How accounting affect stock price

Finance

How does accounting and the stock price affect the CEO compensation? The question of how to compensate CEOs has been a major centre for debate for a long-time. While some financial experts hold that a CEO's compensation ought to be attached with the accounting success of the firm, others hold that the best way is to design the compensation based on the stock price of the firm (Boschen et al. 144-146). Accounting literature alone cannot explain this, and thus, the need to investigate the short term and long-run effects of the both accounting and stock price effects in compensating the CEO.

The long-run effects of unexpected firm performance and its impact on the CEO compensation is demonstrated by both good accounting performance and good stock performance. Unexpected good accounting performance has a significant effect on CEO's pay for a short time. However, on long-term basis, the trend reverses, and the pay starts decreasing and thus the benefits accrued evens out. However, in the compensation using the stock price performance, a good stock price translates into increased CEO salary, which on the long-run maintains the rise.

Accounting performance is arrived at by an aggregate evaluation of all the subunits of the firm. Acquiring all the required information in computing the aggregate departmental performance is a tedious exercise that takes quite a considerable amount of time. A poor performance in one department is likely to negatively affect the other entire firm. Thus, to ensure a high performance level, the CEO must focus on an increasing performance of all the departments of the firm. Accounting performance is very useful when issuing promotions to various departmental managers and supervisors. The best performing managers and supervisors, and the ones who have maintained an upward trend are awarded with promotions, but not the best method to use in determining a CEO’s compensation.

A firm could register an upward growth for a number of years, but assume an upward diminishing growth. This phenomenon occurs when the firm achieves its maximum growth, where all resources are utilized to the optimum. At this point, the firm cannot grow anymore since all its resources are fully utilized. The growth thus becomes stagnant. A CEO who is compensated using this method will start receiving decreasing remuneration as the firm’s performance starts decreasing.

In contrary to the accounting performance, the stock prices method does not reach a maximum growth level. A CEO who works hard to achieve growth of the firms’ stock prices has no limit to the level at which they can rise. In fact, when the firm reaches its optimum growth, the CEO is likely to receive a higher pay than during the growth period (Boschen et al. 144-146). Stock prices are determined by a number of factors, apart from accounting performance. The ability of the CEO to effectively use a combination of all the factors of production is likely to help him receive a high remuneration. When the firm reaches its optimum growth potential, the CEO could use a combination of other factors to make sure that the stock prices remains high. These factors include market positioning, new markets, and economic growth. This ensures that the CEO’s compensation retains an upward growth.

From the discussion above, a conclusion can be drawn that the dynamics of accounting performance and stock prices affect the remuneration of a CEO. However, stock price is the best method to use in remunerating the CEO since it will keep increasing so long as the stock price remains high.

Works Cited

Boschen, John et al. “ Accounting and Stock Price Performance in Dynamic CEO Compensation Arrangements.” The Accounting Review: January 2003, Vol. 78, No. 1, pp. 143-168.