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THE ROLE OF EXECUTIVE COMMUNIST PARTY MEMBERSHIP IN EQUITY INCENTIVES AND FIRM PERFORMANCE: EVIDENCE FROM CHINA

Zhao Zeyi[1], Junainah Jaidi [2*], Debbra Toria Anak Nipo[3]

[1] Faculty of Business, Economics and Accountancy, Universiti Malaysia Sabah, Sabah, Malaysia
Email: 569334440@qq.com
[2] Faculty of Business, Economics and Accountancy, Universiti Malaysia Sabah, Sabah, Malaysia
Email: nenjaidi@ums.edu.my
[3] Faculty of Business, Economics and Accountancy, Universiti Malaysia Sabah, Sabah, Malaysia
Email: debbratoria@ums.edu.my
[*] Corresponding Author

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Abstract:

The equity incentive system is widely recognized as an effective mechanism to mitigate the principal-agent problem in modern corporations. Nevertheless, its implementation may encourage executives to prioritize short-term personal gains over long-term firm interests. This study examines whether equity incentives enhance firm performance, whether executives' Chinese Communist Party (CPC) membership independently contributes to firm performance, and whether CPC membership amplifies the effectiveness of equity incentives. Based on agency theory, using fixed-effects regression on Chinese listed companies that adopted equity incentive plans during 2017-2022, the results show that equity incentives are positively associated with firm performance, CPC membership is linked to favourable firm performance, and CPC executives significantly strengthen the positive relationship between equity incentives and performance. Overall, these findings highlight the dual role of political affiliation, both as an independent driver of firm performance and as a factor that reinforces the effectiveness of incentive mechanisms, offering theoretical insights and practical implications for corporate governance in emerging markets.

Keywords:

Equity Incentive, Communist Party of China (CPC), Firm Performance, Earnings Management, Executive Political Background

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Introduction

With the rapid development of China's market economy and the evolution of modern corporate structures, sustaining firm performance has become a central concern in corporate governance. However, due to the inherent volatility of market forces, listed firms frequently experience performance fluctuations. Financial scandals, earnings manipulation, and instability in performance have attracted wide attention from both regulators and investors. Empirical studies further suggest that equity incentive plans in China often coincide with significant performance swings. For example, Bao and Li (2023) show that the adoption of incentive schemes frequently overlaps with abnormal performance changes, while Chen and Yang (2021) document that firms may engage in subsidiary-based earnings management to satisfy the performance conditions of stock options. Such practices weaken the credibility of financial statements and challenge the intended role of incentives in improving performance.

A key difference lies in the institutional design of equity incentives. In the United States and Europe, stock options are typically unconditional, whereas in China, performance-vested stock options are widely adopted (Zhang et al., 2017). This design aligns managerial payoffs with performance targets, potentially strengthening shareholder–manager alignment. At the same time, however, it may also encourage short-termism, as managers seek to meet exercise conditions even at the expense of long-term firm value. Whether equity incentive mechanisms ultimately enhance or undermine firm performance in China remains an unresolved empirical question.

In addition, the Chinese context is characterized by strong political–corporate linkages. State-owned enterprises account for a substantial share of the economy, and Communist Party committees are embedded within corporate governance structures (Zhao, 2022). Executives with Communist Party of China (CPC) membership are suggested to embody collectivist values, stronger social responsibility, and adherence to party discipline, which may mitigate managerial opportunism (Dai et al., 2017; Wan, 2021; Xu et al., 2023). Prior research further suggests that such executives may prioritize sustainable development and stakeholder interests, thereby enhancing corporate governance effectiveness (Zhu et al., 2024).

While existing literature has separately examined equity incentives in China and the role of political affiliation, a critical gap remains in understanding their interaction. Specifically, it is unclear how the unique political identity of CPC membership, a pervasive yet under-explored feature of China's corporate landscape, moderates the effectiveness of performance-based equity incentives. This study fills this gap by arguing that executive CPC membership is not merely a control variable but a pivotal governance mechanism that can reshape the outcomes of financial incentives.

