Managerial incentives and R&D investments: The moderating effect of the directors' and officers' liability insurance

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ABSTRACT

Literature regarding the impact of managerial incentives on firm's research and development (R&D) investments suggests that due to the riskiness of R&D activities, firms need to provide managerial incentives to encourage managerial discretion on corporate long-term investments of R&D. In spite that managerial incentives influence corporate R&D spending, some also argue corporate R&D spending a function of managerial incentive schemes. This paper applies the simultaneous equation to investigate the association between managerial discretion on R&D investments and the incentive scheme of CEO compensations by using the sample firms listed in Taiwan Security Exchange and Taipei Exchange. The results indicate that the listed firms in Taiwan simultaneously determine corporate R&D investments and CEO compensations. They reward their CEOs in compliance with their efforts on R&D investments and CEO compensation motivates CEOs to align their interests with firms' long-term investments on R&D. A further analysis of the protection effect from the directors' and officers' (D&O) liability insurance suggests that D&O protection intensifies the relationship between R&D investments and CEO compensation. It encourages CEOs to allocate resources on R&D activities and make CEO incentive contracts efficacious on corporate long-term investments. The result is robust in the electronic industry of Taiwan.

Keywords: Managerial incentive, CEO compensation, R&D investment, Directors' and officers' (D&O) liability insurance

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