

Research on Impact of the Senior Executive Incentive Mechanism to Financial Performance

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Abstract Flowing chart method is employed in the paper. It is thought that technological innovation and institutional innovation are inseparable, as one of the important incentive mechanism, innovation couldn't create performance itself, but it could stimulate the senior executive's innovative behavior, through the senior executive's leading in enterprise innovation, the enterprise financial performance will be promoted with technological innovation and institutional innovation further. Those enterprises could obtain comparative advantage with the strong competition and the strategy adjusted with the change of the external environment, thus enterprise's financial performance will be promoted.

Key words Incentive mechanism; Financial performance; Sustainable innovation; Comparative advantage

1 Introduction

1.1 Research situation at home and overseas

It is earlier about the research on incentive mechanism at overseas. Coase, represented institutional economics property right school, he believes that the key to enterprise's performance is to clearly define the limit of property right in law or optimize the property structure. Beyond Property Right Theory think that enterprise performance and change of the property is not necessarily related. It mainly depends on the degree of market competition, the more competitive market is, the more effort enterprise put to improve the efficiency. At home, (Zhong hongwu 2007) systematically studied the relations of charitable donations and corporate performance, if manager want to improve the enterprise environment, financial performance would be improved directly or indirectly.

1.2 The meaning and types of incentive mechanism

Incentive mechanism is the system that the stimulate object would take some economic activity or not according to their own goals. In the modern enterprise system, the so-called incentive system is the progress that enterprise's owner make an interaction with the operator through the incentive factors, its essence is to resolve the problem of the enterprise's power. According to the different forms, incentive mechanism could be divided into salary incentive and non- salary incentive. Salary incentive includes the annual salary incentive, equity-based incentives. Non-salary incentive mostly exists in the form of recessive incentive, and comes from internal and external of the enterprise. The former includes promoting incentives, culture incentives, control power incentive, the latter includes mainly including competitive incentives and reputation incentives.

1.3 Factors affecting financial performance

Enterprise performance is the enterprise's results or performance during a certain operating period, while financial performance can reflect the operation situation and the enterprise's development trend adequately. Enterprise's main idea of core competitiveness is bellow; the decisive factors of enterprise performance and competitive advantage include the internal resources, capabilities, especially for knowledge-based core capability.

The decision factors affecting enterprise performance would change with economic environment change, the enterprise have to innovate constantly to adapt the change of the environment. So enterprise performance would be determined by technical innovation, management innovation and system innovation, they are interlinked organically and mutually reinforce.

2 Analysis on Relationship Between Executive and Financial Performance

2.1 Continuable earnings: the substance security to make enterprise continuable innovation

An economist, Schumpeter believes that uncertainty is one of the basic characteristics of innovation. Based on uncertain innovation itself, enterprise will face series of risk and higher cost^[1]. Sustainable earnings obtained will enable enterprises enhance significantly in enterprise value, the overall level of returns as well as the financing capacity of such areas, which will become a powerful guarantee for enterprise innovation. Innovation is a constant activity, and it's hard to meet the profit in a

short period of time. Continuable earnings could provide adequate financial support for enterprise innovation. Thus, continuable earnings enable enterprise to increase research capital, facilities, technology and human resources capacity, and meanwhile improve the ability to accept the risks in the process of innovation.

2.2 Incentive mechanism: the guarantee to obtain continuable earnings

System are series of rules or ordinance worked for enterprise with the goal to make the maximum profit, attached with compellent obligation during the production management activity^[2]. This is a powerful measure to obtain continuable earnings and realize the enterprise’s goal. The scientific, perfect and useful system would provide the organize guarantee for the achievement of the enterprise’s goal. Incentives for operators can lead and control their behavior, also figure out the dynamic problems in the development^[3].

A perfect incentive contract can combine the operators’ personal interests and enterprise’s interests to make the operators pay more attention to corporate long-term development and receive sustainability profit. In order to maintain long-term incentive function effectively, we have to achieve the institutionalization of incentives. An effective incentive mechanism would enable the proper implementation of incentive plans with the better incentive effect.

