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Executive Compensation White Paper

By

Patricia Arehart, Sarah Levitin, Allison Vernerey

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Under the supervision of

Ariel Babcock (Managing Director, FCLT Global), Romain Cadario (Susilo Senior Academic Researcher),
Matthew Leatherman (Research Director, FCLT Global), and Prof. Nina Mazar (Susilo Co-Director)

About this Report

This report examines how executive compensation timing can positively influence a CEO's long-term decision-making at a public organization. Based on the insights generated, interventions based on behavioral insights are recommended, focusing on the time dimension of executive compensation with an overall objective to increase long-term performance metrics within a public organization.

Executive Summary

In recent years and academic findings¹, more public companies, and executive compensation packages in particular, are favoring short-term incentives to ultimately drive short-term outcomes for organizational performance. While, on the outset, this does not appear in any way harmful or problematic for an organization's overall performance, research indicates that overall, solely focusing on the short term (both organizationally and the delivery of executive compensation design) does not position the company for most successful overall wellbeing². Companies have struggled with recognizing the importance of shifting to long-term performance outlooks and, as a result, executive pay design structure still favors short-term incentives, ultimately leading to short-term results. Focusing on the time dimension of executive compensation package design, this report explores how long-term compensation incentives can yield long-term performance measures for a public organization.

The executive compensation package generally consists of a base salary, stock options, bonuses and other compensation benefits. After studying these components, the area where there is most room for testing via behavioral insights is the bonus, otherwise known as the short-term incentive component of the compensation package.

The primary behavioral insights that most directly relate to this component of the compensation package are myopic loss aversion and hyperbolic time discounting. Based on these insights, we have outlined the following intervention idea that can later be tested by the client, FLCTGlobal, and its member organizations. We have also highlighted several insights that are outside the scope of time dimension. Nevertheless, these aspects that have surfaced through our

¹ "Short-termism: Insights from Business Leaders," FCLTGlobal, January 23, 2014. Accessed April 24, 2019, <https://www.fcltglobal.org/research/reports/article/global-survey-of-business-leaders>.

² "Straight Talk for the Long Term," FCLTGlobal, March 16, 2015. Accessed April 24, 2019. https://www.fcltglobal.org/docs/default-source/default-document-library/straight-talk-for-the-long-term_summary-vfo2263494db5326c50be1cff0000423a91.pdf?sfvrsn=5651258c_2

research indicate other areas of intervention that can aid in the overall objective of executive design scheme for the purpose of long term performance objectives company-wide.

Part I: Introduction & Behavioral Insights

This paper addresses the ways in which executive compensation, in particular variable performance compensation, influences how executives weigh short-term versus long-term priorities. Many companies intend for variable performance compensation to reward executives proportionally to the degree they generate long-term value for the firm. In practice, many forms of variable pay create adverse incentives for executives to maximize firm value in the short-term, at the expense of longer-term objectives. Most of the research underlying executive compensation design stems from management theory, but a growing set of behavioral science research lends new ways of thinking about how compensation influences decision making. This section outlines the key working definitions and behavioral science concepts used throughout this analysis.

Short-termism vs. Long-termism:

Short-termism is a term used to describe any action that increases current returns at the expense of future returns, such as foregoing positive-NPV investments that reduce short-term performance or taking negative-NPV projects that improve short-term performance, earnings management, or accounting manipulation.³ One direct measure of short-term incentives in executive compensation is the quantity of equity scheduled to vest in a given period, as CEOs tend to sell a large portion of equity when it vests.⁴

By contrast, *long-termism* describes corporate actions that prioritize the future value of the firm. The specific timing for what constitutes ‘long-termism’ can vary according to the particular business cycles for a given firm or industry, but the actions and attributes associated with long-termism are associated with higher firm value. Empirical research by Flammer and Bansal shows that firms exhibit long-term orientation through corporate strategies that include robust innovation and strong stakeholder relationships (e.g. with employees, customers, and

³ Edmans, A, Gabaix X, Jenter, D. “Executive Compensation: A Survey of Theory and Evidence.” In *Handbook of the Economics of Corporate Governance*. 2017. Chapter 7, 460

⁴ Ibid, 487.

suppliers).⁵ For example, firms focused on a longer time horizon are more likely to invest in R&D and typically file more patents than firms primarily focused on short-term performance.⁶ FCLTGlobal collected corporate survey data to determine measurable indicators of long-term behavior for corporates, asset managers, and asset owners, as shown in Exhibit 1.⁷ On the corporate side, long-term indicators fall into three categories: capital allocation, governance and culture, and long-term shareholder focus. Viewed together, these measures illustrate a breadth of firm decisions that drive balance sheet performance, corporate strategy, operations, governance, culture, and ultimately, firm value. Compensation packages typically align executive decision making to long-term performance through equity, such as restricted stock, and evaluations of total shareholder return over a multi-year period.

