.81	0.74	3.84	8.12
Pay Persistence (PAYPERS)	0.71	0.74	0.18	0.21	0.94
Corporate Governance Index (CGI)	0	0.04	0.89	-2.41	2.17
Return on Assets (ROA)	0.082	0.074	0.061	-0.19	0.31
Firm Size (ln Assets)	10.87	10.74	1.32	7.41	14.52
Leverage (LEV)	0.39	0.37	0.21	0.02	0.87
Sales Growth (GROWTH)	0.11	0.08	0.29	-0.48	1.34

After applying these filters, the final sample comprises non-financial NIFTY 500 firms with available executive pay and valuation data over the study period. All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of extreme observations.

Empirical Model and Measures

To test the study’s hypotheses, the following baseline panel regression model is estimated:

$$FirmVal_{i,t} = \alpha + \beta_1 PayPersistence_{i,t} + \beta_2 Governance_{i,t} + \beta_3 (PayPersistence_{i,t} \times Governance_{i,t}) + \gamma X_{i,t} + \mu_i + \lambda_t + \varepsilon_{i,t}$$

where $FirmVal_{i,t}$ denotes firm valuation for firm i in year t ; $PayPersistence_{i,t}$ measures executive pay persistence; $Governance_{i,t}$ captures corporate governance quality; $X_{i,t}$ is a vector of control variables; μ_i and λ_t represent firm and year fixed effects, respectively; and $\varepsilon_{i,t}$ is the idiosyncratic error term. Firm-level clustered standard errors are employed to account for heteroskedasticity and serial correlation.

Table 2: Baseline Regression Results: Executive Pay Persistence and Firm Valuation

Variables	-1	-2	-3
Pay Persistence (PAYPERS)	-0.284***	-0.251***	-0.233***
	(-4.62)	(-4.01)	(-3.79)
Corporate Governance Index (CGI)		0.118***	0.104***
		-3.28	-2.91
PAYPERS × CGI			0.146**
			-2.44
ROA	0.912***	0.864***	0.851***
Firm Size (SIZE)	0.073***	0.069***	0.068***
Leverage (LEV)	-0.198***	-0.184***	-0.176***
Sales Growth (GROWTH)	0.091**	0.086**	0.084**
Firm Fixed Effects	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes
Observations	3,820	3,820	3,820
Adjusted R ²	0.41	0.44	0.46

Source: Author’s calculation (***, **, * denote significance at the 1%, 5%, and 10% levels, respectively.)

Firm valuation is proxied by Tobin’s Q, computed as the ratio of the market value of assets to the book value of assets. The market value of assets is calculated as total assets minus book value of equity plus the market value of equity, where market capitalization data are obtained from CMIE Prowess. Tobin’s Q reflects investors’ expectations regarding future growth opportunities, governance quality, and managerial efficiency, making it an appropriate measure for examining valuation effects in the Indian market.

As robustness checks, alternative valuation measures such as the market-to-book ratio are also employed. Executive pay persistence captures the degree of rigidity in executive compensation over time. Following the dynamic compensation literature, pay persistence is measured using a firm-specific autoregressive model of executive pay:

$$Pay_{i,t} = \delta_0 + \delta_1 Pay_{i,t-1} + u_{i,t}$$

where $Pay_{i,t}$ represents the natural logarithm of total executive compensation for firm i in year t . The coefficient δ_1 reflects the degree of persistence, with higher values indicating slower adjustment of pay to changes in firm performance and economic conditions. Total executive compensation includes fixed salary, performance bonuses, perquisites, and long-term incentive payments aggregated across key managerial personnel, as disclosed in CMIE Prowess.

Table 3: Asymmetric Pay Adjustment and Firm Valuation

Variables	(1)
Pay Persistence (PAYPERS)	-0.219***
Negative Performance Dummy (NEG)	-0.133***
PAYPERS × NEG (PAYASYM)	-0.168**
ROA	0.879***
Firm Controls	Yes
Firm Fixed Effects	Yes
Year Fixed Effects	Yes
Observations	3,820
Adjusted R ²	0.45

Source: Author’s calculation (***, **, * denote significance at the 1%, 5%, and 10% levels, respectively.)

This measure captures the dynamic nature of compensation more effectively than static pay levels and directly aligns with the study’s focus on compensation rigidity.

