

# Influence of Executive Compensation Incentives on Enterprise Performance under Different Natures of Property Rights

Yanghaoyu Wang

School of international exchange, Shandong Agricultural University, Taian 271000, China.

1456809489@qq.com

**Abstract:** No unified understanding has been formed in the academic circles of the fact that executive compensation incentive is an important means to improve enterprise performance, and executive compensation differs in the effects on enterprise performance for the enterprises with different natures of property rights. In this paper this issue is further analyzed using empirical analysis method, based on the selected data concerning the A-share companies listed in both Shanghai and Shenzhen stock markets during 2010-2020. Research demonstrates the impact of executive compensation on enterprise performance, and the enhancement role of executive compensation incentive in improving enterprise performance. The role differs under different property right systems. In terms of enterprise performance improvement, executive compensation has a significant positive effect on the non-state-owned enterprises (Non-SOEs), and a significant negative effect on state-owned enterprises (SOEs). Based on the research results, this paper proposes to improve the arrangement of enterprise compensation system, deepen the reform of compensation system in SOEs, enhance the level of marketization of enterprises, eradicate the mechanism barriers, strengthen the internal management of executives, and bring into full play of the executive compensation incentives in promoting enterprise performance.

**Key words:** Executive compensation incentives; enterprise performance; SOEs; Non-SOEs.

## 1. Presentation of questions

The modern enterprise system is mainly characterized by the separation of enterprise ownership and management right. The separation of identities between enterprise shareholders and senior managers, on the one hand, promotes the modernization and specialization of the enterprise management system, since enterprise owners are committed to capital investment while senior managers are responsible for the daily management and operation of the enterprise, which is beneficial to enterprise development and growth; on the other hand, such separation gives rise to the principal-agent problem due to the inconsistent goals between the owners and operators of the enterprise. The shareholders aim to maximize value for shareholders and preserve or increase the value of their own capitals, while the enterprise executives aim to maximize their own interests or enterprise control. The inconsistency between the two goals will cause damage to enterprise operation and shareholder values. Establishing and improving the incentive mechanism is an important means to solve this problem. However, under different property right systems, the diversified relationship between business owners and executives will also lead to the different impact of executive compensation incentives on different types of companies. Research on this issue helps deepen the understanding of the impact of incentive systems on enterprise performance, improve the institutional arrangement for different types of enterprises, enhance the comprehensive strength of enterprises, and promote the sustainable and healthy economic development of China.

## 2. Literature review

There has been a long history of research of the impact of executive compensation incentives on the enterprise performance. At present, extensive research has been conducted, and most research results obtained by the scholars have shown a interaction effect between them. It is generally believed that the higher the level of executive compensation, the better the enterprise performance, which is supported by Giorgio and Arman (2008), Hou Yi (2020), Wang Tian (2020), et al[1-3]. However, the

research result varies, and some scholars stated that executive compensation shows less significant influence, and even a negative impact, on the enterprise performance. Ke Youmeng (2021) et al indicated the little effect of executive compensation on the enterprise performance of listed catering and tourism enterprises [4]. However, Scott (2005), Hong (2016), Li Youjun (2021) et al pinpointed the negative effect, but insignificant, of executive compensation on the enterprise performance [5-7]. Moreover, the impact of executive compensation incentives on enterprise performance is affected by many factors, such as the nature of use rights, equity arrangements, and the industry involved. In terms of equity arrangement, Du Yuan (2021) et al pointed out that executive compensation has a significant effect on enterprise performance improvement under the perspective of equal compensation for the shares of the same type, and a minimal effect under the perspective of unequal compensation for the shares of the same type [8]. Wang Yiming (2022) pointed out in the research that executive compensation incentives can better improve enterprise performance in the context of strong equity concentration [9]. From the perspective of different industries, the research by Yang Hua (2021) on strategic emerging industries, Huang Wanli (2022) on real estate industry, Xu Mohan (2021) on manufacturing industry, etc., show that executive performance incentives can significantly promote enterprise performance [10-12]. The research by Zhang Dongping (2021) in the petrochemical industry and by Ke Youmeng (2021) in the catering industry show a negative correlation between executive compensation and enterprise performance [4][13]. The results are more controversial from the perspective of different property rights. On the one hand, Wang Haifei et al. (2021) indicated that the executive compensation has a promoting effect on enterprise performance of SOEs, but less significant effect on private enterprises [14], while Dai Ying et al. (2021) stated a better effect of executive compensation on the enterprise performance of private enterprises than SOEs [15]. On the other hand, Li Zhuwei (2021) et al indicated in their research that executive compensation and enterprise performance are positively correlated, regardless of the nature of enterprises [16]. Although, on the whole, most recognize the positive impact of executive compensation incentives on enterprise performance, no consensus has been reached, and the understanding of the role of this impact under different property right systems is even more inconsistent. In addition empirical analysis method is generally employed in the academic circles. However, in view of the shortcomings of the current research, such as mostly old data, short time span, and insufficient data volume, in this paper we adopt the empirical analysis method to expand the sample size and time span, analyze the impact of executive performance incentives on enterprise performance under different property right systems, and carry out further verification of such impact and analyze their differences under different property right systems.