Behavioral Insights

Interest Alignment & Behavioral Agency Theory

Dominant management theories on compensation tend to view executive pay as a means of addressing a fundamental principal-agent problem between corporate managers and corporate owners with differing financial goals (e.g. personal compensation versus shareholder return) and time-horizons.⁸ In these ‘agency theories,’ compensation serves as a means of aligning the financial goals and time-horizons of executives and shareholders, with the assumption that executives act as economically rational and rent-seeking actors and shareholders act as rational profit-seeking owners.

Behavioral economic research challenges and broadens the underlying assumptions of this view with the introduction of *behavioral* agency theory, which argues that principals and agents are best aligned when executives (i.e. agents) are not only financially incentivized to deliver firm value, but also non-financially motivated to perform to their best. Behavioral agency theory draws upon four primary behavioral factors that challenge the assumption of pure

⁵ Flammer, Caroline and Pratima Bansal. “Does a long-term orientation create value? Evidence from a regression discontinuity.” *Strategic Management Journal*. 38 (2017): 1827-1847.

⁶ Ibid.

⁷ FCLT Global, “Measuring Long-Term Behavior on a Global Scale.” March, 29 2019.

⁸ Jensen, Michael & H. Meckling, William. “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure.” *Journal of Financial Economics*. 3. (1976): 305-360.

economic rationality on the part of the executive, including (1) loss aversion; (2) risk preferences; (3) intertemporal discounting; and (4) fairness.⁹

(1) *Loss aversion*: Myopic loss aversion also occurs when investors take short-term view over their investment, encouraging them to react too negatively to recent losses, potentially at the expense of long-term gains. Thaler et al. show through experimentation that when investors get the most feedback and most information on their performance is also when they take the less risk and make the less money i.e. perform the worst.¹⁰ Additionally, Kahneman and Lovallo find that “narrow framing,” in this case when projects in an organization are evaluated one at a time, leads to even more risk aversion than a normal individual might display.¹¹

(2) *Varying risk preferences*: Behavioral models rooted in prospect theory¹² show that people evaluate risk and expected utility relative to a particular reference point, as opposed to an absolute outcome, such that losses relative to a reference point ‘feel’ bigger than gains. The framing of an incentive as a loss or gain, therefore, shifts individuals’ risk preferences. For example, consider an executive who has not yet met an annual bonus target. Behavioral agency theory suggests that the executive will feel loss aversion and exhibit an increased willingness to take on short-term risk in order to realize those gains.¹³ Conversely, an executive who has already met the bonus target will hope to avoid loss and exhibit a decreased willingness to take on risk.

(3) *Intertemporal discounting*: The challenges of an executive and a firm balancing short- and long-term pressures centers around intertemporal decision-making—choices that have consequences in multiple periods. In these situations, individuals often discount future rewards in a hyperbolic way, such that they prefer short-term rewards over long-term rewards, even when the long-term rewards are much higher. Actual discounting rates vary by person and need to be evaluated empirically. Flammer and Bansal note that the short-term preference of an executive

⁹ Pepper, A., and Gore, J. "Behavioral Agency Theory: New Foundations for Theorizing About Executive Compensation." *Journal of Management* 41, no. 4 (2012): 1047.

¹⁰ Thaler R.H., Tversky, A., Kahneman, D., & Schwartz, A. (1997). The effect of myopia and loss aversion on risk taking: An experimental test. *The Quarterly Journal of Economics*, 112(2): 659.

¹¹ Kahneman, D. and Lovallo, D. “Timid Choices and Bold Forecasts: A Cognitive Perspective on Risk Taking.” *Management Science*, 39(1): 17-31.

¹² Kahneman, D. and Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica*, 47, 263-291.

¹³ Pepper et al. 1049.

are reinforced by short-term market pressures to meet or exceed analysts' earnings forecasts or address career concerns.¹⁴

(4) *Fairness*: An executive's perception of equity impacts motivation and performance. If an executive subjectively feels that his or her efforts and skills are fairly rewarded by the tangible *and* intangible rewards from the employment agreement, then the executive will feel motivated to contribute at the same or higher level. Behavioral agency theory postulates that perceptions of one's compensation package do not just depend on buying power, but rather how the compensation compares to salient peers inside and outside the firm. If the outputs (e.g. financial rewards, recognition) awarded are not proportional to the executive's contributions of energy, skill, and commitment, then this model suggests dissatisfaction and demotivation will follow.¹⁵ Behavioral agency theory builds on previous research illustrating that individuals do not simply layer intrinsic and extrinsic motivation, rather experiments have shown that external motivations, such as monetary rewards, can actually decrease one's intrinsic motivation for high job performance.¹⁶

Implications

Behavioral agency theory highlights key factors that influence executive decision making and performance, however, most compensation designs do not take these behavioral considerations into account. Behavioral agency theorists acknowledge the limits to designing an incentive scheme that incorporates all of the objectives and flexibility needed to satisfy both the principal and agent, and favor more balanced reward systems and straightforward performance measures.¹⁷ From this perspective, an optimal compensation package can include a mix of fixed and variable pay, short and long-term incentives, and needs to recognize that high stakes incentives may increase extrinsic motivation and the expense of intrinsic motivation. And in order to assure perceptions of fairness, corporate boards should consider how compensation packages vary across the management team.