Table 4: Robustness Tests

Variables	(1) MTB	(2) Lagged TQ	(3) System GMM
Pay Persistence (PAYPERS)	-0.312***	-0.197***	-0.184**
Corporate Governance Index (CGI)	0.142***	0.109***	0.097**
PAYPERS × CGI	0.161**	0.132**	0.128*
Controls	Yes	Yes	Yes
Firm FE	Yes	Yes	No
Year FE	Yes	Yes	Yes
Hansen Test (p-value)			0.31
AR(2) Test (p-value)			0.27
Observations	3,820	3,460	3,460

Source: Author’s calculation (***, **, * denote significance at the 1%, 5%, and 10% levels, respectively.)

Corporate governance quality is measured using a composite governance index constructed from firm-level governance variables available in CMIE Prowess, including board independence, board size, CEO duality, and ownership concentration. Each component is standardized and aggregated to form an overall governance score, with higher values indicating stronger governance mechanisms. To provide additional insights, alternative model specifications also examine individual governance attributes separately to identify which mechanisms most effectively moderate the relationship between executive pay persistence and firm valuation. To assess asymmetric pay adjustment, the study constructs interaction terms between lagged executive pay and indicators of firm performance changes, where performance shocks are captured using changes in return on assets (ROA) and stock returns. This approach enables an examination of whether executive compensation responds more strongly to favorable performance than to unfavorable outcomes, a key characteristic of pay persistence. The regression models further include a comprehensive set of control variables that may influence firm valuation and executive compensation dynamics, including firm size (measured as the natural logarithm of total assets), financial leverage (total debt to total assets), profitability (ROA), growth opportunities (annual sales growth), firm age (years since incorporation), and capital intensity (fixed assets to total assets), along with industry fixed effects based on standard Indian industry classifications to control for sector-specific valuation patterns.

Addressing Endogeneity

Endogeneity concerns may arise due to reverse causality between executive pay persistence and firm valuation or omitted firm-specific characteristics. To mitigate these concerns, the analysis employs firm and year fixed effects and uses lagged explanatory variables. Additional robustness tests employ dynamic panel estimation techniques, such as system GMM, to address simultaneity and unobserved heterogeneity, consistent with best practices in executive compensation research.

Empirical Findings

Descriptive Patterns and Preliminary Evidence

The descriptive analysis of NIFTY 500 firms over the period 2015–2025 reveals substantial heterogeneity in both executive compensation dynamics and firm valuation. Market capitalization data indicate wide dispersion in valuation levels across firms and over time, reflecting differences in firm size, growth trajectories, and governance quality. Executive compensation exhibits pronounced persistence, with year-to-year changes in total executive pay being relatively modest for most firms, even during periods of fluctuating financial performance.

Preliminary trend analysis suggests that firms with consistently high executive compensation levels tend to maintain those levels irrespective of short-term changes in profitability. In contrast, firms experiencing strong valuation growth show greater responsiveness of executive pay to firm performance. These patterns provide initial support for the hypothesis that executive compensation in India is characterized by rigidity rather than flexible adjustment.

Executive Pay Persistence and Firm Valuation

Regression results from the baseline fixed-effects model indicate a statistically significant negative relationship between executive pay persistence and firm valuation, measured using market-based valuation proxies. Firms exhibiting higher pay persistence—defined by slower adjustment of executive compensation over time—are associated with lower valuation levels, after controlling for firm size, leverage, profitability, growth opportunities, and industry effects.

The magnitude of the estimated coefficient suggests that pay rigidity has economically meaningful valuation

implications. A one-standard-deviation increase in executive pay persistence is associated with a decline in firm valuation, indicating that investors discount firms where compensation contracts appear insulated from performance outcomes. This finding is consistent with the view that persistent pay weakens the incentive and signaling roles of executive compensation, increasing perceived agency costs.

Importantly, this negative association remains robust across alternative valuation measures based on market capitalization data, suggesting that the results are not driven by the choice of valuation proxy.

Role of Corporate Governance Quality

The interaction analysis between executive pay persistence and corporate governance quality reveals a significant moderating effect. In firms with stronger governance mechanisms—characterized by higher board independence and lower ownership concentration—the negative impact of pay persistence on firm valuation is significantly attenuated. In some specifications, the interaction term offsets a substantial portion of the baseline negative effect, indicating that effective governance can partially neutralize the valuation penalty associated with rigid compensation structures.

