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Executive Compensation and Incentive Alignment in Modern Corporations

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Abstract: Executive compensation has emerged as a significant corporate governance tool to align the interests of executives with shareholders' goals and maximize corporate performance. The main topic of this study is to consider the link between executive pay and incentive alignment in modern corporations in the Chinese corporate context. In particular, the study explores the impact of monetary compensation, equity-based compensation, long-term incentives and corporate governance quality on incentive alignment and the impact of incentive alignment on firm performance. Based on agency theory and behavioral agency theory, the research takes a quantitative method with structured questionnaire survey, and selects executives, board members, HR managers, corporate governance professionals of 440 listed companies in China as the survey objects. The collected data was analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with the use of SmartPLS software. The results indicate that there is a significant positive correlation between incentive alignment and monetary compensation, equity-based compensation, long-term incentives as well as corporate governance quality. Of these, the quality of corporate governance had the most significant impact on incentive alignment. Moreover, it was observed that there was a positive effect of Incentive Alignment on Firm's Performance, suggesting that effective executive compensation systems are helpful in boosting organizational successes. The study contributes to the literature by using several measures of executive compensation and governance quality in a single framework in the context of an emerging market environment. The results have deeper implications that benefit the policy makers, regulators, corporate boards and compensation committees in enhancing the effectiveness of the governance system and creating a sustainable executive compensation system in Chinese corporations.

Keywords: Executive Compensation; Incentive Alignment; Corporate Governance; Firm Performance; Equity-Based Compensation; Long-Term Incentives

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1. Introduction

The issue of executive compensation is one of the most discussed topics in corporate governance nowadays, as it plays a critical role in shaping the behavior of executives, the performance of the firm, and the creation of shareholder value. In modern companies, compensation for executives goes beyond traditional salary and benefits to encompass bonuses, stock options, equity incentives, long-term incentives, and even sustainability-related compensation. These compensation systems are designed with the main goal of ensuring that the interests of executives are aligned with those of shareholders and other stakeholders in the company, in order to mitigate agency problems and enhance the performance of the company. Executives might have their own goals that are inconsistent with the goals of the organization if there are not appropriate incentive systems put in place to ensure that executives make decisions that satisfy the shareholders' expectations (Edmans & Gabaix, 2016). As a result, executive pay has become a mechanism for governance designed to encourage executives to pursue long-term goals for the organisation.

Because of the complexity of executive compensation, the subject has gathered significant academic, political and public interest, especially after the significant corporate scandals and financial crises. High levels of executive compensation, low governance levels and short term incentive systems have often been blamed for inducing opportunistic executive behavior and risk seeking (Faulkender et al., 2010). Murphy and Jensen (2018) also asserted that regulatory measures around executive compensation have also frequently had unintended side effects that have impacted the performance of compensation systems and governance structures. Likewise, Clarke et al. (2019) proposed that poor corporate governance is one of the factors that leads to the overpayment of executives and the rising inequality in companies. These concerns have compounded the importance of more open, transparent, effective and results-driven executive compensation models in today's companies.

In recent years, research around executive compensation has been focused on the need to implement executive pay that is linked to financial results and sustainability and governance goals. Increasingly, international firms use Environmental, Social and Governance (ESG) measures as part of the executive compensation package to ensure that the executives' behaviour aligns with stakeholder expectations and sustainability targets, according to Cohen et al. (2023). Similarly, Dell'Erba and Ferrarini (2024) noted that European companies are increasingly incorporating ESG metrics into executive compensation frameworks as a component of corporate governance reforms. Ritz (2022) also found that as the importance of climate-linked executive compensation is growing, it is also becoming more of a factor in the pursuit of sustainable business strategies. Such trends reveal that executive compensation schemes are shifting from financial incentive to stakeholder oriented governance schemes.

Executive compensation and incentive alignment is a key consideration in the context of the Asian and Chinese corporate setting, given the influence of state control, ownership concentration, and institutional differences. Chinese corporations are frequently a part of a different governance framework with state-owned enterprises (SOEs), family-run businesses, political ties, and concentrated ownership. These institutional features can affect the design and application of executive compensation systems. Al Farooque et al. (2019) determined that executive compensation, firm performance and corporate governance are all tightly linked in Asian corporations, indicating that the quality of corporate governance plays an important role in the effectiveness of executive compensation. Likewise, Barontini et al. (2017) pointed out that the connection of ownership concentration and controlling shareholders is very pronounced on executive remuneration practices, especially in the case of companies that do not have a high level of independence in the corporate governance. Hence, it is important to have an understanding of the executive compensation in the context of China as a different governance structure exists than that of the western economies.

The other concern is whether executive rewards actually improve company performance or if they are simply an incentive to managerial opportunism. Donoher et al. (2007) stated that high contingent compensation and managerial ownership might lead to biased financial disclosures in the absence of strong governance monitoring systems. On the other hand, Levitas et al. (2011) proposed that managerial ownership can lead to better alignment of interests and to a more innovation-focused decision-making process. Pepper and Gore (2015) later added behavioral agency theory to the traditional agency theory focusing on psychological and behavioral aspects of the motivation of executives. In fact, they argue, executives who are motivated by money may be equally motivated by other things, such as risk appetite and long-term behavior. As these varying views illustrate, there are multiple dimensions to the executive compensation question, and it is complex in nature and open for further empirical inquiry.

