Discussion of Ra & Kim ‘Perils of Limiting the Coverage of Mandatory Pay Disclosure: The Korean Experience’

Tobias H. Tröger
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Summary of the paper

• Uses exogenous shock (regulatory intervention) to test “evasive” behavior of corporate directors (compensation disclosure)
  – Rule (promulgated 5/28/13; effective 11/29/13) mandates any director with pay beyond threshold discloses individual compensation from FY2013 onwards
  – Sample comprises 195 board members who disclose compensation for FY2013 but not for FY 2014 (80 family, 115 non-family)
  – Investigates three possible reasons for “going dark” - (1) deregistration (2) pay cuts below threshold (3) retirement - and relates them to director and firm characteristics

• Relevant for policy-makers contemplating design of disclosure regime in similar CG environment
Main results:

- “Evasive” behavior occurs mainly at family directors in firms with high executive-to-worker pay ratios.
- Preference for (minor) pay cuts over deregistrations.

- Two forms of “evasive” behavior prevail: 11.4% and 10.3% of FY2013 disclosing directors deregister or accept pay cuts respectively.
- Family directors are 28.3% more likely to deregister than non-family directors, but not more likely to accept pay cuts.
- Family executive deregistration “jumps” in 2013 and remains higher than before in 2014, but there may be a pre-trend.
- Likelihood of deregistration increases with wider pay gap between directors and average workers.
- Family directors prefer pay cuts over deregistration if FY2013 compensation is close to threshold.
What we don’t learn from the paper...

- Political and broader legal landscape → potential driver of deregistration if being director less attractive overall
  - What’s different from 2006 and 2009? Generally more hostile environment vis-à-vis chaebols (“public outrage”)? → Family directors’ deregistration seem to pick-up before 2013
  - Any other relevant reform, eg tightening of liability regime?
- What happens in the investor community and the general public in reaction to 2013 disclosures (anecdotal evidence purported to be representative)?
- Motivation of “evasion” as determinant of social impact → Behavior driven by (fear of) shareholder or public discontent? Efficiency vs. distributive concerns
- Any adaptation in compensation of other directors?
Are pay cuts really „evasion“

- Paper establishes that some (family) executives respond to the law and gives observation negative spin

- Policy maker signals that any compensation below threshold is deemed unsuspicious
  - Distributional concern regarding absolute levels (not efficient structure which matters more from shareholder perspective, Jensen & Murphy, 1991)
  - Pay cuts are real (despite potential compensation through other tunneling transactions)
  - Policy objective achieved because (family) directors take economic hit → route for rent seeking partly closed
Think again also about deregistration

• Deregistration can have serious consequences for family director → *ceteris paribus* scenario only if non-director position grants same power, prestige, compensation etc.

• Deregistration may have negative welfare effects

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**Family director premium (Cheong & Kim, 2019) as tunneling**

- Pay for non-performance
- Deregistration impedes rent-seeking (at the margin) → effect hinges on effectiveness of RPT regime
- (Shareholder) welfare enhancing

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**Family director premium as monitoring compensation**

- Costly blockholder mitigation of PA conflict compensated through „optimal tunneling“, Gilson & Schwartz, 2015
- Deregistration hinders blockholder monitoring power → effect hinges on controller’s access to non-family directors (more severe PA conflict)
- Potentially (shareholder) welfare decreasing

Difference in value of firms with many deregistrations compared to those with few deregistrations?
Minor points

• Executive Pay based on annual financial statement → accounting standards matter, eg with regard to incentive compensation (fair value at grant vs. pay-out)

• No clear explanation for “listing” of non-registered executives → legal obligation to do so?

• Qualification of “retirement” hinges on observable retirement payment in FY2013 → hidden parachute in RPT; yet, bias (overstating retirements) works in authors’ favor

• High foreign ownership expected to decrease evasive behavior → foreign investors may be good monitors only after disclosure (enforcers not investigators)

• Any sanctions for non-disclosure/“evasion”? → fraudulent evasion, misuse of legal form etc.
Tobias H. Tröger
SAFE professor of private law, commercial and business law, jurisprudence
Goethe University House of Finance
Theodor-W.-Adorno-Platz 3
60629 Frankfurt am Main
Germany
p +49 69 798 34391
f +49 69 798 34536
troeger@jur.uni-frankfurt.de