### 3. Theoretical analysis and research hypotheses

Based on the principal-agent theory and optimal contract theory, entrusting managers to manage the enterprise by shareholders forms the principal-agent relationship. However, in the relationship, the conflict of interest between the principal, pursues greater wealth for himself, and the agent, who pursues the maximum salary and allowance income for himself, leads to agency costs. In order to reduce the agency cost caused by information asymmetry and other reasons, the board of shareholders will sign a compensation-performance contract with the executives to clarify the rights and obligations of both parties. Shareholders, as the principal, can reduce agency costs by signing the optimal executive compensation contract, and encourage executives as agents to work actively to improve company performance, thereby maximizing shareholder wealth. The enterprise compensation contract correlates executive compensation with enterprise performance, and the increased executive compensation can improve enterprise performance by affecting the behavior of executives. Kevin (2011), Jiang Zefang (2019) et al have validated the significant positive correlation between executive compensation and enterprise performance, that is, the higher the executive compensation, the higher the enterprise performance [17-18].

This paper, accordingly, proposes the following hypothesis I: Executive compensation plays a positive role in promoting enterprise performance.

Many domestic scholars believe that the nature of property rights in enterprises will affect the effect of executive compensation on enterprise performance, and most scholars such as Tong Aiqin (2012) are inclined to believe that, executive compensation has a more significant effect on the enterprise performance of Non-SOEs, compared with SOEs[19]. Wang Zhuo (2020) et al believe that the reason for this case is that, compared with private enterprises, SOEs must not only maintain or increase the value of state-owned assets, but also achieve many policy goals, making it difficult for the performance level of SOEs to accurately reflect the work enthusiasm of executives [20]. In addition, the government has also unveiled a number of policies to cap the excessive high salaries in SOEs and reduce the inequality of salary distribution among employees. These policies further mitigate the significance between executive compensation and enterprise performance in SOEs.

This paper, accordingly, proposes the following hypothesis II: Regardless of the nature of property rights, executive compensation has a positive correlation with enterprise performance, which is more significant in Non-SOEs.

#### 4. Research design

##### 1. Empirical model

In the empirical analysis in this paper, the explained variable is enterprise performance; the explanatory variable includes executive compensation and other related variables, namely financial leverage, growth and the company’s operating capability. This paper adopts a two-sided fixed-effect model in order to control the individual effects of enterprises that do not change with time and the time effects that do not change due to individuals. Moreover, this paper adopts the panel data model for empirical analysis, because panel data can reflect the regularity of data change simultaneously from the two dimensions of time and cross-section. The specific form of the regression model in this study is as follows:

$$ROA_{it} = \beta_0 + \beta_1 top3\_pay_{it} + \beta_2 Debt_{it} + \beta_3 TATO_{it} + \beta_4 Grow_{it} + \varepsilon$$

The definitions of variables in this paper are shown in Table 1

Table 1. Table of variable definitions

Variable types	Variable name	Variable symbol	Variable declaration
Explained variable	Enterprise performance	ROA	Net profit rate of total assets= Net profit/balance of total assets
explanatory variable	executive compensation	top3_pay	The logarithm of the top 3 executives’ compensation
Control variable	financial leverage	Debt	Net profit rate of total assets = Total liabilities / Total asset
	the company’s operating capability.	TATO	Total asset turnover rate
	growth	Grow	The total asset growth rate

In the above model,  $\beta_0$  is a constant, and  $\beta_1$  to  $\beta_4$  represent the regression coefficients of the aforementioned four variables, respectively;  $i$  and  $t$  represent the serial number of sample enterprises and year, respectively; and  $\varepsilon$  represents the error terms of the model.