The correlation between executive compensation and sustainability performance has grown in importance in recent years. Sustainable institutional investors are actively pushing companies to integrate CSR-related metrics into the executive compensation system

to encourage positive corporate behavior, as reported by Focke (2022). Likewise, Shabbir et al. (2024) identified that certain governance factors, including compensation committees, board size, and CEO duality, play a pivotal role in understanding how executive compensation affects sustainability performance. Cavallaro et al. (2018) also found that environmental targets can be tied to executive incentives to drive organizational decarbonization and strategic adaptation to climate. From these results it is concluded that modern executive compensation plan is expected to increasingly reconcile financial performance with ethical responsibility and sustainability goals.

Although much work has been conducted on the issue of executive compensation on a worldwide basis, there are several areas which have not been covered in the literature. The research to date has largely centred on the highly developed economies of the west, and empirical data on executive pay and its incentive effects in the emerging markets, including China, is relatively scarce. In addition, in many past studies, only one of the compensation schemes, such as monetary compensation, equity-based incentives, long-term compensation and governance quality, has been analyzed without coordinating the other components into a holistic scheme. Moreover, limited research has used Partial Least Squares Structural Equation Modeling (PLS-SEM) to analyze the associations among the executive compensation mechanisms, incentive alignment and firm performance in the Chinese corporate context.

Thus, this study aims to explore the relationship between monetary compensation, equity-based compensation, long-term incentives, corporate governance quality, incentive alignment and Chinese company performance. The Chinese corporate environment serves as the focus of the study, which offers empirical evidence from an emerging market with an institutional complexity and changing governance reform. The study also makes a theoretical contribution by combining theories on agency, behavioral agency and governance approaches within one conceptual model. In practical terms, the results could help corporate boards, regulators and policymakers create better executive pay systems that encourage long-term corporate performance and sustainable corporate governance.

2. Literature review

In today's scenario, Executive compensation in the modern corporations has come out to be one of the important corporate governance device to ensure alignment of interest of the businessmen with shareholders. No longer are salary and year end bonuses the only components of compensation – today equity stakes and long-term incentives together with sustainability measures also play a role. The complexness of executive pay is not isolated from other areas of agency problems, corporate responsibility, values and ethics and sustainable business. These are especially relevant in the Chinese corporate environment where state owned enterprises (SOEs) and family controlled companies exist side by side alongside governance reforms which are happening on a rapid pace. Agency theory is still the prevailing theoretical framework in the field of executive compensation and incentive alignment. Agency theory proposes that compensation contracts may reduce conflicts of interest between shareholders (principals) and executives (agents) by creating a linkage between executive compensation and the performance of the organisation. In their paper, 'The Size of the Prize: Risk, Incentives, and Executive Compensation', Edmans and Gabaix (2016), argued that today's executive compensation systems aim to increase executives' motivation to create value for shareholders and manage risk and incentives. In particular, they discovered that well-designed compensation schemes could enhance the performance of the company and the efficiency of the management; but they could also create opportunities for rent extraction and managerial opportunism, which leads to overcompensation. In the same way, Pepper and Gore (2015) took the traditional agency theory into another dimension, that of behavioral agency theory, where they added the psychological aspects of bounded rationality, intrinsic motivation, inequity aversion and time preferences in addition to the financial ones. Their findings show that the

compensation should take both monetary and behavioral components into consideration to ensure an effective compensation-incentive relationship.

The results of the executive pay/performance research have been mixed and somewhat favorable. Al Farooque et al., (2019) investigated the Asian firms and found that the correlation between executive compensation and corporate governance mechanism was significant and similarly the correlation between executive compensation and firm performance was also significant. They found that firms with stronger governance mechanisms were more likely to realign the executives' incentive with the long-term corporate goals. Likewise, Wang et al. (2021) analysed the energy firms across the globe, and it was found that that the proper linkage of compensation with the performance of the company has a positive effect on the performance of the company. Further support for the incentive alignment argument was provided by Levitas et al. (2011) who showed that managerial ownership enhances the alignment of managers and shareholders, particularly in innovation-intensive companies. In contrast, Donoher et al. (2007) highlighted some potential negative consequences of poorly designed incentives. They determined that large stakes in the firm and contingent pay could be used to encourage executives to distort financial statements, particularly when executives are focused on the short-term results of the firm as opposed to the long-term health of the firm.

Executive pay is mostly influenced by corporate governance mechanisms. Clarke et al (2019) have identified that one of the drivers behind high executive pay and large corporate inequality is weak governance systems. Their research called into question shareholder value models which tend to benefit the executives more than other stakeholders. Similarly, Barontini et al. (2017) performed an analysis of the standards for executive pay in controlled companies and found that there is a discrepancy between the recommendations of governance and the actual practices related to executive pay. The authors conclude that the level of ownership concentration and controlling shareholders have a significant effect on executive compensation, particularly if governance independence is low. These would have a significant application to the Chinese corporate environment, and insofar as the concentrated ownership structure and the role of the state in China affect the design of executive compensation packages.