Against this backdrop, this study investigates the role of executive CPC membership in shaping the effectiveness of equity incentives in Chinese listed firms. Using a sample of listed companies from 2017 to 2022, we examine (i) whether equity incentives enhance firm performance, (ii) whether executives' CPC membership is associated with superior performance outcomes, and (iii) whether CPC executives reinforce the positive impact of equity incentives on firm performance. By incorporating political affiliation into the analysis of incentive mechanisms, this study enriches the literature on corporate governance and offers novel evidence from China's distinctive institutional setting.

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To formalize our inquiry, this study addresses the following research questions:
1. Does the implementation of equity incentives improve firm performance in Chinese listed companies?
2. Does the presence of Communist Party of China (CPC) members in the executive team lead to better firm performance?
3. Does executive CPC membership strengthen the positive relationship between equity incentives and firm performance?

This study makes three primary contributions. First, it extends the literature on equity incentives by examining their performance effects in the unique institutional environment of China, where performance-vested stock options are widely implemented. Second, it introduces executive CPC membership as a novel explanatory factor that interacts with equity incentives, highlighting the role of political identity in shaping managerial behaviour. Third, by employing recent data on Chinese listed firms from 2017 to 2022, the study provides contemporary empirical evidence that enriches both the corporate governance literature and the broader discussion on how political institutions interact with market mechanisms.

Literature Review

Equity Incentive and Firm Performance

The relationship between equity incentives and firm performance has been extensively studied, but the findings remain mixed. Several studies suggest a positive correlation, arguing that aligning employees' interests with organizational outcomes through equity ownership can generate favourable performance results (Sun & Zhang, 2021; Wan, 2021). In contrast, other research has found no significant link, indicating that such incentives do not necessarily translate into improved outcomes (Zou, 2016). Some scholars have even identified an inverted U-shaped relationship, suggesting that there is an optimal level of equity incentives beyond which additional incentives fail to produce performance gains and may even result in diminishing returns (He et al., 2019).

In the Chinese context, however, most empirical studies find evidence supporting a positive relationship between equity incentives and firm performance. For example, Zhu and Ibrahim (2024) show that equity incentives significantly enhance firm performance for up to four years after implementation, with the strongest effect observed in the second year and with no significant differences between SOEs and non-SOEs. Similarly, Chen and Lin (2022), and Ma et al. (2024) provide consistent evidence that increases in equity incentives contribute to improved performance in Chinese firms. From a different angle, Gao et al. (2022) focus on risk-taking behaviour and demonstrate that equity incentives are positively associated with operational risk, particularly when investor ownership is low.

Taken together, while the evidence is not entirely unanimous, the prevailing findings in the Chinese literature support a positive link between equity incentives and firm performance. On this basis, the first hypothesis of this study is proposed:

H1: Equity incentives have a positive relationship with firm performance.

Executive Political Background

Party organizations serve as intermediaries between local governments and private enterprises, enabling firms to navigate external environments more effectively (Ke, 2023). Strengthening

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ties with local governments to secure political connections and social resources is a key incentive for private entrepreneurs and executives to join the Party. Such connections can provide enterprises with strategic advantages, including dismantling industry barriers, accessing subsidies, receiving tax benefits, and ultimately improving firm performance. Wang et al. (2023) provide evidence that the embeddedness of Communist Party organizations in state-owned enterprises enhances corporate value by alleviating financing constraints and mitigating hidden corruption, thereby strengthening corporate governance. Similarly, Ma et al. (2023) take the anti-corruption campaign launched by the Chinese Communist Party in December 2012 as a quasi-natural experiment, and find that enhanced public governance significantly reduces tunnelling behaviour among listed firms in China. Moreover, Party organizations within companies integrate personal, collective, and national interests, thereby encouraging executives to fulfil broader social and environmental responsibilities (Yang & Wang, 2021).