Conversely, in firms with weaker governance arrangements, executive pay persistence exerts a stronger negative influence on valuation. These firms experience larger valuation discounts, suggesting that compensation rigidity is interpreted by the market as a symptom of managerial entrenchment rather than long-term incentive alignment. This result highlights the importance of governance institutions in shaping how compensation practices are priced by investors.

Asymmetric Pay Adjustment and Valuation Risk

Further analysis examining asymmetric pay adjustment provides additional insights into compensation dynamics. The results indicate that executive pay responds more strongly to favorable performance outcomes than to unfavorable ones. In periods of declining profitability, executive compensation exhibits limited downward adjustment, reinforcing the presence of pay stickiness.

Firms displaying greater asymmetry in pay adjustment are associated with lower valuation and higher valuation volatility. This suggests that asymmetric compensation structures amplify uncertainty regarding managerial discipline and risk-sharing, leading investors to demand a valuation discount. The findings imply that not only the level but also the structure and responsiveness of executive pay matter for valuation outcomes.

Control Variables and Robustness

Among the control variables, firm size and profitability are positively related to firm valuation, while leverage exhibits a negative association, consistent with established valuation literature. Growth opportunities, proxied by sales growth, show a positive and significant relationship with valuation. These results remain stable across alternative specifications and sample variations.

Robustness checks using lagged explanatory variables and alternative estimation approaches confirm that the core findings are not driven by reverse causality or unobserved firm-specific factors. The negative association between executive pay persistence and firm valuation persists across subsamples and alternative model specifications, reinforcing the validity of the results.

CONCLUSION

This study examines whether the persistence of executive pay inhibits optimal firm valuation, using a comprehensive panel of non-financial NIFTY 500 firms over the period 2015–2025 drawn from the CMIE Prowess database. By shifting the focus from static pay levels to the dynamic behavior of executive compensation, the study contributes to the executive compensation and corporate governance literature by highlighting how compensation rigidity shapes investor perceptions and market valuation in an emerging market context.

The empirical findings provide consistent evidence that executive pay persistence is negatively

associated with firm valuation. Firms in which executive compensation adjusts slowly over time experience lower market valuation, even after controlling for firm fundamentals, growth opportunities, and macroeconomic effects. This result suggests that persistent pay weakens the incentive and signaling roles of executive compensation, leading investors to perceive higher agency costs and governance inefficiencies. From a valuation standpoint, compensation rigidity appears to distort the alignment between managerial rewards and firm performance, thereby inhibiting optimal valuation.

The study further demonstrates that corporate

governance quality plays a crucial moderating role. Strong governance mechanisms—such as higher board independence and lower ownership concentration—significantly attenuate the adverse valuation effects of executive pay persistence. In well-governed firms, compensation rigidity is less likely to be interpreted as managerial entrenchment and more likely to reflect long-term incentive alignment or retention considerations. Conversely, in firms with weaker governance structures, persistent executive pay magnifies valuation discounts, reinforcing the importance of effective monitoring in compensation design.

Additional evidence on asymmetric pay adjustment strengthens these conclusions. Executive compensation is found to respond more strongly to favorable performance outcomes than to poor performance, indicating downward rigidity in pay. Firms exhibiting greater asymmetry in compensation adjustment experience lower valuation and higher valuation risk, suggesting that investors penalize compensation structures that insulate executives from downside performance. These findings highlight that not only the level but also the responsiveness and symmetry of executive pay matter for valuation efficiency.

Collectively, these findings have important implications for theory, practice, and policy. From a theoretical perspective, the results challenge the assumption of optimal contracting by demonstrating that persistent compensation structures can undermine value creation, lending support to the managerial power and entrenchment views of executive pay. For practitioners, particularly boards and compensation committees, the evidence underscores the need to design compensation contracts that are responsive to firm performance and transparent to investors. From a policy standpoint, the results reinforce the relevance of recent governance and pay disclosure reforms in India, suggesting that enhanced transparency and stronger board oversight can improve valuation outcomes by disciplining executive pay behavior.

Despite its contributions, this study is subject to certain limitations. The analysis relies on publicly disclosed compensation data, which may not fully capture implicit incentives or non-monetary benefits. Additionally, while the study employs rigorous panel and robustness techniques, causal interpretation remains subject to the usual limitations of observational data. Future research could extend this framework by examining sector-specific dynamics, incorporating executive characteristics, or exploring the interaction between executive pay persistence and risk-taking or investment efficiency.

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