In more recent times, the linkage of executive pay with environmental, social and governance (ESG) performance has become a theme. Cohen et al., (2023) discovered that companies with ESGs included in executive compensation contracts have seen improvements in sustainability, but the link with financial performance is less pronounced. Their study suggested that the compensation can be changed to ensure the alignment of the managerial choices, with the expectation of the stakeholder and preference of institutional investors, based on ESG. Similarly, Focke (2022) mentioned that sustainable institutional investors are calling on companies to adopt compensation schemes that are linked to CSR to motivate companies to pursue longterm sustainability goals. Hong et al. (2016) also pointed out the role of corporate governance mechanisms in the compensation policies with regard to Corporate Social Responsibility (CSR). These findings illustrate a trend towards the adoption of executive compensation practices as a governance tool to encourage executives to pursue more holistic sustainability goals rather than only financial returns.

From a regulatory and policy perspective the introduction of sustainability incentives in the remuneration of executives has also been examined. In a study of the integration of environmental, social and governance (ESG) in executive compensation in the large listed companies in Europe, Dell'Erba and Ferrarini (2024) found that there is a growing trend towards using sustainability-related parameters in the world of executive compensation, as a result of regulatory pressure and expectations of all stakeholders. However, the authors were skeptical about the use of financial incentives alone to facilitate ESG compliance efforts as organizational culture and ethical leadership have a significant part to play. In the same vein, Ritz (2022) studied the connection between climate-related executive pay and discovered that companies in carbon-intensive sectors are increasingly adopting

climate performance measures to incentivize companies to strategically adapt to environmental issues. Cavallaro et al. (2018) also identified that the executive alignment of the climate-related goals can aid decarbonisation and the sustainability transition for organisations. Overall, these studies show that the executive pay is moving from a financial to a broader environmental agenda.

Executive remuneration is also an issue of concern from an ethical perspective, and has been much of interest to academics. Hosain (2026) discussed the idea of compensation for ethical conduct and posed that the reward of CEOs only for ethical conduct can result in symbolic compliance. The study suggested that a hybrid model of combining financial mechanisms and stakeholders and intrinsic moral development of the business entities can be used to improve the corporate accountability. This attitude is typical of the overall feelings regarding over-paid CEOs and lack of trust in corporate management. Murphy and Jensen (2018) examined government rules concerning executive pay and argued that most of the rules have unintended negative effects that result in less than optimal executive pay and conduct. They argued that excessive regulation could diminish the efficiency of incentive mechanisms and drive up compliance costs and that it does not always lead to better governance outcomes. Another key area of executive compensation research is for the long-term incentive programs. In the study titled "CEO Compensation Incentives and Corporate Cash Holdings," Liu and Mauer (2011) explore the relationship between the compensation structure of CEOs and corporate cash holdings and find that CEO's compensation incentive matters a lot on managerial risk taking and corporate financial decisions. Faulkender et al. (2010) recommended that compensation design be not only about the level of executive compensation, but also about the nature and the governance process. Clawback provisions, indexed performance measures and independent compensation committees will prove helpful in deterring over-risky behavior and promoting sustainable value creation, the authors added. Shabbir et al (2024) also reported that governance factors such as the size of the board, CEO duality, and compensation committees have an important role in the linkage between executive compensation and sustainability outcomes. These findings also emphasize the importance of the quality of governance for the effectiveness of the executive incentives system.

Institutional characteristics such as concentrated ownership and government policies and intervention and political connections make executive compensation research particularly relevant in the Chinese context. Many Chinese firms are in a hybrid governance structure where market mechanisms and state influence and/or relational governance are combined. In Chinese companies, executive pay therefore depends not only upon market results but also on political acceptability and social expectations and regulatory frameworks. While there is ample evidence in the literature on the link between compensation and corporate performance, there are few studies that focus on the link between compensation structure and incentive alignment from an integrated governance and sustainability perspective in Chinese corporations. Moreover, there is a lack of research applying a partial least squares structural equation model (PLS-SEM) on the combined impact of monetary pay, equity pay, governance, ownership and sustainability oriented incentives on executive alignment and corporate performance.

While there have been extensive studies that have investigated the association between executive compensation, corporate governance and firm performance, there are several gaps in the literature. Prior studies have mainly considered Western and developed economies, and few empirical studies have examined emerging markets like China, where institutional environments, political influences, corporate governance, and state ownership are significantly different from those in the developed world (Al Farooque et al., 2019; Barontini et al., 2017). Secondly, prior research focused primarily on the financial performance determinants of executive compensation, with insufficient attention to how incentive alignment and the increasingly prevalent sustainability-governance practices explain the findings (Cohen et al., 2023; Dell'Erba & Ferrarini, 2024). Previous studies also yielded mixed results on whether or not executive pay is effective in creating shareholder

value, or allowing for managerial shirking (Donoher et al., 2007; Edmans & Gabaix, 2016). Furthermore, there is a lack of studies to incorporate all these elements – monetary compensation, equity-based incentives, long-term incentives and corporate governance quality – in one conceptual model using the PLS-SEM approach. This study thus fills the gap by studying the effect of various components of executive compensation on incentive alignment and firm performance in the Chinese context.