One notable behavioral field experiment on compensation design testing the power of loss aversion in the context of teacher performance incentives. This 2012 study by Fryer Jr. et. al.

¹⁴ Flammer, Caroline and Pratima Bansal. "Does a long-term orientation create value? Evidence from a regression discontinuity." *Strategic Management Journal*. 38 (2017): 1827-1847.

¹⁵ Pepper et al. 1048.

¹⁶ Ibid.

¹⁷ Ibid. 1061.

worked with teachers in Chicago Heights, offering one group of teachers a bonus incentive for their students' performance on a math exam at the end of the year with payment allocated after the exam. The second group of teachers received the bonus payment in advance and required to give back all or some of the money if students did not improve test scores sufficiently. The group of teachers paid in advance yielded higher test scores than the alternative treatment groups, and the simple reframing of the payment as a 'loss' as opposed to a 'gain' showed an equivalent result to increasing teacher quality by more than one standard deviation. This experiment demonstrates the power of framing and loss aversion and suggests that these concepts can significantly shape the influence of compensation design on performance.¹⁸

Part 2: Intervention

As seen above, even within the compensation package, encouraging executives to make more long-term oriented decisions is complex. Compensation packages vary greatly by individual executive and across industries, but do seem to follow a common structure and commonly include long-term incentive plans (LTIP).¹⁹ Exhibit 2 illustrates a basic compensation structure. We see two elements of this compensation package as candidates for a time-focused intervention trying to encourage more long-term decision-making: annual bonus and LTIP. The consistent base pay does not generate time-related pressures.

While the restricted stock ownership and stock option pieces do have an adjustable time element tied to them, the value of these components rely on stock price maximization at a given point in time. Even though this point in time can seem more long or short-term from the perspective of when the compensation package is set (i.e. stocks can technically be set to vest in two or ten years, for example), it seems inevitable that as the end of the vesting period approaches, this setup will incentivize short-term profit maximization for the CEO, and thus short-term oriented decision making. Professor Jesse Fried and Lucian Bebchuk argue in *Pay without Performance, The Unfulfilled Promise of Executive Compensation* (2004) that the idea of not having executives hold equity long-term ultimately distorts long-term incentives. This

¹⁸ Fryer, Roland G., et al., "Enhancing the Efficacy of Teacher Incentives through Loss Aversion: A Field Experiment." Cambridge: National Bureau of Economic Research, Inc, 2012. *ProQuest*. Accessed April 29, 2019.

¹⁹ Nili, Yaron."Long-Term Incentive Grant Practices for Executives." Harvard Law School Forum on Corporate Governance and Financial Regulation. January 5, 2015. <https://corpgov.law.harvard.edu/2015/01/05/long-term-incentive-grant-practices-for-executives/>

concept, known as early unwinding,²⁰ leads executives to focus on the short-term at the expense of the organization's long-term value. The presentation of the stock component for executives, therefore, does not align strictly with long-term performance metrics. This effect can also be seen in the form of retirement stock incentives. If the executive is a short-term shareholder, decisions will be framed for short-term success to then sell the stock at a good price, rather than focus on the long-term wellbeing of the organization.²¹

Considering the short-term pressures associated with typical compensation incentives, some firms have envisioned a structural change. Exhibit 3 highlights an alternative compensation plan with restricted stock, as opposed to a LTIP. The plan illustrated here is based on a specific firm, the Weir Group in the UK, as this firm was specifically highlighted by the CEO of the head of Norway's sovereign wealth fund—a long-term oriented institution—as an example of a simple and transparent alternative to established payment practices.²² Under this alternative type of compensation plan, a CEO's stock payment is spread over a seven year period, with vested shares released 5 to 7 years from the grant. The restricted stock plan does not include specific target metrics for CEO performance. Rather, the stocks are contingent on general 'underpinning' of balance sheet health, investor returns, and corporate governance. This overall plan still creates the same short-term pressures associated with annual bonuses, but the restricted shares do seem to align the CEO's personal financial incentives with the longer-term performance of the firm, especially with the staggered vesting years. Each vesting period may still promote the kind of restriction of investment, as measured in the Edmans' study, but the multiple vesting periods may encourage a CEO to think in terms of a repeated game. We believe this structural change is promising and a reaffirming step in the right direction. However, it is important to keep in mind that the focus of this report is rooted in behavioral changes rather than structural reforms.