At the managerial level, executives' personal culture, experience, behavioural tendencies, and leadership style inevitably reflect the institutional environment in which they operate. Party members, guided by CPC values and discipline, are more likely to prioritize collective over individual interests. Within this context, Party organizations can improve firm performance by shaping board dynamics and reducing internal dissent in decision-making (Liu et al., 2020). Executives with Party membership also demonstrate stronger identification with collective goals and a commitment to advancing corporate social and environmental objectives (Xu et al., 2022). As a result, CPC executives are constrained not only by formal corporate and governmental regulations but also by informal Party discipline and programmatic norms, which help reduce self-interested behaviour and enhance corporate governance efficiency (Tang & Yi, 2021; Zhang, 2021).

Taken together, these findings suggest that executives with CPC membership tend to hold themselves to higher standards and are less inclined toward self-serving behaviours compared to their non-Party counterparts. Such characteristics are particularly advantageous in the context of equity incentives, which are designed to align individual and organizational interests. Accordingly, equity incentives are likely to have stronger and more favourable effects when executives are CPC members.

Based on these findings, the following hypotheses are proposed:

H2a: Firm performance is greater for firms whose executives have membership in the Communist Party of China.
H2b: Equity incentives with CPC participation will have a stronger impact on firm performance.

Methodology

Data and Sample Selection

The data employed in this study were drawn from the China Stock Market Accounting Research (CSMAR) database, which provides comprehensive financial and governance information on Chinese listed firms. The sample covers the period from January 1, 2017 to December 31, 2022.

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To ensure data validity and consistency, the following criteria were applied in sample selection: (1) Excluding listed companies in finance and insurance. Because of the special business of companies in this industry, the applicable accounting standards and accounting methods are different from those of listed companies in other industries, and their financial indicators are not consistent (and the relevant indicators are not comparable), and in compliance with the research practice, this study excludes them. (2) Excluding listed companies that are ST, *ST or PT in the sample period. Existing studies found that the investment and financial behaviors of companies with special treatment changes (ST or *ST) or equity structure changes (PT) are significantly different from those of "normal companies", and in order to avoid eventual delisting, such companies often seek asset restructuring, asset replacement or capital operation, or even financial management, so this study are excluded.(3) Excluding listed companies that also issue B shares or H shares. (4) Excluding listed companies with major asset restructuring during the implementation of the equity incentive plan. (5) Excluding listed companies with less than two years of equity incentive implementation and those with missing data.

After applying these criteria, the final sample consists of 240 firms, yielding 1,199 unbalanced panel observations. The raw data were pre-processed using Microsoft Excel, and the empirical analyses, including fixed-effects regressions, were conducted in Stata.

Dependent Variables

Firm performance is the dependent variable of this study. Consistent with prior research (Zhu & Ibrahim, 2024; Gong, 2021; Que & Ren, 2019; Xia, 2023; Qiao et al., 2023; Rasyid et al., 2019), several indicators are commonly used, including return on assets (ROA), return on equity (ROE), operating margin (ROM), and the market-to-book ratio (MBV). Among these, ROA is selected as the primary measure because prior studies (Zhu & Ibrahim, 2024; Gong, 2021) show it has the highest robustness and explanatory power.

Independent Variables

The first independent variable is equity incentives. Rather than using a simple dummy for the existence of incentive plans, this study follows Wang and Huang (2020), and Sun (2024) by capturing the intensity of incentives. Specifically, equity incentives are measured as the ratio of outstanding and effective stock options and restricted shares granted under equity incentive plans to total firm equity.

The second independent variable is CPC membership. Following Zheng et al. (2019) and Zhao (2022), CPC is defined as a dummy variable equal to 1 if at least one of the top three executives (chairman, CEO, CFO) is a member of the Communist Party of China, and 0 otherwise.

Control Variables

In examining the relationship between equity incentives, CPC membership, and firm performance, this study incorporates a set of control variables to mitigate potential omitted variable bias. Specifically, firm size, leverage, growth opportunities, ownership concentration, and industry effects are included as controls, as these factors are widely recognized in the corporate governance literature to influence firm performance. The detailed definitions, measurements, and data sources of all variables are provided in Table 1.