##### 2. Sample selection and data sources

The relevant financial data required for this study stems from the China Stock Market & Accounting Research Database (CSMAR), and the samples selected for empirical analysis are all the A-share companies listed in Shanghai and Shenzhen stock markets during 2010-2020. The collected samples are screened by excluding the listed ST companies and financial companies. A total of 29,785

pieces of data in 10 years were obtained. Taking into account the adverse effects of extreme values in the research process, this paper also carried out the corresponding winsorize on the 1% and 99% quantiles of the relevant indicators in the regression analysis. The relevant data were processed by Stata16.0.

### 3. Variable Definition

**Explained variable:** In this paper the explained variable is enterprise performance. Enterprise performance refers to the enterprise's operating efficiency and operator's performance during a certain period of operation in order to achieve the set goals. There is no unified enterprise performance measurement method at home and abroad. Most of the foreign studies adopt Tobin's Q value for measurement. However, compared with foreign countries, China has a relatively not mature stock market, and the fluctuation of enterprise stock prices is affected by many other factors. Tobin's Q value cannot accurately represent the performance of enterprises, and ROA, ROE and other accounting performance indicators are mostly used in domestic researches to measure corporate performance (Han Huilin et al., 2014) [21]. However, the ROE indicator represents the return to shareholders, and the net profit is very easily swayed in the Chinese market. Therefore ROA is employed in this paper to reflect the performance level of an enterprise, that is, the net profit rate of total assets.

**(2) Explanatory variable:** In this paper the explanatory variable is executive compensation. Executive compensation includes explicit compensation such as monetary compensation, and other hidden compensation such as development opportunities and achievement honors. Since the data concerning implicit executive compensation in China is not easily available, we measured the overall compensation level of senior management team by using the total amount of the top three executive compensations based on previous research, and selected the natural logarithm of the top three executive compensations for research according to Chang Qijun (2015) [22].

**(3) Control variables:** in this paper the control variables are the financial leverage, operational capability and growth of enterprises. Based on the previous related research, the enterprise performance will, in the enterprise operation, be affected by its asset-liability ratio, the turnover rate of total assets and the growth rate of total assets. In this paper we employ asset-liability ratio to measure the financial leverage, total asset turnover ratio to measure the operational capability, and growth rate of total assets to measure the growth ability of enterprises. Asset-liability ratio, an important indicator of capital structure, affects and determines enterprise performance. Enterprise debt will bring financial leverage effect. The total asset turnover ratio reflects the operating capacity of enterprise assets. In general, the higher the total asset turnover rate of the enterprise, the faster the turnover rate, the stronger the operation capability, and the better the enterprise benefit. The total asset growth rate is the main indicator to analyze the capital accumulation ability and development ability of the enterprise in that year.

## 5. Empirical analysis

### 1. Descriptive statistics

Table 2. The descriptive statistical of variables

Variable	N	mean	Sd	min	max	p50
ROA	29785	0.041	0.059	-0.230	0.204	0.040
top3_pay	29785	14.371	0.712	12.657	16.359	14.352
Debt	29785	0.419	0.209	0.049	0.888	0.409
TATO	29785	0.620	0.424	0.075	2.525	0.523
Grow	29785	0.211	0.395	-0.303	2.380	0.103

The descriptive statistical results are shown in Table 2. The results show that the mean, maximum, minimum ROA, as well as the standard deviation of the sample companies' return on total assets is

0.041, 0.204, -0.23, and 0.059, respectively. The data reveals both positive and negative profit rate of total assets, indicating that serious polarization, proved by the positive or negative value, exists in performance among different companies, and is accompanied with so relatively significant gap that there is a large room for improvement. The mean, maximum, minimum, as well as the standard deviation of the logarithm of the top three executive compensations is 14.371, 16.359, 12.657, and 0.712, respectively. Although the overall data shows a relatively small difference in the top three executive compensations among enterprises, this gap is narrowed due to the logarithm treatment of the top three executive compensations in this paper. The mean, maximum, minimum, as well as the standard deviation of asset-liability ratio is 0.419, 0.888, 0.049, and 0.209, respectively, indicating that the asset-liability ratio varies greatly among different enterprises. The mean, maximum, minimum, as well as the standard deviation of total asset turnover ratio is 0.620, 2.525, 0.075, and 0.424, respectively, indicating the large difference and drastic gap in the total asset turnover ratio and operation capability among enterprises, which leads to a huge gap in the enterprise benefits. The mean, maximum, minimum, as well as the standard deviation of total asset growth rate is 0.211, 2.380, -0.303, and 0.395, respectively. The analysis reveals the serious polarization, proved by the positive or negative value, in the total asset growth rate, and some enterprises with negative growth.