The other component affecting greatly time-related pressure is the bonus. Bonuses, otherwise known as short-term or annual incentives, "are intended to compensate executives for achieving the company's short-term business strategy based on achievement of goals by the board compensation committee"²³ An annual (or bi-annual) bonus is typically contingent upon

²⁰ Fried, Jessie. Presentation. UN PRI Executive Roundtable, March 29, 2019.

²¹ Ibid.

²² Fouche, Gwladys. "From Disney to Dior, Norway wealth fund challenges CEO pay." Reuters. April 27, 2018. Accessed April 8, 2019. <https://www.reuters.com/article/us-norway-swf/from-disney-to-dior-norway-wealth-fund-challenges-ceo-pay-idUSKBN1HY0W3>

²³ "Issues in Executive Compensation." Accessed April 09, 2019. <http://www.execcomp.org/Issues>.

firm-specific KPIs and personal targets for the CEO. For simplicity, we are considering the annual bonus as a cash bonus, as is often the case. The criteria for annual bonuses can change each year, which creates time-pressure for a CEO to deliver this year's targets and negotiate with the Board to set achievable targets for next year.²⁴ As seen in Exhibit 2, the bonus aspect is currently the one that is initially the most short-term (paid after six months or a year) but also recurring at equivalent intervals in the long-term making it possible to influence behavior at different points in time. Providing a compensation package where a significant portion is comprised of and disbursed as the bonus, which is most commonly driven by short-term outcomes, creates a weak spot, and thus a behavioral intervention opportunity, for the time dimension of long-term performance.

Success Criteria & Measurement

Based on behavioral insights relating to myopic loss aversion and hyperbolic time-discounting as described in Part I, the following sections detail a possible behavioral intervention in the form of executive pay design in order to increase long-term decision making amongst executives. Intervening in this one aspect of the compensation package will not serve as a panacea and is likely to bring in only marginal improvements. For that reason, further areas suggested for research and possible interventions are described in future sections of the report.

Measures of success:

The intervention would be considered successful if the participating companies showed statistically superior performance when compared to public firms of the same size category (large, medium or small) on the metrics detailed in Exhibit 1. These metrics are, according to FCLTGlobal's research²⁵, indicators that can act as proxies representing healthy long-term oriented behavior. The performance should be measured as a growth year-over-year (or decline depending on the metric) or as an average over a multiple year period to avoid single occurrence spending or other similar types of gaming. Because the report's focus spotlights long-term metrics, results should be monitored over multiple years to capture significant effects. While the

²⁴ "Remuneration of the CEO Asset Manager Perspective." Norges Bank Investment Management. July 4, 2017. Accessed April 9, 2019. <https://www.nbim.no/contentassets/bc85c448e6b24ff5a31088883695a344/ceo-remuneration---amp-1-17---norges-bank-investment-management.pdf>

²⁵ FCLT Global, "Measuring Long-Term Behavior on a Global Scale," *Presentation*, March, 29 2019.

bonus targets may themselves be only tied to a few of these metrics, success of the intervention would be measured on all identified long-term metrics.

A participating company would also need to measure the impact of this compensation change by comparing firm performance in the years prior to the intervention with performance under the new bonus system. This within subject testing would provide further insight into the impact of the intervention on the long-term proxy measures. In order to begin this testing, any participating company would need to obtain data on the proxy measurements for the years prior to the intervention (e.g. employee satisfaction, ESG controversies, and others from Exhibit 1) to compare with the results under the new compensations design.

Ideal target(s) for intervention:

The ideal target for a behavioral intervention like this would be public companies of medium or large size who are FCLTGlobal partners. The CEOs of these companies should currently be on a ‘traditional’ compensation package, similar to the one described in Exhibit 2. Ideally, these companies would belong to different industries, allowing to control for industry specific factors and effects.

Intervention:

Exhibit 4 provides a visual of what this intervention could look like. Keeping other aspects of the compensation package the same, alter the bonus component by:

- (1) Disbursing the bonus amounting to three years’ time at time $T=0$ (i.e. time the compensation package is implemented).
- (2) Tying the bonus’ merit directly to average long-term performance metrics over the last three years listed.
 - (a) More specifically, growth (or decrease depending on the variable) over time on the aforementioned metrics as well as average over the past three years measured against industry average. I.e., dissuading looking at a metric’s performance specifically at time x , but rather looking at the average over a years’ time.
- (3) Conducting review of performance at $T=1$ and $T=2$ years focusing on the progress of the long term performance metrics to date. At this point, reviews would not lead to any monetary action. Rather, this check-in provides a point of reference for the executive and

the Board of Directors and allow for adjustment in the overall business strategy and decision-making.

(4) Conducting a formal review at $T=3$ of whether the targets were achieved or not. If all metric projections are met, the Board and executive begin planning for the next three-year cycle. This includes the renegotiation of future targets (still related to the same long-term metrics) and bonus amounts to reflect market value and other factors.