2.3 Incentive mechanism: the engine of enterprise's sustainable innovation

1) Internal innovative incentive mechanism

In the changing market, only relying on sustainable innovation can keep the constant competitive advantage of the enterprise and achieve sustainable earnings growth for enterprises, the senior executives are leaders in innovative enterprises, the whole innovation program would be promoted by the senior executives who have innovation ideas , incentive to executive is the key to keep the enterprise continually innovation. innovative power is an important factor affecting the senior executive’s innovation. An effective incentive mechanism could make the owners’ interests consistent with the operators’ and linked the self-interest with the enterprise’s long-term development. after the executives were given innovative motivation the implementation of innovative strategies, technical innovation, management innovation and system innovation, would enhance the company's core production capacity, and the growth of performance will provide a material guarantee for enterprise’s sustainable innovation. At the same time, the enterprise's performance growth yield huge innovation driving force through incentive mechanism. So back and forth, enterprise will achieve sustainable innovation, its principle is shown in Figure 1:

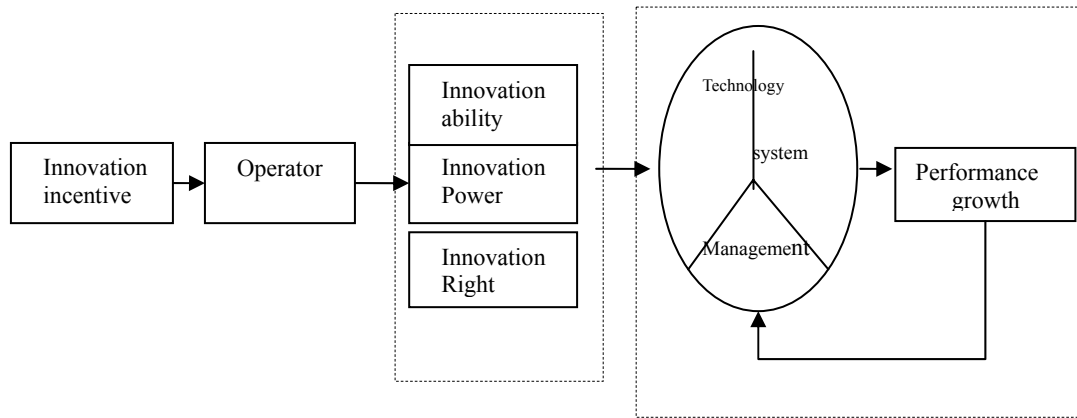


Figure 1 Impact Of Innovation Incentive to the Performance

2) External innovation incentive mechanism

① The Government's incentive innovation

Government's fiscal policies can significantly affecting the input of the enterprise’s innovation resource, and thus have a direct impact on the enterprise’s growth. The government's various innovative incentive policies, such as science and technology policy, financial policy, tax policy and a variety of incentive policies, can provide motivation for enterprises’ continually innovation.

② Market innovation incentive

According to Schumpeter's innovative basic theory, market economy system is the basic condition

for achieving innovation. Therefore, the market innovation incentives constitute the basis of entrepreneur's continuous innovation incentives system. The market price system will continue to give the direction to induce the enterprise innovation, innovative ideas and creative implementation. Enterprise with product advantage and great technological capabilities would gain competitive advantage, and stand on an indefectible position in the fierce market competition. These two external innovate incentives cannot directly act on the operators but the direct worked with the enterprise, and react through the company's internal innovation incentive to operator. However, the Government's innovation incentive system for entrepreneur could have an effect on incentive directly.

3 Principle of Executive Incentive Mechanism to Financial Performance

From the relative analysis in incentive system and financial performance, we can see that technological innovation and institutional innovation are inseparable. To obtain sustainable development, enterprises have to be accompanied by technical innovation and system innovation. But the system innovation cannot act on the development of enterprises directly, and need an indirect effect through technological innovation. As one of the important governance mechanism, incentive cannot create performance itself, but to stimulate the innovative behavior of executives, through executive's leading in innovation , the technological capabilities would be promoted, and act on the enterprise performance further. the senior executive's management has effects on the enterprise performance indirectly. Executives' incentive's mechanism to financial performance can be illustrated by Figure 2.