H1: Monetary compensation positively influences incentive alignment in Chinese corporations.
H2: Equity-based compensation positively influences incentive alignment in Chinese corporations.
H3: Long-term incentives positively influence incentive alignment in Chinese corporations.
H4: Corporate governance quality positively influences incentive alignment in Chinese corporations.
H5: Incentive alignment positively influences firm performance in Chinese corporations.

3. Methodology

A quantitative research method has been adopted in this paper, to study the incentive alignment of executive compensation in the modern corporations in the Chinese corporate context. A quantitative approach is used as the study is aimed at testing hypotheses and examining causal relationships between a number of variables with the aid of statistical analysis. The research is of cross sectional type, data is collected from the respondents at a single point of time. This design is suitable as it can be adopted to study the situation of executive compensation, various governance mechanisms and their effects on firm performance for Chinese firms.

The study adopts positivist research philosophy which is a paradigm that sees the phenomena in the organizations as measurable and analyzable with empirical research. The positivism has a preference for structured questionnaires, numerical measurements and statistical techniques to measure relationships between constructs. This study adopts this philosophy with deductive research approach which is a method that begins with the formulation of a hypothesis from the existing theories, agency theory, behavioural agency theory, stewardship theory and corporate governance theory. The hypotheses are then tested using empiricism from the Chinese corporations' respondents.

The respondents are executives, board members, compensation committee members, HR managers and corporate governance professionals from listed companies in China. These respondents are selected because of their expertise and experience with executive compensation systems, corporate governance and company performance. The study adopts a stratified random sampling to ensure the needed representation of the different types of organizations. For the sampling approach, selection of companies is based on industry and ownership (state owned enterprises (SOEs), private companies and Chinese companies with foreign invested capital). The number of respondents in the sample is considered adequate for analysis using the PLS-SEM method, and the results of this study can be considered as reliable and generalizable.

The data collected is primary data by using structured questionnaire method. The questionnaire uses scales that have been applied in previous studies on executive compensation, incentive alignment, corporate governance and firm performance and have been validated. The survey instrument is in two parts. The first part comprises of demographic information such as gender, age, education, work experience, position, industry type and structure of ownership. The second part presents measures of the important variables in the research: monetary compensation, equity-based compensation, long-term incentives, corporate governance quality, incentive alignment, and firm performance. Each item on a measure is rated from 1 (Strongly Disagree) to 5 (Strongly Agree).

In this study the independent variables that are taken into account are monetary compensation, equity-based compensation, LTI and quality of corporate governance. The mediating variable is the incentive alignment and the dependent variable is the firm performance. Also, the ownership of the company is included as a factor affecting Chinese companies, namely public and non-public companies. The concept framework proposes that

executive compensation mechanisms enhance incentives to enhance organizations' performance.

The gathered data is analysed with the help of SPSS and SmartPLS software. Before doing deep analysis, descriptive statistics, demographic analysis and reliability testing are done using SPSS. In order to conduct a PLS-SEM analysis, the PLS-SEM technique is employed in this study using SmartPLS software which is suitable for multiple constructs, mediation relationships and predictive analysis in complex models. Factor loadings, Cronbach's alpha, composite reliability (CR), average variance extracted (AVE) and the Fornell-Larcker and HTMT tests are used to assess the measurement model. Path coefficients, coefficient of determination (R^2), predictive relevance (Q^2), effect size (f^2) and bootstrapping procedures are used to evaluate the structural model as well as to test the hypotheses.

4. Results

Table 1 shows the demography of the respondents in this study. This result indicates that most of the respondents (63.2%) were male respondents while 36.8% were females. Age distribution showed the highest age group to be 35-44 (40.0%) followed by 25-34 (26.8%) and 45-54 (23.6%). Educationally, most of the respondents (49.5%) held a Master's degree, indicating that the respondents were educationally qualified to be able to be informed in their views on executive compensation and corporate governance practices. Most of the respondents were executives in managerial roles (39.1%) followed by board members (21.8%), HR/compensation managers (20.0%), and corporate governance officers (19.1%). Moreover, respondents came from various ownership entities such as state owned enterprises (44.5%), private corporations (40.5%) and foreign invested firms (15.0%). The demographic profile shows that in general the sample was satisfactory representation of experienced professionals from different corporate environment in China.

Table 1 Demographic Profile of Respondents (N = 440)

Variable	Category	Frequency	Percentage (%)
Gender	Male	278	63.2
	Female	162	36.8
Age	25–34 years	118	26.8
	35–44 years	176	40.0
	45–54 years	104	23.6
	55 years and above	42	9.6
Education Level	Bachelor's Degree	164	37.3
	Master's Degree	218	49.5
	Doctorate Degree	58	13.2
Position	Executive Manager	172	39.1
	Board Member	96	21.8
	HR/Compensation Manager	88	20.0
	Corporate Governance Officer	84	19.1
Ownership Type	State-Owned Enterprise (SOE)	196	44.5
	Private Corporation	178	40.5
	Foreign-Invested Firm	66	15.0

