Appendix 1: Questionnaire Used in the Main Study

All questionnaires in the main study were administered online and were anonymous. Participants first completed a cover sheet providing basic demographic information, e.g., age, nationality, job title, industry sector. They were also asked to place themselves in one of three annual earnings bands. If the approximate annual value of their remuneration package was $350,000 or less, then they were asked to complete Questionnaire A; if their remuneration package was valued between $350,000 and $725,000, then they were asked to complete Questionnaire B; if the annual value was $725,000 or more, then they were asked to complete Questionnaire C. Monetary amounts in the three questionnaires were calibrated by reference to the earnings band. For convenience, the questions below include the monetary amounts which were included in Questionnaire A.

1. You are invited to participate in a one-off gamble. Which of the following choices would you prefer?

	Code
A. 50% chance of winning $5,250; otherwise nothing.	**1**
B. $2,250 for certain.	**2**
C. I am indifferent between A and B.	**3**

2. Given that the annual bonus of a senior executive of a large company is around $45,000 which of following choices would you prefer?

	Code
A. 50% chance of receiving $90,000; otherwise nothing.	**1**
B. $41,250 for certain.	**2**
C. I am indifferent between A and B.	**3**

3. You are invited to participate in a one-off gamble. Which of the following choices would you prefer?

	Code
A. A chance of winning $2,250 tomorrow with a probability of 75%; otherwise nothing.	**1**
B. A chance of winning $5,250 in three years' time with a probability of 75%; otherwise nothing.	**2**
C. I am indifferent between A and B.	**3**

4. Given that the median long-term incentive award of a senior executive of a large company is around $67,500 per year, which of the following choices would you prefer?

	Code
A. A chance of receiving $37,500 tomorrow with a probability of 75%; otherwise nothing.	**1**
B. A chance of receiving $90,000 in three years' time with a probability of 75%; otherwise nothing.	**2**
C. I am indifferent between A and B.	**3**

5. Given the same facts as in question 4, which of the following choices would you prefer?

	Code
A. A chance of receiving $56,250 tomorrow with a probability of 75%; otherwise nothing.	**1**
B. A chance of receiving $90,000 in three years' time with a probability of 75%; otherwise nothing.	**2**
C. I am indifferent between A and B.	**3**

6. You are invited to participate in a one-off gamble. Which of the following choices would you prefer?

	Code
A. 50% chance of winning $5,250; otherwise nothing.	**1**
B. A chance P% of winning $5,250 where P is unknown but is expected to be somewhere between 25% and 75%.	**2**
C. I am indifferent between A and B.	**3**

7. Given that the annual bonus of a senior executive of a large company is around $45,000 and the median long-term incentive award is around $67,500 per year, which of the following choices would you prefer?

	Code
A. A guaranteed bonus of \$45,000 payable in three years' time.	1
B. A guaranteed bonus of 10,000 shares deliverable in three years' time. The current share price is \$4.50. In the last 12 months the share price has fluctuated between \$2.25 and \$6.75.	2
C. I am indifferent between A and B.	3

8. Given the same facts as in question 7, which of the following would you prefer?

	Code
A. A cash bonus of up to \$52,500 payable in three years' time provided that your employing company's earnings per share during the period grows at a rate of at least 3% in excess of the Retail Price Index.	1
B. A bonus of up to 11,650 shares deliverable in three years' time, depending upon the company's relative total shareholder return over the period compared with a basket of comparable companies. The current share price is \$2.95. In the last 12 months the share price has fluctuated between \$2.50 and \$3.75. In previous years bonus payments have ranged between 62% and 72% of target.	2
C. I am indifferent between A and B.	3

9. Jean is invited to join the senior management team of Company A with a total reward package worth \$187,500. Jacques, a contemporary of Jean's with comparable expertise and experience, is invited to join the senior management team of Company B with a total reward package of \$195,000. Subsequently Jean discovers that the average total reward package of her peers in Company A's management team is \$180,000. Jacques discovers that the average total reward package of his peers in Company B's management team is \$202,500. All other things being equal, who do you think is likely to be more highly motivated?