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Table 1: Summary of Variables

Variables	Acronym	Definition	Operationlization
Firm performance	ROA	The ratio of net profit to total assets	ROA=Net Income/Total Asset
Equity incentive	EI	The ratio of the number of equity incentives to the total share capital of the company	EI=number of equity incentives/total share capital of the company
Executive Political Background	CPC	Dummy variables for measuring whether executives have party membership	For executives with party membership, CPC=1, and vice versa CPC=0
Equity concentration	Topone	Percentage of shareholding of the largest shareholder	Percentage of shareholding of the largest shareholder
Board	Board	Size of the board	Natural logarithm of the number of board members
Board independence	IDP	The ratio of independent directors to number of directors	IDP=Number of Independent Directors / Total Number of Directors
Financial leverage	LEV	The ratio of total liabilities to total assets was selected as the measure.	Levi=Total liabilities/Total assets
Firm size	LnSize	Log of total assets	Log of total assets

Model Design

In order to test the hypotheses proposed in this study, the following model is constructed to verify and explore the relationship between equity incentive, CPC and firm performance：

$$FP_{i,t} = \alpha_0 + \alpha_1 EI_{i,t} + \theta X_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$FP_{i,t} = \alpha_0 + \alpha_1 CPC_{i,t} + \theta X_{i,t} + \varepsilon_{i,t} \quad (2)$$

$$FP_{i,t} = \alpha_0 + \alpha_1 EI_{i,t} + \alpha_2 CPC_{i,t} + \theta X_{i,t} + \varepsilon_{i,t} \quad (3)$$

Where: i (company number) = 1, ... , N; t (year time) = 1,…T; $FP_{i,t}$represents Firm Performance indicator of company i at time t; $EI_{i,t}$ represents equity incentive intensity or equity incentive level of company i at time t; $CPC_{i,t}$ is a dummy variable referring to political background of executives; $CPC_{i,t}$ =0 means executives do not have Chinese Communist Party membership, $CPC_{i,t}$ =1 means executives have Chinese Communist Party membership. $X_{i,t}$ represents a set of control variables affecting the level of firm performance, including equity structure, board structure, financial leverage level and firm size, etc.; and $\varepsilon_{i,t}$ is a random disturbance term.

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Results and Discussion

Descriptive Analysis

Firstly, the descriptive statistics were performed and the result for the descriptive analysis for the relationship between equity incentives and firm performance in this study is presented in Table 2. The results consist of mean, standard deviation, median, minimum and maximum percentiles of variables used in this study.

The mean strength of equity incentives (EI) is 0.055, ranging from 0 to 0.389, which is broadly consistent with Xu et al. (2023). The mean CPC membership is 0.201, comparable with Yang and Wang (2021).

Among the control variables, the average ownership of the largest shareholder (Topone) is 29.39%, similar to Ma and Kang (2022). Board size (log) averages 2.082, and the proportion of independent directors (IDP) is 38.39%, consistent with Gong (2021). Firm size (LnSize) averages 22.38, close to Wang and Huang (2020), while financial leverage (LEV) has a mean of 1.196, broadly in line with Gong (2021).

Table 2: Descriptive Statistics

Variable	Mean	Standard Deviation	Min	Max
ROA	0.0510	0.0630	-0.601	0.280
EI	0.0550	0.0510	0	0.389
CPC	0.201	0.401	0	1
Board	2.082	0.184	1.386	2.639
IDP	38.39	5.694	20	66.67
LnSize	22.38	1.300	19.70	28.61
Topone	29.39	14.18	5.823	82.44
LEV	1.196	6.412	-36.31	219.0

Multicollinearity Test

The multicollinearity test is mainly used to detect whether there is a potential multicollinearity among the explanatory variables. Table 3 reports the Variance Inflation Factor (VIF), which has a mean value of 1.63. According to the criterion suggested by Ye (2020), multicollinearity is a concern if the VIF exceeds 10. Therefore, the results indicate that multicollinearity is not an issue in this study, and the regression estimates are unlikely to be biased by collinearity.