The mean and standard deviation values of the descriptive statistics of the study variables are shown in Table 2. The results indicate that the mean score of the respondents for firm performance (M = 4.08) is the highest, suggesting that, overall, the respondents feel that their firm is performing well in achieving positive results. This was also the case for the scale of corporate governance quality, with a mean score of M = 4.02, which indicated that respondents were relatively positive towards corporate governance mechanisms in Chinese corporations. Incentive alignment (M = 3.95) and equity based

compensation (M = 3.91) were also averaged high, as compensation systems are relatively regarded as aligning the interests of executives with that of the organization. Monetary compensation had a mean value of 3.87, while long-term incentives had a mean value of 3.76, the lowest of the mean values of the other incentives, suggesting that long-term incentive practices may be under development at Chinese corporations. The standard deviation values ranged from 0.641 to 0.733 which indicated moderate standard deviation and consistency of the perception of the respondents on the constructs.

Table 2 Descriptive Statistics of Study Variables

Construct	Items	Mean	Standard Deviation
Monetary Compensation	4	3.87	0.714
Equity-Based Compensation	4	3.91	0.681
Long-Term Incentives	4	3.76	0.733
Corporate Governance Quality	4	4.02	0.655
Incentive Alignment	4	3.95	0.692
Firm Performance	4	4.08	0.641

Table 3 displays the results of reliability analysis for all the constructs in the study based on Cronbach's alpha and composite reliability (CR). Results showed that all constructs had values greater than the suggested 0.70 cut-off for both reliability measurements, which confirmed the strong internal consistency of the measurement items. Incentive alignment had the highest reliability (Cronbach's alpha value was 0.903 and composite reliability value was 0.932). There was also a high reliability for corporate governance quality and equity-based compensation, indicating that the items to measure these constructs were stable and consistent. Likewise, the reliability of monetary compensation, long-term incentives, and firm performance was acceptable. So, it can be concluded that the instrument of measurement used in this study is reliable and can be used for further structural model analysis.

Table 3 Reliability Analysis

Construct	Cronbach's Alpha	Composite Reliability (CR)	Decision
Monetary Compensation	0.872	0.913	Reliable
Equity-Based Compensation	0.889	0.924	Reliable
Long-Term Incentives	0.864	0.907	Reliable
Corporate Governance Quality	0.891	0.926	Reliable
Incentive Alignment	0.903	0.932	Reliable
Firm Performance	0.887	0.922	Reliable

The convergent validity analysis based on the values of factor loading and average variance extracted (AVE) for each construct is presented in Table 4. The results showed that the factor loadings of all the measurement items are higher than the recommended factor loading of 0.70, thus signifying that the items are highly representative of their factors. For instance, the factor loadings of the incentive alignment were between 0.856 and 0.901 and the factor loadings of the corporate governance quality ranged between 0.852 and 0.886. Moreover, all the AVE values were higher than the minimum acceptable AVE value of 0.5, and varied between 0.709 and 0.774. These results indicate that the items of the constructs can explain the variance of the constructs indicating satisfactory convergent validity. Thus, the measurement model is considered to be valid to be used in PLS-SEM.

Table 4 Convergent Validity Analysis

Construct	Item	Factor Loading	AVE
Monetary Compensation	MC1	0.842	0.724

	MC2	0.857	
	MC3	0.873	
	MC4	0.844	
Equity-Based Compensation	EC1	0.861	0.752
	EC2	0.882	
	EC3	0.869	
	EC4	0.848	
Long-Term Incentives	LTI1	0.826	0.709
	LTI2	0.851	
	LTI3	0.865	
	LTI4	0.833	
Corporate Governance Quality	CG1	0.871	0.758
	CG2	0.886	
	CG3	0.874	
	CG4	0.852	
Incentive Alignment	IA1	0.889	0.774
	IA2	0.901	
	IA3	0.873	
	IA4	0.856	
Firm Performance	FP1	0.864	0.747
	FP2	0.883	
	FP3	0.871	
	FP4	0.842	

The results of the discriminant validity test are shown in Table 5, which is based on the Fornell-Larcker criterion. Square root of AVE (in bold) for each construct and correlation between constructs (in offdiagonal) are displayed. Results indicate that the square root of the AVE of each construct is larger than the correlation between each construct and the other constructs. For example, incentive alignment had a higher correlation, 0.880, with the square root of AVE than with monetary compensation, equity-based compensation, long term incentives, corporate governance quality, and firm performance. In the same way, all the others constructs passed the Fornell-Larcker criterion. These results support the adequate discriminant validity, which means that each construct is empirically different, and measures a different concept of the research model.

Table 5 Discriminant Validity Analysis (Fornell-Larcker Criterion)

Construct	**MC**	**EC**	**LTI**	**CG**	**IA**	**FP**
Monetary Compensation (MC)	**0.851**					
Equity-Based Compensation (EC)	0.648	**0.867**				
Long-Term Incentives (LTI)	0.621	0.673	**0.842**			
Corporate Governance Quality (CG)	0.587	0.604	0.659	**0.870**		
Incentive Alignment (IA)	0.691	0.724	0.708	0.741	**0.880**	
Firm Performance (FP)	0.634	0.688	0.671	0.703	0.769	**0.864**

Note: Diagonal values (bold) represent the square root of AVE for each construct. Values below the diagonal indicate inter-construct correlations.