	Code
A. Jean	1
B. Jacques	2
C. They are likely to be equally motivated	3

Please give your answers to the following questions by writing an amount in $s in the relevant box.

In an experiment two people are brought together. Person X is given $5,250 and is told he or she can split this in any way they like with Person Y. Person Y can accept or reject the offer. If Y accepts the offer then X and Y both get their money. If Y rejects the offer then neither X nor Y get to keep the money. Both parties are aware of the amount involved and the terms of the arrangement but are anonymous to each other and cannot negotiate over the outcome.

10. If you were person X, how much would you offer person Y? $ ☐

11. If you were person Y, what is the minimum offer you would accept from person X? $ ☐

In a separate experiment with different people, the rules are the same as in questions 10 and 11, but the amount to be shared is now $45,000.

12. If you were person X, how much would you offer person Y? $ ☐

13. If you were person Y, what is the minimum offer you would accept from person X? $ ☐

Francis is a senior executive at a large listed company where, in a typical year, he expects to earn around $225,000. While he enjoys his job, he does not feel particularly fulfilled. Outside work his principal hobby is music – he is an accomplished clarinet player and competent singer. Francis is approached by a head-hunter and asked if he would be interested in taking on a senior management role at a prestigious music college, a dream job. However, he is told that it would mean a significant reduction in salary. Except for his employment income, Francis is of modest wealth but also has limited outgoings.

14.	Other things being equal, what do you think is likely to be the minimum salary Francis would be prepared to accept if he were to take the new job?	$
15.	Relative to your current total earnings, what is the maximum discount on your current level employment income which *you* would be prepared to accept if you were offered your dream management job, like Francis?	%

Comment on the following statements as they apply to you personally by placing a √ in the box on the scale from 1 to 5 which most closely represents your views.

		1	2	3	4	5	
16.	I am strongly motivated by the opportunity to participate in my firm's long-term incentive plan						I am not particularly motivated by the opportunity to participate in my firm's long-term incentive plan
17.	I value the opportunity to participate in my firm's long-term incentive plan						I do not particularly value the opportunity to participate in my firm's long-term incentive plan
18.	My firm's LTIP is an effective incentive						My firm's LTIP is not an effective incentive

Appendix 2: Main Study Demographics

Variable	All participants[a] N= 756		Panel N= 12,860	
	Number	%	Number	%
Job title[b]				
Chairman	61	8.0	396	3.1
CEO/president/managing director	293	38.8	1,703	13.2
CFO/treasurer/comptroller	64	8.5	465	3.6
CIO/technology director	90	11.9	404	3.1
Other C-level executive	72	9.5	663	5.2
Senior vice president/vice president/director	144	19.0	690	5.4
Head of business unit	5	0.7	915	7.1
Head of department	11	1.5	1,303	10.1
Senior manager	3	0.4	2,824	22.0
Other senior executive	13	1.7	3,497	27.2
Age[c]				
Under 39	194	25.7	3,761	29.2
40–44	142	18.8	2,550	19.8
45–49	143	18.9	2,296	17.9
50–54	115	15.2	1,783	13.9
55–59	80	10.6	1,301	10.1
60–64	51	6.7	770	6.0
65+	31	4.1	399	3.1
Gender[d]				
Male	619	81.9	9,824	76.4
Female	137	18.1	3,036	23.6

(Continued)