(a) If metric targets are not met at the end of three years' time, the CEO owes the company the amount of his bonus for which he did not achieve the targets to be repaid within a previously agreed-upon time frame. Following that, the next bonus cycles proceeds as described above.

In this model, the vehicle for intervention remains the design of the executive compensation package. Specifically, the actual intervention is at $T=0$ when the terms of executive compensation are being actually disbursed. At this point, both the monetary compensation and criteria for goal setting is agreed upon simultaneously. This design makes use of the insights explained earlier in the report regarding the general behavioral tendency to be loss averse and also more specifically to fall towards myopic loss aversion. The goal here is to link the early disbursement of the bonus to incentivize long-term performance strategy. Here, the concept of the bonus is directly tied to the concept of loss aversion, in that it is better not to lose the bonus monies rather than 'finding' the bonus monies. The actions a CEO may take to meet an annual bonus target, for example, may create a narrow framing such that the executive is only focused on what actions are necessary to reach this immediate goal, rather than thinking about how those actions could impact performance and payment years in the future. This is especially important if the bonus is directly tied to short-term performance indicators. By giving the bonus ahead of time, linking it to long-term performance metrics and giving a full three year time frame before potentially taking it back, we might be able to refocus the CEO's attention on long-term, mitigate his risk-aversion as well as overall increase his performance and motivation.

This also reflects the notion of hyperbolic time discounting in the fact that the executive is receiving compensation now, and would prefer it, rather than in three years' time when, at $T=0$, the monetary amount is discounted mentally. Additionally, from a cost point of view linked to the hyperbolic time discounting principle, the full bonus payout amount at $T=0$ would most

likely be less now than it would have been for a bonus to be distributed at some point in the future.

The purpose of the reviews at T=1 and T=2 and these check-in points purposefully not having any monetary repercussions echoes the behavioral concept of narrow framing in that less pressured feedback amounts to less risk aversion, allowing the executive to continue on the long-term performance strategies (as originally incentivized in T=0). The review at T=3 is the final review assessing to what extent the executive has met all the long-term performance targets agreed upon in T=0. If the executive has successfully met the targets, both the executive and Board can move forward in creating a new three-year plan that includes bonus disbursement, and the cycle begins once again. If, however, the executive does not meet the thresholds of the targets set, then a certain percentage of the original disbursement, proportional to extent to which the goals were met, would be returned.

Part III: Next Steps and Additional Considerations

As previously mentioned in this report, the scope of both the research insights and intervention were primarily focused around the time dimension of executive compensation. In terms of behavioral insights, this scope relates most strongly to the theories of loss aversion, hyperbolic time discounting and narrow framing. However, research indicates that in order to achieve the long term performance that is sought after, there are several other aspects of the executive compensation package that can further analyzed. This is to say that the time dimension design of executive compensation for the goal of long term organizational performance can potentially be merely one facet of a larger research study.

Relationship Between Board and Executive

As Exhibit 5 shows, there are many stakeholders that are related to an executive of an organization, specifically involved in the area of executive compensation. As the exhibit highlights, the executive's decision-making is not only influenced by but also impacted by the Board of Directors. The relationship between the Board of Directors and the executive is an important one that can provide insight into how the design of executive pay can yield long term performance measures. An executive is typically a calculated and strategic decision maker that adopts the growth mindset in order to make well-rounded decisions for the overall

organization.²⁶It is interesting that though the focal person of an organization innately approaches decisions with long-term implications, decision making that is currently seen as most favorable and successful by his/her stakeholders are driven by short-term metrics. Given this dichotomy in thought, an additional area to research can be to assess executive decision making approaches and mindset and how that relates to current short-term driven metrics and outcomes in the executive compensation package and the organization's performance. Exploring the relationship between an executive's innate long-term, strategic growth mindset and various types of executive compensation packages can be interesting in observing how this can affect long-term performance goals for the overall organization.

Board Members' understanding of compensation package and accountability

Another important aspect of the compensation package is the formation, approval and vote of the package on the floor as it is brought to both the Board and the executive (see Exhibit 6). Delving deeper into how much the Board truly understands the fine details of the aspects of compensation could help stimulate packages that are designed to create long-term performance objectives for the organization. Currently, the traditional model involves the help and guidance of an external consultant in creating and forming the compensation package. What that means is that even though a compensation committee exists within the Board of Directors, even they might not understand what the package really entails. The Board has to approve the package but it is apparently rare that they take the time to fully understand and challenge it. Understanding both parties' potential competing commitments²⁷ in regard to compensation package format and outcomes may create alignment between the Board and executive on the goals of long term performance metrics being the primary focus of company objectives.