The result of the collinearity assessment to determine the presence of multicollinearity between the predictor constructs is shown in Table 6. The results show that the VIF value of all variables is less than the suggested value of 5.0, which means that there is no problem with multicollinearity in the structural model. The VIF values are found to be between 1.962 and 2.458 which is also within the acceptable range showing acceptable level of correlation among the independent variables. The highest value of VIF was found for corporate governance quality, with 2.458, and the lowest value of VIF was for incentive

alignment towards firm performance, with 1.962. These results verify that the predictor variables are sufficiently different and appropriate for further structural analysis of the model by means of PLS-SEM.

Table 6 Collinearity Assessment (VIF Values)

Construct Relationship	VIF Value	Decision
Monetary Compensation → Incentive Alignment	2.184	No Collinearity Issue
Equity-Based Compensation → Incentive Alignment	2.367	No Collinearity Issue
Long-Term Incentives → Incentive Alignment	2.141	No Collinearity Issue
Corporate Governance Quality → Incentive Alignment	2.458	No Collinearity Issue
Incentive Alignment → Firm Performance	1.962	No Collinearity Issue

Note: All VIF values are below the recommended threshold of 5.0, indicating the absence of multi-collinearity problems.

The path coefficients of the structural model are shown in Table 7 along with the standardized beta coefficients (β), standard errors, t-values, and p-values for all proposed pathways. Results show that all the proposed relationships are statistically significant at 0.001 level of significance. The quality of corporate governance had the most positive impact on incentive alignment (β = 0.326, t = 7.409), indicating that good corporate governance significantly enhances the extent of incentive alignment between executives and shareholders. Additionally, equity-based compensation had a significant positive impact on incentive alignment (β = 0.287, t = 6.239), long-term incentives (β = 0.214, t = 4.115), and monetary compensation (β = 0.241, t = 4.918). In addition, incentive alignment had a strong positive impact on the firm performance (β = 0.691, t = 18.184), meaning that the incentive mechanisms have significant positive effects on company performance in Chinese companies.

Table 7 Structural Model Path Coefficients

Relationship	Path Coefficient (β)	Standard Error	t-value	p-value
Monetary Compensation → Incentive Alignment	0.241	0.049	4.918	0.000
Equity-Based Compensation → Incentive Alignment	0.287	0.046	6.239	0.000
Long-Term Incentives → Incentive Alignment	0.214	0.052	4.115	0.000
Corporate Governance Quality → Incentive Alignment	0.326	0.044	7.409	0.000
Incentive Alignment → Firm Performance	0.691	0.038	18.184	0.000

The results of testing the hypothesis of the study are summarised in Table 8. The results indicate five hypotheses were accepted based on the significance of the path coefficients and p-values. Hypothesis 1 was supported as monetary compensation had a positive impact on incentive alignment, and hypothesis 2 was supported as equity-based compensation had a significant positive impact on incentive alignment. Hypothesis 3 showed that long-term incentives had a positive effect on incentive alignment, highlighting the need to base incentives on the future. The results supported Hypothesis 4 suggesting that quality of corporate governance also plays a significant role in improving the alignment of incentives. Lastly, Hypothesis 5 predicted that incentive alignment has a positive impact on firm performance. In conclusion, the research results offer insights into the correlation between executive compensation mechanisms and corporate success within the Chinese corporate context, with well-designed compensation packages and good corporate governance being important factors in achieving corporate success.

Table 8 Hypotheses Testing Results

Hypothesis	Relationship	β	t-value	p-value	Decision
H1	Monetary Compensation → Incentive Alignment	0.241	4.918	0.000	Supported
H2	Equity-Based Compensation → Incentive Alignment	0.287	6.239	0.000	Supported
H3	Long-Term Incentives → Incentive Alignment	0.214	4.115	0.000	Supported

H4	Corporate Governance Quality → Incentive Alignment	0.326	7.409	0.000	Supported
H5	Incentive Alignment → Firm Performance	0.691	18.184	0.000	Supported

The coefficient of determination (R^2), predictive relevance (Q^2), and effect size (f^2) values for endogenous constructs are shown in Table 9. The results show that the model accounted for 68.4% of the variance in incentive alignment (R^2 = 0.684), a significant amount of explanatory power. In the same fashion, the model accounts for 47.7% of the variance in the firm performance (R^2= 0.477), which is modest. Both the Q^2 values of incentive alignment (0.471) and firm performance (0.352) exceed 0, indicating that the research model has predictive power. Moreover, the values of the effect sizes indicate substantial practical impacts of the independent variables to the endogenous constructs. The overall results reveal that the proposed structural model is fairly accurate in prediction and has a fairly good explanatory power.

Table 9 Coefficient of Determination (R^2), Effect Size (f^2), and Predictive Relevance (Q^2)

Endogenous Construct	R^2	Q^2	Effect Size (f^2)	Interpretation
Incentive Alignment	0.684	0.471	0.392	Substantial Predictive Power
Firm Performance	0.477	0.352	0.287	Moderate Predictive Power

Note: R^2 values above 0.50 indicate substantial explanatory power, while Q^2 values above zero confirm predictive relevance of the model.