Variable	All participants[a] N = 756		Panel N = 12, 860	
	Number	%	Number	%
Industry sector[e]				
Aerospace	12	1.6	142	1.1
Defence	6	0.8	92	0.7
Asset management	9	1.2	189	1.5
Automotive	14	1.9	337	2.6
Banking and capital markets	38	5.0	586	4.6
Business services	55	7.4	1,053	8.2
Capital projects and infrastructure	17	2.2	178	1.4
Chemicals	20	2.6	263	2.0
Communications	18	2.4	426	3.3
Energy, utilities and mining	23	3.0	361	2.8
Engineering and construction	53	7.0	950	7.4
Entertainment and media	22	2.9	399	3.1
Financial services	37	4.9	586	4.6
Forestry, paper and packaging	12	1.6	101	0.8
Government and public services	10	1.3	414	3.2
Healthcare	34	4.5	547	4.3
Hospitality and leisure	22	2.9	450	3.5
Industrial manufacturing	54	7.2	888	6.9
Insurance	23	3.0	331	2.6
Metals	14	1.9	183	1.4
Oil and gas	17	2.2	281	2.2
Pharmaceuticals and life sciences	15	2.0	308	2.4
Retail and consumer	60	7.9	1,024	8.0
Technology	69	9.1	840	6.5
Transport and logistics	26	3.4	411	3.2
Other	76	10.1	1,520	11.7
Country[f]				
United States	123	16.3	1,417	11.0
United Kingdom	34	4.5	826	6.4
France	35	4.6	976	7.6
Netherlands	55	7.3	255	2.0
Switzerland	40	5.3	325	2.5
Germany	31	4.1	340	2.6
Spain	30	4.0	270	2.1
Russia	45	6.0	380	3.0
Poland	30	4.0	275	2.1

Brazil	52	6.9	395	3.1
Mexico	28	3.7	536	4.2
Argentina	14	1.9	170	1.3
China	51	6.7	1,602	12.5
India	31	4.1	1,161	9.0
Australia	31	4.1	626	4.9
Middle East	75	9.9	431	3.3
South Africa	31	4.1	410	3.2
Other	20	2.6	2,463	19.2

Note: [a]Goodness of fit with the demographics of the underlying panel was tested using a χ^2 test, the overall result being χ^2 (62 df, N = 756) = 2.57, p < .005, indicating a significant degree of fit. Goodness of fit at individual factor level are shown in the following notes b to f. [b] χ^2 (9 df, N = 756) = 1.85, p < .001; [c] χ^2 (6 df, N = 756) = .011, p < .005; [d] χ^2 (1 df, N = 756) = .017, p < .25; [e] χ^2 (25 df, N = 756) = .055; p < .005; [f] χ^2 (17 df, N = 756) = .637, p < .005.

Appendix 3: Mathematical Proof of the Importance of Fairness in Teams

I. Assume that $\alpha + \beta \geq 0$, i.e., either that $\alpha, \beta \geq 0$ or, if $\beta < 0$, that $|\alpha| > |\beta|$

II. Given that:

(i) X and Y are members of a two-person team T, i.e., T: (X, Y)

(ii) X's utility function is:

$$U_X(v) = v_x - \alpha_x \max\left[\left(\frac{V_y}{C_y} - \frac{V_x}{X_c}\right), 0\right] - \beta_x \max\left[\left(\frac{V_x}{X_c} - \frac{V_y}{C_y}\right), 0\right]$$

(iii) Y's utility function is:

$$U_Y(v) = v_y - \alpha_y \max\left[\left(\frac{V_x}{C_x} - \frac{V_y}{C_y}\right), 0\right] - \beta_y \max\left[\left(\frac{V_y}{C_y} - \frac{V_x}{C_x}\right), 0\right]$$

(iv) We want to maximise team utility, i.e., $U_T(\nu) = U_X(\nu) + U_Y(\nu)$

III. Let $\left(\frac{V_x}{C_x}\right) = \delta$ and $\left(\frac{V_y}{C_y}\right) = \varepsilon$

IV. We know (from I.) that:

$$\begin{aligned} U_T(v) = {} & v_x - \alpha_x \max[(\varepsilon - \delta), 0] - \beta_x \max[(\delta - \varepsilon), 0] \\ & + v_y - \alpha_y \max[(\delta - \varepsilon), 0] - \beta_y \max[(\varepsilon - \delta), 0] \end{aligned}$$

V. If we assume that $\varepsilon > \delta$, then:

(i) $U_T(v) = v_x - \alpha_x(\varepsilon - \delta) + v_y - \beta_y(\varepsilon - \delta)$

(ii) $U_T(v) = v_x + v_y - \alpha_x(\varepsilon - \delta) - \beta_y(\varepsilon - \delta)$

(iii) $U_T(v) = (v_x + v_y) - (\alpha_x + \beta_y)(\varepsilon - \delta)$

Therefore, because $(\alpha_x + \beta_y) > 0$ and $(\varepsilon - \delta) > 0$, then:

(iv) $(v_x + v_y) > (v_x + v_y) - (\alpha_x + \beta_y)(\varepsilon - \delta)$

VI. If, alternatively, we assume that $\delta > \varepsilon$, then:

(i) $U_T(v) = v_x - \beta_x(\delta - \varepsilon) + v_y - \alpha_y(\delta - \varepsilon)$
(ii) $U_T(v) = v_x + v_y - \beta_x(\delta - \varepsilon) - \alpha_y(\delta - \varepsilon)$
(iii) $U_T(v) = (v_x + v_y) - (\alpha_y + \beta_x)(\delta - \varepsilon)$

Because $(\alpha_y + \beta_x) > 0$ and $(\delta - \varepsilon) > 0$, then:

(iv) $(v_x + v_y) > (v_x + v_y) - (\alpha_y + \beta_x)(\delta - \varepsilon)$

VII. If, as a further alternative, we assume that $\delta = \varepsilon$, therefore:

(i) Because $(\varepsilon - \delta) = (\delta - \varepsilon) = 0$
(ii) Then $U_T(v) = v_x + v_y$

VIII. Thus $U_T(v)$ is maximised when $\delta = \varepsilon$, i.e., when $\left(\frac{V_x}{C_x}\right) = \left(\frac{V_y}{C_y}\right)$. QED.

Future Research

The first scholarly paper to combine perspectives from behavioural decision theory with agency theory was written by Robert Wiseman and Luiz Gomez-Mejia and published in the *Academy of Management Review* in 1998.[1] This theoretical paper examined the impact of diverse compensation mechanisms and corporate governance arrangements on executive risk taking, and first coined the phrase "behavioural agency model". The paper was deliberately narrowly drawn, focusing on one dependent variable (executive risk taking), and it offered no empirical evidence. Sanders and Carpenter subsequently developed the behavioural agency framework (which they elevated to the status of a "theory") in their study of how stock repurchase programmes are used to help top managers manage shareholder expectations,[2] building on earlier empirical work by Sanders.[3]

Finkelstein, Hambrick and Cannella included a section on behavioural agency theory in their book summarising the research on executives, top-management teams and corporate boards ("upper echelons theory").[4] This anticipates the connection made in Chapter 3 between the behavioural agency model and upper echelons theory. What was until now the most comprehensive summary of behavioural agency theory can be found in Rebitzer and Taylor's chapter in the 4th volume of Ashenfelter and Card's authoritative *Handbook of Labor Economics*.[5] This in turn anticipates a number of the themes which have been developed further in this monograph, including ideas about intrinsic and extrinsic motivation, crowding-out, identity, and inequity aversion.

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[1] Wiseman, R., & Gomez-Mejia, L. (1998). A behavioral agency model of managerial risk taking. *Academy of Management Review, 23*(1), 133–153.

[2] Sanders, G., & Carpenter, M. (2003). A behavioral agency theory perspective on stock repurchase program announcements. *Academy of Management Journal, 46*(3), 160–178.

[3] Sanders, W. G. (2001). Behavioral responses of CEOs to stock ownership and stock option pay. *Academy of Management Journal, 44*(3), 477–493.

[4] Finkelstein, S., Hambrick, D., & Cannella, A. (2009). *Strategic leadership: Theory and research on executives, top management teams, and boards*. Oxford: Oxford University Press.

[5] Rebitzer, J., & Taylor, L. (2011). Extrinsic rewards and intrinsic motives: Standard and behavioral approaches to agency and labor markets. In O. Ashenfelter & D. Card (Eds.), *Handbook of Labor Economics* (Vol. 4A, pp. 701–772). Amsterdam: North-Holland.

My research builds upon these scholarly foundations, expanding the analysis of risk and uncertainty, incorporating time preferences, developing the analysis of intrinsic and extrinsic motivation, and extending the work on inequity aversion. Importantly, by conjoining upper echelons theory and behavioural agency theory, it builds an explicit link between agent compensation, motivation and corporate (firm) performance. It also includes empirical evidence from a unique primary data set of executive preferences from around the world. Nevertheless, I recognise that there are still many gaps in the theory and the evidence base, and I have described the most obvious of these in the following section.