A final additional aspect of assessing executive pay design's effects on long term performance, still within the scope of the relationship between the Board and the executive, is holding the Board accountable for its duties and responsibilities during the process of establishing and voting on a compensation scheme. That is to say that currently, the Board votes in favor of compensation packages; however, the extent to which individual members have done

²⁶ Carol Dweck: The power of believing that you can improve. [Video file]. TedxNorrkoping. November 2014. Accessed April 20, 2019.

https://www.ted.com/talks/carol_dweck_the_power_of_believing_that_you_can_improve?language=en

²⁷ Robert Kegan and Lisa Laskow Lahey, "The Real Reason People Won't Change," Harvard Business Publishing, October 31, 2001. Accessed April 24, 2019. <https://hbsp.harvard.edu/product/R0110E-PDF-ENG?itemFindingMethod=Other>.

their due diligence on understanding the components of the package remains ambiguous.²⁸ Because of that, it is hard to know if the package is really designed in any way to incentivize long-term decision-making. A behavioral solution to test for that might be to make compensation committee members take a “pledge” stating that each individual participated in the design of this package and has done so in such a way as to best serve the long-term interests of the company. From behavioral research on commitment,²⁹ we know that even such a simple action might go a long way in focusing the committee towards creating long-term oriented packages and making them accountable for that.

Conclusion

In conclusion, the research conducted and interventions designed lead to indicate the values of creating an executive compensation package that affects long term decision making. Recently, more research yields the sentiment that corporate short-termism is hampering business’ success³⁰ and that executive pay is directly tied to short-term results³¹. This ultimately dissuades executives and shareholders from tying executive payoffs to long term performance. This is important because, as the aforementioned behavioral insights demonstrate, there are potential behavioral interventions that can yield executive compensation packages that focus on leading long term performance metrics.

Taking these behavioral insights and recommendations into consideration, it is important to remember the larger picture of focusing on the long term capital for public organizations. The time dimension of executive compensation is a very small slice of the larger goal, with many stakeholders and shareholders involved. Though this report’s scope is narrow, research proves that behavioral insights can have a meaningful impact in the design scheme of executive compensation for long term performance in public firms.

²⁸ Carmen Nobel, "Who Really Determines CEO Salary Packages?" Working Knowledge: Business Research for Business Leaders, November 18, 2015. Accessed April 24, 2019. <https://hbswk.hbs.edu/item/who-really-determines-ceo-salary-packages>.

²⁹ Brady Josephson, "6 Principles of Influence You Can Use For Your Cause," HuffPost, December 07, 2017. Accessed April 08, 2019. https://www.huffpost.com/entry/6-principles-of-influence_b_7102348.

³⁰ Flammer, Caroline. Academic Presentation. UN PRI Executive Roundtables, March 29, 2019.

³¹ Fried, Jessie. Academic Presentation. UN PRI Executive Roundtables, March 29, 2019.

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Exhibits

Exhibit 1: Long-term performance metrics

FCLTGlobal Corporate Indicators of Long-Term Behavior	
Long-Term Capital Allocation	Calculation
Overdistribution of capital (23%)	= (Dollar value of net issuance (net of buybacks) - dividends + (FCF)/assets
Leverage ratio (7%)	= Total debt/assets
Fixed investment (17%)	= (Capex – depreciation)/assets
RQ (12%)	= % increase in revenue for 1% in R&D
Sales growth (8%)	= Trailing 5-year average of year-over-year change in revenue
Long-Term Governance & Culture	
ESG Controversies (12%)	Based on 23 ESG controversy topics ranging from child labor to tax fraud. A lower number is better, and the metric aims to avoid double counting.
Board gender diversity (23%)	
Long-term Shareholder Focus	
Short-term guidance (9%)	Instances of quarterly/semi-annual guidance over past 5 years
Long-term investor presence (4%)	= % of company owned by firms with <50% dollar turnover (effectively holding period >2 years) per year
<i>Green = positive and Red = negative.</i> Numbers represent factor weights.	
FCLT Global, "Measuring Long-Term Behavior on a Global Scale", <i>Presentation</i> , March, 29 2019.	

Exhibit 2: Traditional executive compensation package and related short-term pressures