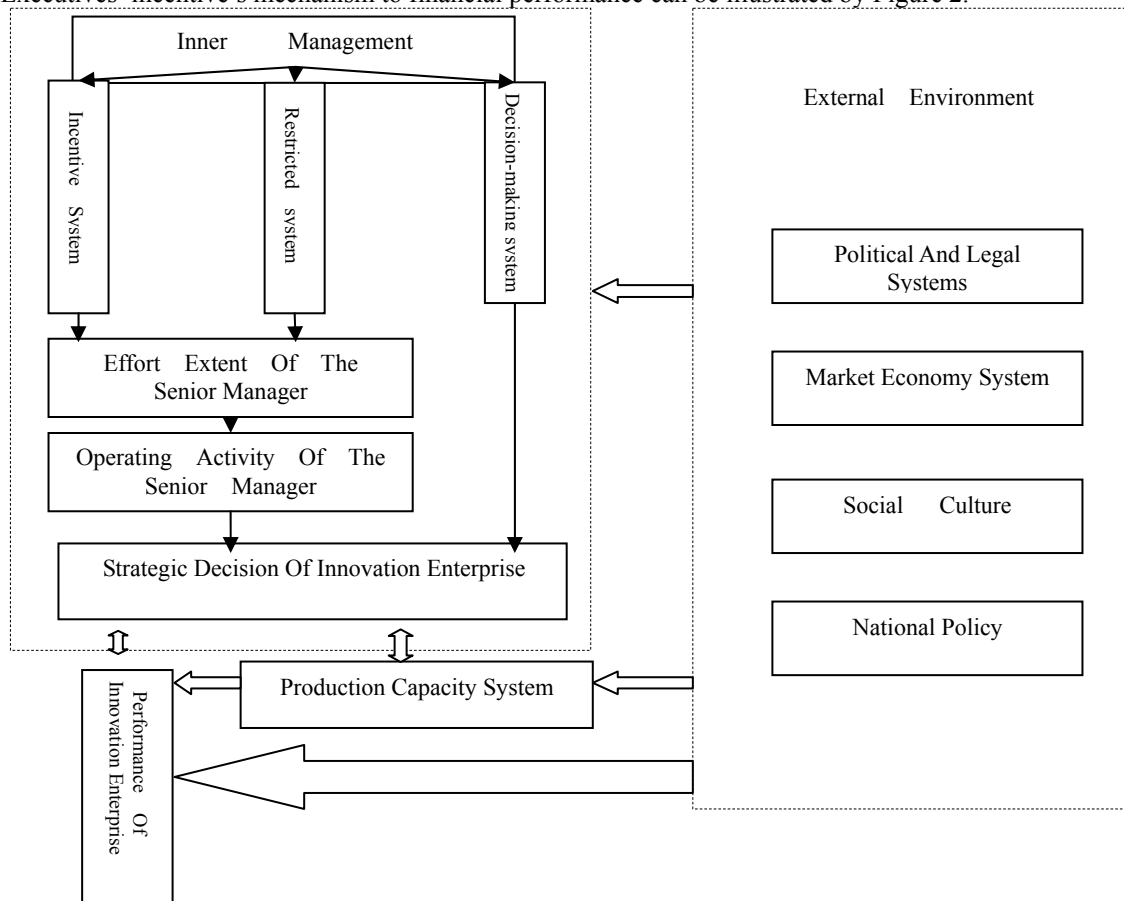


Figure 2 Graphical Representation of the Senior Executive Incentive Mechanism to Financial Performance

As figure 2 shows, in the enterprise, the internal incentive system leads the senior executives' activity through the incentive, in which innovation incentive mechanism could motivate executive's innovation activity, while the salary incentive motivate executive's innovation power; controlling power incentive gives innovator innovation rights and internal promotion incentive, the selection, appointment mechanisms makes sure that the executive should have certain ability to innovate. The

negative incentive—restraint mechanism can regulate the behavior of executives, meanwhile make the negative effect to incentive system. In this way, executive can worked out innovation strategy under the system of enterprise decision-making.

In order to realize innovation strategy of enterprises, under the leadership of the executives, technical innovation, management innovation, system innovation would be implemented ,and enterprise would raise the core competitiveness level. Enterprises which have competitive advantage in market will win in the market competition thereby raise the financial performance of innovative enterprises. Enterprise's external environment constitutes the enterprise's external governance environment and has influence on the internal governance through the enterprise's internal governance mechanism. Among them, the policy environment, market environment, legal environment constitute the executive's external incentive system. The legal environment guide and constraint operators by regulate the operator's rights and responsibility; manager market, capital and product market constitute the external market incentives of the executives.

Under the influence of the external market, incentive mechanisms just as executive's reputation incentive, equity incentive and credit incentive will be fully effective social culture affect people's behavior by influencing people's opinion .innovation in the whole society obviously have a function that lead and demonstration for executive and enterprise's innovation activity; national policy of incentive manifest favorable policy and incline to guide the enterprise and operator.

4 Conclusions

The environment which enterprises exist is also the touchstone of the innovative strategy, product ability and management level for the enterprise. Whether the enterprise's innovative strategy is flexible, whether an enterprise has a sustainable competitive advantage, as well as the enterprise's internal governance structure will be tested in the changeable environment. Only those enterprises could obtain comparative advantage with the strong competition, the strategy adjusted with the change of the external environment, thus raise enterprise's financial performance.

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