Future research

Two of the three factors – agent ability and work opportunity – which, it is postulated, along with agent motivation, determine individual performance, are not explored in detail in this monograph. Agent ability, conceptualised in terms of education, experience, skills, values and habits, (some economists would describe this as "individual human capital") is taken as given. Clearly, however, individual human capital varies from person to person and this is likely to be causally connected in some way with agent performance. This gives rise to an interesting research idea: if a financial value could be placed on individual human capital, then it might be possible to compare an executive's return on their human capital with an investor's return on their financial capital – fixed salary equating to interest on debt, while variable pay (annual bonuses and long-term incentives) equates to dividends on shares. However, it in turn begs the question of how to value individual human capital. One possibility is by aggregating inputs – for example, the cost of an executive's education and training – but this ignores the value of the skill and experience which an executive acquires on the job. Another approach would be to capitalise the expected income which the executive might obtain from their second best career option, that is, their most obvious alternative job opportunity. Work opportunity might simply be regarded as an exogenous, uncontrollable variable ("the luck of the draw"), although I wonder if network theory could be used to explain how some executives "make their own luck" by positioning themselves strategically in their various work and social networks.

The empirical work on intrinsic motivation described in Chapter 5 is incomplete; in particular there is limited evidence among senior executives in support of the strong crowding-out conjecture (as opposed to the weak crowding-out conjecture, where the theoretical case and empirical evidence is more compelling). Does increasing pay beyond a certain point actually undermine intrinsic motivation, so that total motivation begins to decrease? Observers of recent organisational behaviour in the banking and securities industry might be tempted to answer this question in the affirmative, but scientific information is hard to find (and may be hard to collect).

The fairness study in Chapter 6 appears to establish that incorporating a factor for greed into the fairness equation is necessary to explain some agent behaviour, but the extent of this is not quantified. Is greed, however narrowly defined, a significant feature of executive behaviour? If so, how should companies (and society) respond? To what extent can regulatory action be used to nudge executive behaviours in a direction which might be regarded as more socially acceptable (and who is to judge this)? At what point do positive or instrumental questions about what is or, pragmatically speaking, might be the case, become normative questions about what should be – in other words at what point do ethics force their way back into the fairness debate? Opinions about this are plentiful, but scholarly evidence is limited. An eclectic approach to researching these questions would appear to be necessary.

Finally, Chapter 7 sets out the conundrum of the remuneration committee's dilemma and explains how good design thinking might be undone by "strategic" behaviour. It describes in general terms how new norms (formal and informal institutions) are needed to address the situation, and draws some parallels with the social and legal response to tax avoidance in the UK. However, this part of the story is far from complete and more work, by institutional economists and political scientists, is clearly needed.

Further Reading

I set out below details of the books, articles and collections of essays which I have found most useful in my research. An extensive bibliography can also be found at the end of the book.

Executive pay

While there are many books about pay, one of the best general introductions is Gomez-Mejia, L., Berrone, P., & Franco-Santos, M. (2010). *Compensation and organizational performance: Theory, research, and practice*. M.E. Sharpe, Inc. Another introduction to the subject which is worth considering, written in non-technical language by a well-known labour economist, is: Hallock, K. (2012). *Pay: Why people earn what they earn (and what you can do now to make more)*. Cambridge University Press. Both books cover pay theory and practice generally, as well as containing important sections on executive compensation. On executive pay specifically, you might like to look at my own short book: Pepper, A. (2006). *Senior executive reward – Key models and practices*. Aldershot: Gower.

Agency theory

The seminal article which scholarship on agency theory generally refers back to is Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305–360. Michael Jensen's work on agency theory and the theory of the firm has been brought together in two volumes: Jensen, M. (1998). *Foundations of organizational strategy*. Cambridge, MA: Harvard University Press; and Jensen, M. (2000). *A theory of the firm: Governance, residual claims, and organizational forms*. Cambridge, MA: Harvard University Press.

A good, short summary of agency theory written by a management scholar, without recourse to formal language, is Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review, 14*(1), 57–74. A useful edited collection of articles on agency theory generally is Pratt, J., & Zeckhauser, R. (Eds.). (1991). *Principals and agents: The structure of business*. Cambridge, MA: Harvard Business School Press.