## 2. Correlation analysis

After controlling the financial leverage, operational capability and growth of enterprises, this paper conducts correlation analysis on the relationship between the executive compensation incentives and enterprise performance. The specific results are shown in Table III.

Table 3. Correlation analysis of variables

	ROA	top3~y	Debt	TATO	Grow
ROA	1.000				
top3_pay	0.159***	1.000			
Debt	-0.363***	0.087***	1.000		
TATO	0.126***	0.084***	0.151***	1.000	
Grow	0.253***	-0.011**	-0.166***	-0.087***	1.000

Standard errors in parentheses

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

The results in Table 3 indicate that executive compensation, total asset turnover rate, and enterprise growth are all positively correlated with enterprise performance at the level of 1%, demonstrating that the increase in the above three factors contributes to the improvement of enterprise performance and have a positive impact on the enterprise performance. The asset-liability ratio and enterprise performance are negatively correlated at the level of 1%, indicating that the increase in the asset-liability ratio is not conducive to the improvement of enterprise performance. Both the asset-liability ratio and total asset turnover ratio are positively correlated with executive compensation at the level of 1%, indicating that the increase in asset-liability ratio and total asset turnover ratio is conducive to the raise in executive compensation, and the enterprise growth is negatively correlated with executive compensation at the level of 5%, indicating that the improvement of enterprise growth is not conducive to the increase in executive compensation.

## 3. Regression analysis

Stata software is used for regression analysis in this paper. The regression results are shown in Table 4,5,and 6.

Table 4. Regression results under the full sample

	(1) ROA
Lntop3_pay	0.006*** (0.001)
Debt	-0.130*** (0.003)
TATO	0.056*** (0.001)
Grow	0.031*** (0.001)
_cons	-0.028*** (0.009)
N	29785
r2	0.186
r2_a	0.060

Standard errors in parentheses  
\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

Table 4 reports the whole-sample regression results of enterprise performance and other variables based on which the authenticity of hypothesis is verified. The regression results in Table 4 show that executive compensation has a positive impact on enterprise performance at a significant level of 1%, with a coefficient of 0.006, indicating that a logarithmic increase of executive compensation by 1 unit will increase ROA by 0.006, that is, assumption I holds. The asset-liability ratio has a negative impact on enterprise performance at the significance level of 1% , while the total asset turnover rate at the significance level of 1% has a positive impact on enterprise performance, and enterprise growth is positively correlated with enterprise performance at the significance level of 1%. The model used in this paper is 0.186, and the adjusted value is 0.06, indicating that the independent variables selected in this paper have a certain explanatory effect on the dependent variable.

Table 5. The regression results of executive compensation and enterprise performance of SOEs

	(1) ROA
Lntop3_pay	-0.009*** (0.003)
Debt	-0.120*** (0.014)
TATO	0.041*** (0.006)
Grow	0.009*** (0.002)
_cons	0.190*** (0.046)
N	21891
r2	0.009
r2_a	-0.203

Standard errors in parentheses  
\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

Table 6 The regression results of executive compensation and enterprise performance in Non-SOEs

	(1) ROA
Lntop3_pay	0.038*** (0.012)
Debt	-0.329*** (0.048)
TATO	0.085*** (0.029)
Grow	0.020** (0.009)
_cons	-0.237 (0.184)
N	501
r2	0.158
r2_a	-0.170

Standard errors in parentheses

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

The regression results and analysis of executive compensation and enterprise performance under different property rights are as follows.