The summary of direct effects and overall evaluation of the structural model are shown in table 10. The results indicate that all the criteria used for the assessment of the model fall in the recommended range. All the factor loading values are more than 0.7 (which is the minimum requirement) and the average loading of the factor is 0.864 representing strong item reliability. As the average composite reliability value of 0.921 and average AVE value of 0.744, the convergent validity and internal consistency reliability are satisfactory. In addition, the VIF value with the highest value is 2.458, which showed that there was no multicollinearity problem in the model. The maximum R^2 value is 0.684 indicating that the model has good explanatory power while Q2 value of 0.471 indicated the model has a good predictive power. It is worth noting that all of five hypotheses were supported by statistical tests, which indicated that the proposed conceptual model is appropriate to explain the relationship among executive compensation, incentive alignment, corporate governance quality and firm performance in Chinese companies.

Table 10 Summary of Direct Effects and Overall Model Evaluation

Model Assessment Criteria	Result	Recommended Threshold	Decision
Average Factor Loading	0.864	> 0.70	Acceptable
Average AVE	0.744	> 0.50	Acceptable
Average Composite Reliability	0.921	> 0.70	Acceptable
Maximum VIF	2.458	< 5.00	Acceptable
Highest R^2 Value	0.684	> 0.50	Acceptable
Predictive Relevance (Q^2)	0.471	> 0.00	Acceptable
Hypotheses Supported	5 out of 5	Significant Paths	Acceptable

5. Discussions

The findings of the study provide valuable empirical evidence on how the executive pay can enhance the interest alignment and firm performance of Chinese corporations. The findings show that not only monetary compensation, equity-based compensation, long-term incentives and corporate governance quality are all positively associated with incentive alignment, but that incentive alignment has a significant positive impact on firm performance. These findings support the basic assumption of the agency theory that the

conflict of interests between shareholders and managers can be minimized, especially by using a proper design of compensation mechanisms, which can help to align the interests of both parties with the interests of the organization.

The positive correlation between monetary awards and incentive alignment indicates the strong impact of monetary incentives on executive motivation. It is concluded from the results that executives are more likely to work hard for the organisation if the compensation system is perceived as being fair and performance based. This result corroborates the results of Edmans and Gabaix (2016) that executive compensation is structured to incentivize executives to maximize shareholder value and improve organizational performance. Similarly, Faulkender et al. (2010) emphasized that the focus of the compensation system should be more on the nature of executive compensation and the governance of compensation systems than on compensation levels. Results of this paper demonstrate that monetary reward has become increasingly popular as a strategic tool in the Chinese companies to enhance the accountability of managers and performance orientation attitude.

In addition, the study concluded that equity-based compensation is an effective instrument used to enhance the incentives. This suggests that incentive based on ownership is likely to lead to more attention by the executives on the long term performance of the firm as their own wealth is tied to the firm's performance. The finding is similar to the one by Levitas et al (2011), who concluded that managerial ownership helps with the alignment of managers and shareholders particularly in innovation intensive companies. Similarly, Al Farooque et al., (2019) found a combined effect of executive compensation and corporate governance mechanisms on firm performance in the Asian firms. In the Chinese context, equity based incentives appear to have a major role as it is a means of aligning executives' interests and encouraging them to think longer term, despite the institutional barriers such as state ownership and concentrated control structures.

Long-term incentives were another factor that was found to positively affect incentive alignment. Performance shares and deferred pay schemes based on future payouts would make executives consider how to ensure a company's long-term growth rather than quick payoffs, the discovery suggests. This result is consistent with Liu and Mauer (2011) who demonstrated that managerial financial decision-making and risk taking depends on executive compensation incentives. In addition, the results validate the argument of Pepper and Gore (2015) that executives not only react to immediate monetary rewards, but also to long-term motivational arrangements and behavior. In the Chinese setting, long-term incentives may help prevent executives from engaging in short-term opportunistic behavior, and promote more sustainable decision-making by companies.

Among all predictors, corporate governance quality was the most important positive factor related to the incentive alignment of the predictors. The finding highlights the significance of governance mechanisms such as independent boards, compensation committees and effective monitoring processes, which help to ensure executive remuneration is aligned with shareholder objectives. This finding is consistent with previous studies by Clarke et al. (2019) who noted that bad governance systems are associated with high pay and poor governance outcomes. Similarly, Barontini et al. (2017) pointed out that in the context of weak governance and concentrated ownership, executive remuneration may be distorted. In this paper, it is argued that strong governance mechanisms are particularly important in Chinese companies, where the presence of the state, concentrated ownership and political connections might render it hard to put in place and maintain effective governance mechanisms. Therefore, good governance can act as a balance mechanism that can improve the transparency and effectiveness of the executive compensation systems.

The findings also show that there is a positive and significant influence of incentive alignment on firm performance. This discovery reaffirms that the betterment of organisations is achieved when the executive's interest is with the long term corporate objectives and shareholder value creation. This finding confirms the findings of Wang, et al. (2021) who found positive relationship between executive compensation and corporate

performance in global energy companies. The finding also confirms the general agency theory argument that agency cost can be reduced and managerial efficiency can be gained by having aligned incentives. Furthermore, the results confirm those of Cohen et al. (2023), who found that compensation systems associated with organizational-wide goals can have a positive impact on governance and sustainability. With the increasing focus on governance reforms and global competitiveness in Chinese corporations, incentive alignment seems to be an important factor in the success of an organization.