Table 3: Variance Inflation Factor

Variable	VIF	1/VIF
EI	1.030	0.971
CPC	1.210	0.828
Board	1.690	0.590
IDP	1.610	0.620
LnSize	1.220	0.818
Topone	1.090	0.916
LEV	1.010	0.993
Mean	VIF	1.270

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Regression Analysis

To empirically examine the hypotheses proposed above, this section reports the baseline regression results on the relationship between equity incentives, CPC membership, and firm performance. Prior to estimation, a Hausman test was conducted to determine the appropriate panel data model. The test results reject the null hypothesis that the random effects estimator is consistent, indicating that the fixed-effects model is more appropriate for this study. Accordingly, all regression analyses are based on the fixed-effects specification. The regression results are presented in Table 4.

Model 1 shows the regression between equity incentive and firm performance without CPC participation. The results show that the coefficient estimate of equity incentive without CPC participation is 0.309, which is positively correlated with firm performance at the 1% level, indicating that an increase in equity incentive leads to an increase in firm performance. Thus, hypothesis H1 is verified. This finding is consistent with the studies of Chen and Lin (2022) and Zuo et al. (2024). Based on the principal-agent theory, the problem of information asymmetry still exists due to the fact that corporate managers and shareholders act from the perspective of their respective interests, which adversely affects the long-term development of enterprises. In addition, corporate shareholders may be lax in supervising managers, and managers may make unfavourable behaviours and decisions in order to seek more benefits. Therefore, the equity incentive mechanism designed to resolve the conflict between the two can effectively alleviate the principal-agent problem and bring positive benefits to the company. However, there are also scholars who come to different conclusions. Some scholars found that after the implementation of equity incentives, managers push the share price to rise in the short term and then reduce their holdings to arbitrage in order to meet the exercise performance conditions of the equity incentive programme to profit. Management will reduce the intensity of R&D expenditures and cut R&D funds for mergers and acquisitions during the exercise waiting period (Liu & Guan, 2022) as a way to manipulate surpluses and cater for stock mispricing by using R&D investments (Xu & Deng, 2020).

Model 2 shows the regression between CPC and firm performance. The results show that the coefficient estimate of CPC is 0.0375, which is positively correlated with firm performance at 1% level, which indicates that firms whose executives have CPC status have higher firm performance than firms whose executives do not have CPC status. Thus, hypothesis H2a is verified. This finding is consistent with the studies of Yang and Wang (2021). Most Chinese scholars believe that party executives are shaped by collectivist values and are able to integrate party values with company development, and value environmental protection, social responsibility and public interest (Dai et al., 2017; Xu, et al. 2020; Wan, 2020). In addition, party discipline constraints are an important institutional safeguard against executive corruption, mitigating the harm of corruption-related decision-making failures. As a result, party executives do not excessively pursue a single profit in corporate governance and are able to examine the firm's business objectives from a multidimensional perspective to achieve higher firm performance in a robust manner (Liu, 2022).

Model 3 shows the regression between equity incentive and firm performance with the participation of the variable CPC. The results show that the coefficient estimate of equity incentive with the participation of CPC is 0.314 and the coefficient estimate of CPC is 0.0407, both of which are positively correlated with firm performance at the 1% level, indicating that an increase in both equity incentive and CPC will lead to an increase in firm performance increases. Meanwhile, the coefficient estimate of CPC increases from 0.0375 to 0.0407, while

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the coefficient estimate of equity incentive increases from 0.309 to 0.314, indicating that CPC and equity incentive have a mutually reinforcing effect on firm performance. Thus, hypothesis H2b is verified.

Table 4: Regression Analysis Results

	MODEL 1 Coef t statistic	MODEL 2 Coef t statistic	MODEL 3 Coef t statistic
EI	0.309***		0.314***
	(7.30)		(7.45)
CPC		0.0375***	0.0407***
		(2.96)	(3.30)
Topone	0.00254***	0.00275***	0.00256***
	(6.13)	(6.52)	(6.21)
Board	-0.0334	-0.0435*	-0.0464*
	(-1.40)	(-1.77)	(-1.94)
IDP	-0.00170**	-0.00173**	-0.00189***
	(-2.55)	(-2.53)	(-2.84)
LEV	-0.000486**	-0.000442*	-0.000489**
	(-1.97)	(-1.75)	(-1.99)
LnSize	0.00892*	0.00928*	0.00828*
	(1.83)	(1.86)	(1.71)
_cons	-0.104	-0.0872	-0.0650
	(-0.75)	(-0.61)	(-0.47)
N	1199	1199	1199
R^2	0.104	0.062	0.114
adj. R^2	-0.126	-0.179	-0.115
F	18.43	10.58	17.52