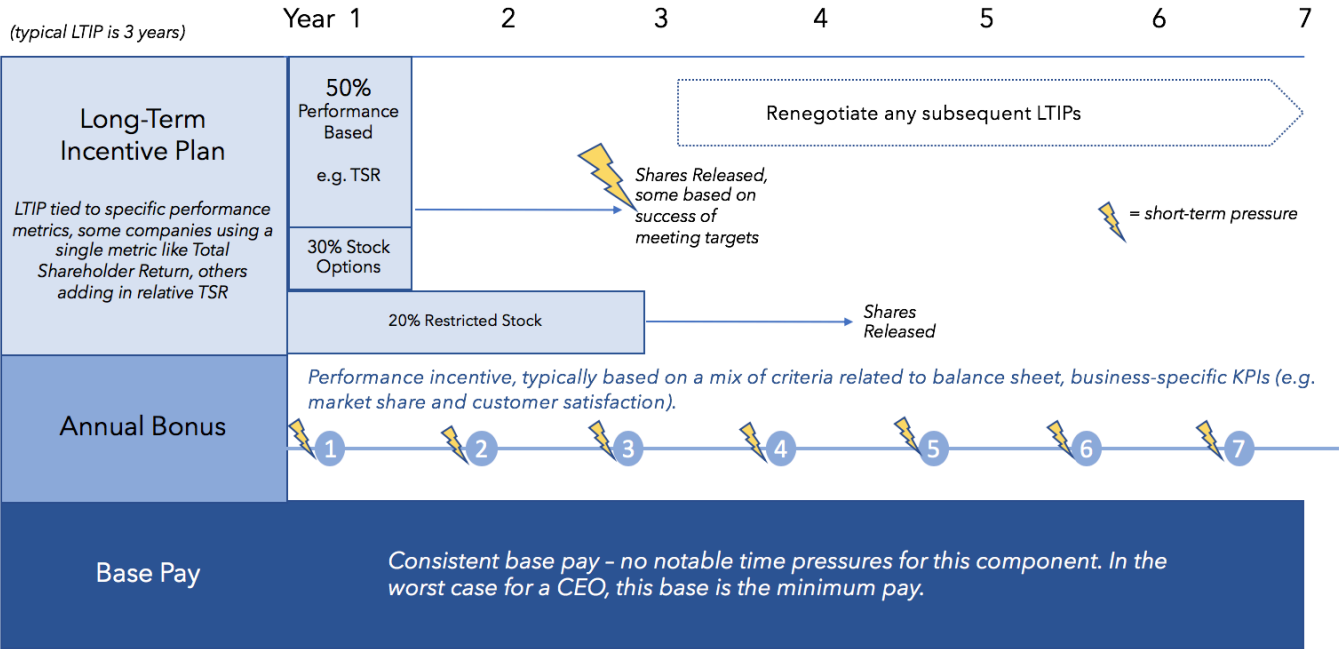


Exhibit 3: Compensation plan with restrictive stock

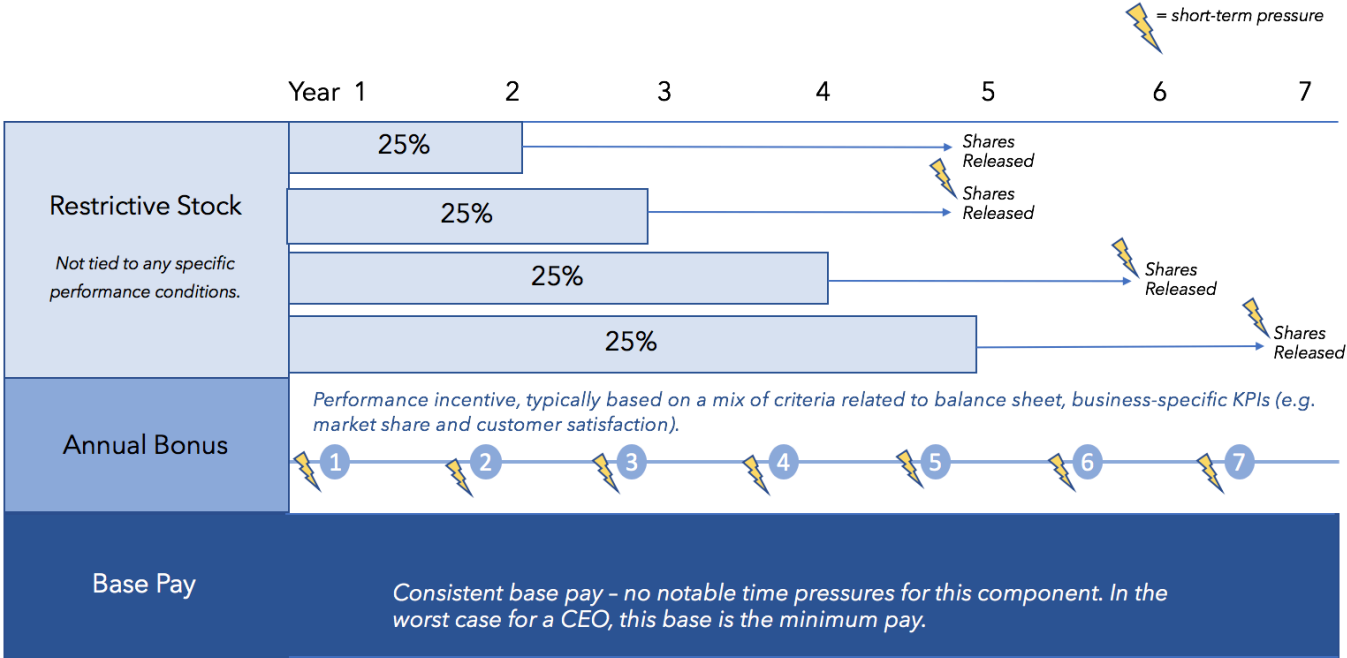


Exhibit 4: Proposed reform to mitigate short-term pressures associated with annual bonuses