According to the regression results in Tables 5 and 6, the regression coefficient between the executive compensation of SOEs and company performance is -0.009, and the significance level is 0.006, indicating that the executive compensation of SOEs is very significant at the 1% significance level. , and it has a negative inhibitory effect on company performance. The regression coefficient of executive compensation and company performance in Non-SOEs is 0.038, and the significance level is 0.002, indicating that the regression coefficient of executive compensation in Non-SOEs is significantly positive at the level of 1%, and it has a significant impact on company performance and it is a positive promotion. Since the regression coefficient of executive compensation and enterprise performance of Non-SOEs is higher than that of SOEs, the executive compensation of Non-SOEs has more significant positive correlation with enterprise performance than that of SOEs. To sum up, hypothesis II does not hold, and executive compensation has a negative correlation, rather than a positive correlation, with enterprise performance in SOEs, although the executive compensation, indeed, has more significant effect on enterprise performance in Non-SOEs.

Whether in SOEs or in Non-SOEs, however, the asset-liability ratio has a negative impact on enterprise performance at the significance level of 1%, and the total asset turnover ratio has a positive impact on enterprise performance at the significance level of 1%. Compared with Non-SOEs, the growth of SOEs has a more significant positive impact on enterprise performance, indicating that the enterprises with stronger operational capabilities, more growth opportunities and lower asset-liability ratio have higher enterprise performance.

## 6. Conclusions and recommendations

### 1. Conclusion

Based on the data regarding all the A-share companies listed in Shanghai and Shenzhen stock markets during 2010-2020, in this paper we ruled out ST companies and financial companies from the samples, and conducted empirical research on the relationship between the executive compensation gap and enterprise performance in Non-SOEs and SOEs. Through descriptive statistics, correlation analysis and regression analysis of the data, the following conclusions are obtained.

The study revealed that, in the enterprises with different property rights, executive compensation has different effect on enterprise performance to a certain degree. In SOEs, executive compensation is significantly negative at the significance level of 1%, that is, executive compensation of SOEs has a negative inhibitory effect on enterprise performance. This shows that the increased executive

compensation in SOEs cannot play a good role in motivating executives, so that the enterprise performance cannot be improved. In Non-SOEs, however, the regression coefficient of executive compensation is significantly positive at the level of 1%, that is, the executive compensation of Non-SOEs has a positive effect on enterprise performance, indicating that in Non-SOEs, the raise in executive compensation is still an important factor in promoting the enterprise performance (Yan Youliang, 2018). The listed companies among Non-SOEs in China can, based on their actual conditions, reasonably design a compensation system and motivate the management personnel by increasing the compensation, so as to improve the enterprise performance. In addition, since the regression coefficient of executive compensation and company performance in Non-SOEs is higher than that in SOEs, the positive correlation between executive compensation of Non-SOEs and company performance is more obvious than that of SOEs. This means that with the increase of executive compensation, in Non-SOEs, the enthusiasm of executives to improve enterprise performance is higher than that of SOEs.

## 2. Recommendations

Based on the above research conclusions, this paper proposes the following suggestions for the operating management of listed companies in China:

First, enterprises are required to further develop a reasonable compensation mechanism. Enterprises can encourage senior executives to contribute to the enterprise development by improving the executive compensation system, so that the enterprise performance can be further improved. Meanwhile, however, the enterprise compensation should also be designed within a reasonable range, especially in SOEs. The salary distribution system generally adopted for employees is based on the posts. Unreasonable salary distribution and treatment could probably lead to conflicts and result in psychological imbalance among employees, which is not conducive to the establishment of a good group relation in the enterprise, to the extent that the enterprise progress is hindered in turn by the decreased enterprise performance, accompanied with increased executive compensation of the enterprise.

Second, it is necessary to deepen SOE reform and promote the marketization of SOEs. In addition to launching a reasonable compensation mechanism system, SOEs also need to further advance the marketization. Compared with Non-SOEs, SOEs have the executive compensation negatively correlated with enterprise performance, mainly because that the control exercised by the government on the employee compensation of SOEs inhibits the enthusiasm of executives. Basically, we should handle the relationship between the government and SOEs scientifically and rationally, minimize the government's intervention and regulation on SOEs, and enhance the correlation between executive compensation and enterprise performance, thereby motivating executives to improve enterprise performance with every effort.

Third, enterprises should, depending on their own specific conditions, enhance the internal management of senior executives. Enterprises need to strengthen the internal management of executives with consideration to their actual situation. Only by taking into account its own reality more comprehensively can an enterprise make more scientific and reasonable decisions and construct the executive compensation incentive mechanism that is more suitable for itself. In this way, the incentive effect on executives will be more fully exerted to achieve the goals the enterprises desire.

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