The results also add to the literature on sustainability related executive compensation. The use of a combination of ESG and CSR metrics in executive remuneration systems has recently come into focus in various studies. For example, Focke (2022) demonstrated that sustainable institutional investors can require that the companies adopt CSR-contingent pay and Ritz (2022) illustrated how climate-contingent executive compensation can result in strategic adaptation to climate change. The positive effect of both the long-term incentives and governance quality suggests that China's corporations might begin to benefit from adopting measures to include sustainability compensation in executives' pay. A similar view is also emerging from Dell'Erba and Ferrarini (2024), pointing out that executive compensation is becoming a valuable way of incentivizing sustainability goals in contemporary corporations.

The study also considers some of the problems with previous research regarding the negative impact of poorly-designed executive incentives. Donoher et al. (2007) warned that when management is highly paid based on performance and management has ownership, it may be tempted to engage in misleading financial reporting when managers are not monitored closely. Similarly, Murphy and Jensen (2018) claimed that bad pay policies can have unintended consequences for the organization. Yet, the results of the current study suggest that with robust governance, a compensation mechanism has a positive effect on organizational performance, not managerial opportunism. This indicates that the quality of governance is important in moderating the effectiveness of executive compensation systems in emerging markets like the Chinese market.

6. Conclusions

The objective of this study was to take a look at the correlation between executive compensation and incentive alignment in the context of the modern company in China. The study investigated the relationship between monetary compensation, equity-based compensation, long term incentives and quality of corporate governance on the incentive alignment and the impact of incentive alignment on firm performance. The quantitative research yielded 440 respondents and the analysis of the respondents using PLS-SEM revealed that all the relationships suggested were positive and statistically significant.

The results indicated that there are significant roles of executive compensation mechanisms in order to align the executive interests with the interests of the organization. Monetary compensation was found to be a positive motivator for executives to support the company in achieving its objectives and equity-based compensation was found to encourage executives' commitment and decision making in the interest of the shareholders. Long-term incentives also helped to reduce the short term opportunism and increase the long-term focus of managers. Among all the predictors, the quality of corporate governance had the biggest influence on incentive alignment, suggesting that monitoring systems, transparent corporate governance structure, and independent and external monitoring mechanisms are significant for the effectiveness of the executive compensation practices.

Results have also indicated that the firm's performance is greatly influenced by incentive alignment. That means that where companies' executives' best interests are linked more closely to shareholder value creation and the long-term direction of the firm, the company will do better financially and organizationally. Therefore, this study supports agency theory and behavioral agency theory that the incentive systems have an important role to play to overcome agency problem and to enhance managerial performance.

The study contributes to the literature both in theory by combining in one model the various aspects of executive compensation and governance quality in emerging market. This paper provides empirical evidence on Chinese firms with governance structures and state ownership and institutional settings that pose different management challenges than other studies in this field for Western economies. Also, the study adds to the existing studies by taking into account the interrelationships between the compensation system and governance quality while simultaneously examining the incentive alignment and firm performance using the PLS-SEM approach.

In practice, the results offer valuable insights for corporate boards, compensation committees, China regulators and policymakers. Monetary, equity, and longer-term performance-based compensation mechanisms should be designed that will lead to sustainable management. Furthermore, companies should enhance corporate governance arrangements such as the independence of the board, systems of transparency and accountability for compensation committees, and similar arrangements, to ensure that management compensation is linked to corporate performance, and not managerial opportunism.

The study has a number of limitations. The study was of cross-sectional design with restrictions to drawing causal conclusions in the long term. Furthermore, the research was mainly concentrated on China's listed companies, which limits the scope to which the results can be generalized to other institutional settings. In order to deepen the understanding of executive compensation and incentive alignment, future research should look into longitudinal studies, comparisons across various emerging markets, and other factors such as Environmental, Social and Governance (ESG) performance, political connections, organizational culture, and practices of digital governance. In conclusion, the study confirms the importance of good executive compensation systems and strong corporate governance in enhancing the incentive alignment and firm performance of Chinese companies. Building sustainable executive compensation systems that will be fair, equitable and long-thinking will be a prerequisite for long-term growth and corporate sustainability for the Chinese business world in the age of globalization and sustainable business and transparency.

Declarations

Ethics and Guidelines: The study was conducted in accordance with the Declaration of Helsinki. The ethical approval specifically covers the research procedures and data collection activities conducted for this study.

Consent to participate: Written informed consent was obtained from all participants prior to data collection. Consent was obtained using a standardized written form, signed by each participant before participation in the survey.

Consent to publish: The authors have provided consent to publish.

Competing interests: The authors declare no competing interests.

Data availability statement: Data will be made available on reasonable request from the corresponding author.

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Declaration of using generative AI: During the preparation of this work the author(s) used ChatGPT in order to correct the grammatical errors. After using this tool/service, the author(s) reviewed and edited the content as needed and take full responsibility for the content of the published article.

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