Intervention Awards CEO Bonus in Advance

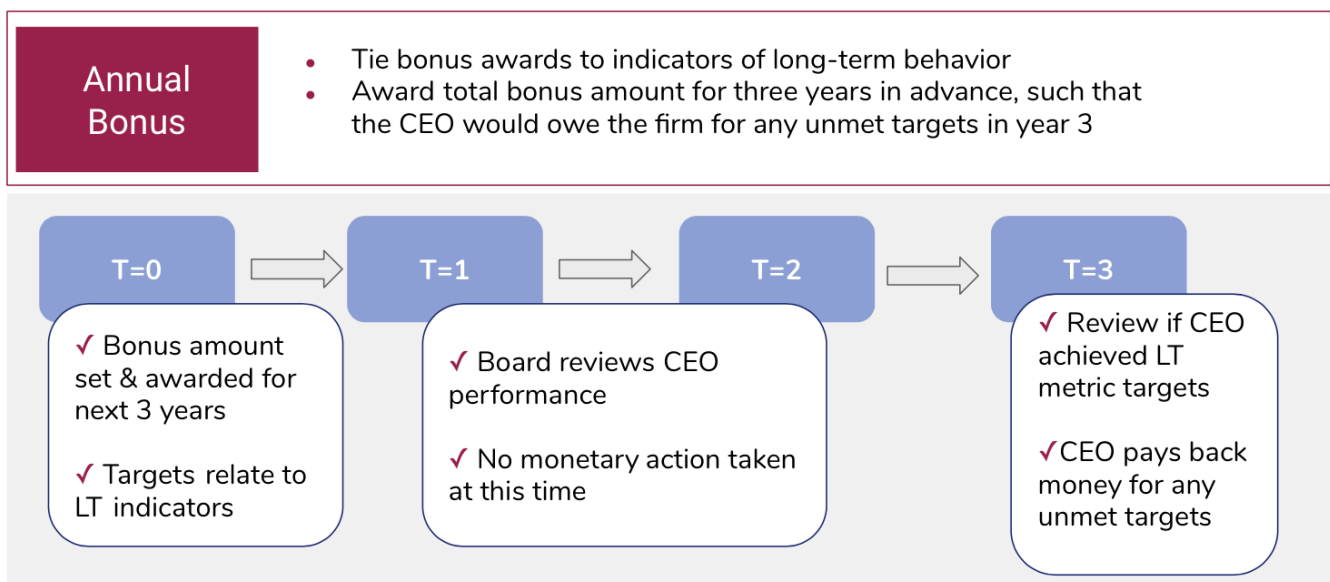


Exhibit 5: Stakeholder Map

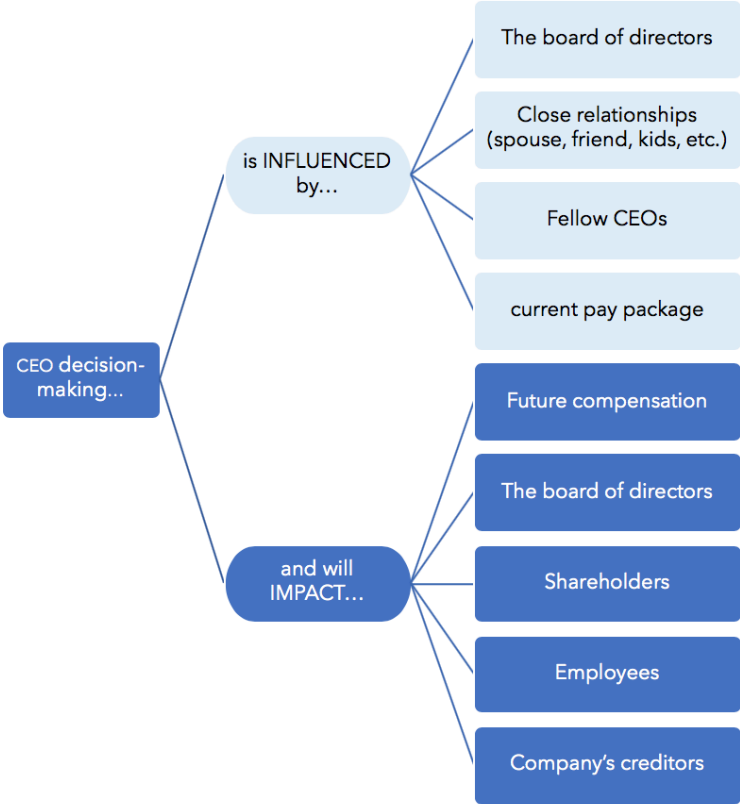


Exhibit 6: Compensation package formation process

