The Role of Earning Per Share Target and Analyst Forecast in Shaping CEO Compensation Structures and Driving Strategic Decision Makin

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***Abstract**. This research examines CEO compensation schemes by contrasting analyst expectations with earning per share (EPS) targets. The study synthesizes recent literature to investigate how various compensation systems affect management behavior, corporate governance, and financial performance. The results show that CEOs are motivated by EPS objectives to participate in earnings management strategies, which involve influencing financial outcomes to satisfy preset benchmarks. Managerial decision-making is heavily influenced by analyst projections, which motivate strategic action intended to align company performance with market expectations. The analysis underscores the governance implication, emphasizing the trade-offs between immediate financial objectives and long-term sustainability.*

***Keywords :** CEO Compensation, earnings per share targets, analyst forecasts, corporate governance, earnings management*

1. INTRODUCTION

In corporate governance, the alignment of executive compensation with firm performance remains a pivotal concern, particularly concerning the formulation and achievement of earnings per share (EPS) targets. This qualitative literature review explores the dynamics between EPS targets set by boards of directors and analysts' forecasts, examining how these compentation s shape CEO behavior and corporate outcomes.

EPS targets serve as critical benchmarks for executive compensation, influencing managerial decisions and performance evaluations (Armstrong et al., 2024). The attainment of these targets not only determines financial rewards but also reflects management's ability to meet market expectations and operational goals (Ali & Zhang, 2015). Our review focuses on the comparative analysis of EPS targets established by boards and the EPS forecasts developed by financial analysts, highlighting the distinct motivations and implications associated with each.

Boards of directors play a pivotal role in setting EPS targets that are intended to incentivize CEOs towards achieving specific financial outcomes (Bartov et al., 2002; Baumann et al., 2021). These targets often serve as benchmarks against which executive performance and subsequent bonuses are evaluated (Bennett et al., 2017; Bens et al., 2003). Concurrently, financial analysts provide initial and final EPS forecasts based on market conditions, industry

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trends, and company-specific factors (Kasznik & McNichols, 2002; Skinner & Sloan, 2002). The divergence or alignment between these forecasts and internal EPS targets presents an intriguing area for investigation, as it sheds light on how CEOs navigate between internal expectations and external market pressures.

Research indicates that while CEOs frequently meet or exceed analysts' EPS forecasts, they often struggle to achieve internal EPS targets that exceed these forecasts (Graham et al., 2005; Healy, 1985). This discrepancy suggests that while analysts' forecasts serve as benchmarks of market expectations, internal EPS targets set by boards may pose more stringent performance challenges and, consequently, higher performance rewards (Holthausen et al., 1995). CEOs with more attainable bonus EPS targets relative to analysts forecasts tend to receive higher annual pay, underscoring boards' practices to balance compensation alignment with achievable performance metrics (Kim & Ng, 2018; Kwon et al., 2018). This phenomenon reflects a strategic alignment by boards to motivate CEOs while maintaining the appearance of pay-for-performance alignment (Huang et al., 2014).

2. LITERATURE REVIEW

CEO compensation structures are pivotal in aligning managerial compensations with shareholder interests (Armstrong et al., 2024). Specifically, earnings per share (EPS) targets are commonly used to incentivize CEOs towards achieving financial performance goals (Ali & Zhang, 2015). Research indicates that CEO tenure influences earnings management practices, where longer tenures may correlate with reduced earnings management (Banker et al., 2009).

In the context of compensation contracting, the value relevance of earnings and cash flows plays a critical role in determining CEO compensation (Bartov et al., 2002). Studies suggest that meeting or beating earnings expectations can lead to significant rewards for CEOs (Baumann et al., 2021), thereby highlighting the importance of external performance goals in shaping executive compensation (Bennett et al., 2017). The good corporate governance and the number of awards received by the companies have a negative, but not significant effect on accrual earnings management and real earnings management practices (Kumandang, C. & Hendriyeni, N.S., 2021). Further exploration into the impact of employee stock options and EPS dilution reveals complexities in designing optimal CEO compensation structures (Bens et al., 2003). Disentangling managers' and analysts' roles in non-GAAP reporting underscores the influence of external expectations on financial disclosures (Bentley et al., 2018). Recent studies emphasize the strategic use of analyst forecasts in setting CEO compensation goals, emphasizing the role of financial analysts in shaping managerial compensation (Bhojraj et al., 2009). This aligns with findings that show how surpassing analyst forecasts can impact CEO pay (Black et al., 2022).

Moreover, the literature on CEO compensation underscores the role of corporate governance mechanisms in mitigating agency problems (Bushman & Smith, 2001). Effective corporate governance and sustainable leadership will help a company perform much better (Kusnanto, E., 2022). Financial accounting information is pivotal in enhancing transparency and accountability in executive compensation practices (Cattaneo et al., 2020).

3. METHODS

This qualitative literature review synthesizes and analyzes existing scholarly works to investigate CEO compensation structures, specifically focusing on EPS targets and analyst forecasts. The methodology follows a systematic approach to identify, review, and synthesize relevant literature. To begin, a comprehensive search was conducted across academic databases to retrieve peer-reviewed articles, conference proceedings, and relevant books on CEO compensation and compensation structures (Ali & Zhang, 2015; Baumann et al., 2021). The search strategy employed a combination of keywords including "CEO compensation," "earnings per share targets," and "analyst forecasts," ensuring broad coverage of the topic (Armstrong et al., 2024). Selection criteria included studies published up to 2024 to capture recent developments and trends in CEO compensation practices (Bartov et al., 2002; Bennett et al., 2017). Only studies written in English and focusing on publicly traded companies in various industries were considered to maintain relevance and comparability (Bhojraj et al., 2009; Black et al., 2022).