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Robustness Test

To ensure the robustness of the findings, this study conducts additional regressions by replacing the measure of firm performance. Specifically, Tobin's Q is employed as an alternative proxy (Zhu & Ibrahim, 2024). Detailed regression results are presented in Table 5.

Table 5 reports the regression results using Tobin's Q. The coefficient of equity incentives is 1.755 and remains significantly positive at the 5% level, suggesting that higher equity incentives are associated with improved firm performance. The coefficient of CPC membership is 0.736 and significantly positive at the 1% level, indicating that firms with CPC executives outperform those without.

Overall, the direction and significance of the key explanatory variables remain unchanged, confirming that the main conclusions on the relationships among equity incentives, CPC membership, and firm performance are robust.

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Table 5: Robustness Test Results

	MODEL 1	MODEL 2	MODEL 3
	TOBINQ	TOBINQ	TOBINQ
EI	1.667*		1.755**
	(1.94)		(2.05)
CPC		0.718***	0.736***
		(2.87)	(2.94)
Topone	-0.0149*	-0.0135	-0.0146*
	(-1.78)	(-1.61)	(-1.75)
Board	-1.025**	-1.244**	-1.260***
	(-2.13)	(-2.56)	(-2.59)
IDP	-0.0209	-0.0235*	-0.0244*
	(-1.55)	(-1.74)	(-1.80)
LEV	-0.00573	-0.00552	-0.00579
	(-1.15)	(-1.11)	(-1.16)
LnSize	0.274***	0.268***	0.262***
	(2.78)	(2.73)	(2.67)
CONS	-0.607	-0.0204	0.104
	(-0.22)	(-0.01)	(0.04)
N	1199	1199	1199
R^2	0.029	0.033	0.038
ADJ. R^2	-0.221	-0.215	-0.211
F	4.712	5.472	5.308

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Conclusions and Implications

This study investigates the relationship between equity incentives, CPC executive membership, and firm performance in Chinese listed companies during 2017-2022. Three main conclusions are drawn. First, equity incentives are positively associated with firm performance, confirming their effectiveness as a governance tool. Second, executives with CPC membership independently contribute to higher firm performance, suggesting that political identity shapes managerial behaviour and strategic decision-making. Third, CPC executives amplify the positive impact of equity incentives, indicating that political affiliation can reinforce the effectiveness of incentive mechanisms. These results enrich the application of agency theory in the Chinese institutional context and highlight the novel role of political affiliation in shaping managerial behaviour and corporate outcomes.

From a practical perspective, the study offers two main recommendations. First, it is important to improve the equity incentive environment. Equity incentives are most effective when supported by a sound institutional and regulatory framework. Governments and regulators should introduce stricter supervisory measures, strengthen monitoring of capital markets, and refine exercise conditions to ensure that incentive mechanisms promote long-term value creation rather than short-term opportunism. Second, enterprises should enhance the development of CPC executives. Party executives not only improve corporate governance but also help align managerial decisions with broader collective and organizational interests. Strengthening the training, development, and professional competence of CPC executives can

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further enhance the effectiveness of equity incentive mechanisms and contribute to the sustainable growth of listed firms.

Despite its contributions, this study has several limitations that provide opportunities for further research. First, the sample period is limited to 2017-2022, which coincides with the COVID-19 pandemic. As China lifted pandemic-related restrictions in 2022, future research could extend the sample to cover the post-pandemic era, allowing for more stable and generalizable conclusions. Second, this study considers only one managerial attribute (CPC membership). Future studies could incorporate additional executive characteristics to provide a more comprehensive understanding of how managerial traits affect the effectiveness of equity incentives.

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