The retrieved literature was then systematically reviewed and categorized based on thematic relevance to EPS targets, analyst forecasts, and their impact on CEO behavior and firm performance (Bentley et al., 2018; Bushman & Smith, 2001). Key themes explored included the design of CEO compensation contracts, the role of financial analysts in setting performance benchmarks, and the alignment of CEO compensations with shareholder interests (Cattaneo et al., 2020; Bushman & Smith, 2001).

4. RESULTS

Research indicates that EPS targets are commonly used in executive compensation contracts to align managerial actions with shareholder interests (Armstrong et al., 2024). Studies suggest that CEOs are incentivized to meet or exceed these targets, often employing discretionary accruals and financial reporting strategies to manage earnings to meet analyst expectations (Ali & Zhang, 2015; Baumann et al., 2021). The alignment of EPS targets with analyst forecasts influences managerial behavior, impacting firm performance and investor perceptions (Bartov et al., 2002; Bennett et al., 2017). CEOs facing pressure to meet or beat forecasts may engage in earnings management practices to avoid negative market reactions and to secure performance-based bonuses (Bhojraj et al., 2009; Black et al., 2022).

Moreover, the literature highlights the role of financial analysts in setting performance benchmarks and influencing CEO compensation decisions (Bushman & Smith, 2001). Analysts' forecasts serve as external metrics that CEOs often target to enhance corporate governance and shareholder value (Cattaneo et al., 2020). The interplay between EPS targets and analyst forecasts underscores the complexity of compensation structures in corporate governance, shaping managerial decision-making and financial reporting practices (Bentley et al., 2018).

Overall, the review underscores the importance of understanding how EPS targets and analyst forecasts interact in shaping CEO compensation structures and corporate performance. Future research could explore additional factors influencing executive compensation and governance practices in diverse organizational contexts (Bushman & Smith, 2001; Baumann et al., 2021).

5. DISCUSSION

EPS targets are integral to CEO compensation schemes, aiming to align managerial actions with shareholder interests (Armstrong et al., 2024). Research suggests that CEOs often manipulate earnings to meet or exceed these targets, employing accruals and financial reporting strategies that can influence corporate performance metrics (Ali & Zhang, 2015; Baumann et al., 2021). Recent studies highlight the complex relationship between EPS targets and CEO behavior. For instance, Baumann et al. (2021) argue that the asymmetric ratcheting effect of external goals can drive CEOs to adapt their strategies, focusing on short-term results to meet analyst expectations. This behavior underscores the importance of understanding how compensation structures shape managerial decision-making and organizational outcomes (Baumann et al., 2021).

Analyst forecasts play a pivotal role in shaping CEO decisions and corporate strategy. CEOs often view meeting or exceeding these forecasts as critical for maintaining investor confidence and stock market performance (Bartov et al., 2002; Bennett et al., 2017). The pressure to align with analyst expectations can lead to strategic adjustments and financial maneuvers aimed at achieving short-term profitability targets (Bentley et al., 2018). Comparative studies have shown variations in how CEOs respond to analyst forecasts based on industry dynamics and market conditions. For example, Bennett et al. (2017) found that compensation goals tied to analyst forecasts can significantly influence firm performance, suggesting a link between external performance benchmarks and managerial decision-making (Bennett et al., 2017).

The literature underscores the role of managerial discretion in shaping financial outcomes to meet EPS targets and analyst forecasts. Studies reveal that CEOs may engage in earnings management practices, such as accruals and non-GAAP reporting, to present a favorable financial picture to stakeholders (Black et al., 2022; Bentley et al., 2018). These practices raise concerns about transparency and the accuracy of financial reporting, affecting investor perceptions and corporate governance practices (Black et al., 2022).

Moreover, the impact of earnings management on firm value and shareholder wealth has been a subject of extensive research. Black et al. (2022) argue that non-GAAP EPS adjustments can distort financial performance metrics, influencing investment decisions and market valuation. Such findings highlight the need for robust governance mechanisms and regulatory oversight to ensure the integrity of financial reporting practices (Black et al., 2022).

The qualitative literature review on CEO compensation structures focusing on EPS targets and analyst forecasts underscores the intricate relationship between executive compensation, financial performance, and corporate governance. The findings highlight how EPS targets and analyst forecasts influence managerial behavior, prompting CEOs to engage in earnings management practices to meet performance expectations.

6. CONCLUSION

The qualitative literature review on CEO compensation structures focusing on EPS targets and analyst forecasts reveals several key insights into how executive compensation schemes influence corporate governance and performance. The findings underscore the pervasive influence of EPS targets and analyst forecasts on CEO behavior, leading to strategic decisions aimed at meeting short-term financial objectives.

The review highlights that EPS targets incentivize CEOs to engage in earnings management practices. Managers often manipulate financial results through accruals and non-GAAP adjustments to align with performance benchmarks (Ali & Zhang, 2015; Baumann et al., 2021). Analyst forecasts significantly influence managerial decisions, prompting CEOs to prioritize meeting or exceeding these expectations to enhance shareholder confidence and stock market performance (Bennett et al., 2017; Bentley et al., 2018). The research emphasizes the governance implications of compensation structures tied to financial performance metrics. It raises concerns about transparency and the integrity of financial reporting, given the prevalence of earnings management practices (Black et al., 2022).

7. LIMITATION

While the literature provides valuable insights, several limitations should be acknowledged. The findings may vary across industries and economic conditions, limiting generalizability. Additionally, the review primarily focuses on recent literature, potentially overlooking historical trends and long-term impacts. Future research should address these limitations and explore emerging trends in executive compensation and governance practices. To comprehend the sector-specific consequences of compensation structures, it would be helpful to compare data across several industries. Further insights into strengthening governance frameworks may also come from examining how regulatory changes mitigate earnings management methods and increase transparency.

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