The growing literature on behavioural agency theory includes: Wiseman, R., & Gomez-Mejia, L. (1998). A behavioral agency model of managerial risk taking. *Academy of Management Review, 23*(1), 133–153; Sanders, G., & Carpenter, M. (2003). A behavioral agency theory perspective on stock repurchase program announcements. *Academy of Management Journal, 46*(3), 160–178; and Rebitzer, J., & Taylor, L. (2011). Extrinsic rewards and intrinsic motives: Standard and behavioral approaches to agency and labor markets. In O. Ashenfelter & D. Card (Eds.), *Handbook of labor economics* (Vol. 4A, pp. 701–772). Amsterdam: North-Holland.

Top-management teams

"Upper echelons theory", a way of thinking about top-management teams which has influenced my thinking about agency, was first described in Hambrick, D., & Mason, P. (1984). Upper echelons: The organization as a reflection of its top managers. *Academy of Management Review, 9*(2), 193–206. The upper echelons literature is summarised and examined in Finkelstein, S., Hambrick, D., & Cannella, A. (2009). *Strategic leadership: Theory and research on executives, top management teams, and boards*. Oxford: Oxford University Press.

Risk, uncertainty and time discounting

The key works on heuristics and biases are of course Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica, 47*, 263–291; and Tversky, A., & Kahneman, D. (1992). Advances in prospect theory: Cumulative representation of uncertainty. *Journal of Risk and Uncertainty, 5*, 297–323. Both these articles are also contained in two very comprehensive collections of essays on risk and uncertainty: Kahneman, D., Slovic, P., & Tversky, A. (1982). *Judgment under uncertainty: Heuristics and biases*. Cambridge: Cambridge University Press; and Gilovich, T., Griffen, D., & Kahneman, D. (2002). *Heuristics and biases: The psychology of intuitive judgment*. Cambridge: Cambridge University Press.

Much of Daniel Kahneman's thinking has been summarised in non-technical language in his book *Thinking fast and slow*, first published by Allen Lane in 2011 and subsequently reissued in paperback by Penguin Books.

Collections of essays on time preferences can be found in: Loewenstein, G., & Elster, J. (1992). *Choice over time*. New York: Russell Sage Foundation; and Loewenstein, G., Read, D., & Baumeister, R. (2003). *Time and decision: Economic and psychological perspectives on intertemporal choice*. New York: Russell Sage Foundation.

Motivation

Three standard text books on work motivation generally are: Pinder, C. C. (2008). *Work motivation in organizational behaviour* (Second ed.). New York and Hove: Psychology Press, Taylor & Francis Group; Kanfer, R., Chen, G., & Pritchard, R. (2008). *Work motivation, past, present and future*. New York and Hove: Taylor & Francis Group; and Latham, G. (2012). *Work motivation: History, theory, research, and practice*. New York: Sage Publications Inc.

A surprisingly good introduction to motivation theory written in non-technical language by a popular writer on business, work and management and is by Pink, D. (2009). *Drive: The surprising truth about what motivates us*. New York: Riverhead Books.

The economist Bruno Frey has written extensively on the relationship between intrinsic and extrinsic motivation. Much of this is summarised in his short book: Frey, B. (1997). *Not just for money: An economic theory of personal motivation*. Cheltenham, UK: Edward Elgar Publishing.

The connection between prospect theory and motivation is made in Steel, P., & Konig, C. (2006). Integrating theories of motivation. *Academy of Management Review, 31*(4), 889–913.

Fairness

The main journal articles underpinning Chapter 6 are: Fehr, E., & Schmidt, K. (1999). A theory of fairness, competition, and cooperation. *Quarterly Journal of Economics, 114*(3), 817–868; Varian, H. (1974). Equity, envy and efficiency. *Journal of Economic Theory, 9*(1), 63–91; and Varian, H. (1975). Distributive justice, welfare economics and the theory of fairness. *Philosophy and Public Affairs, 4*(3), 223–247. The second article by Varian restates many of the ideas in the first article, but without calling upon mathematics.

The different philosophical positions on fairness are found in: Nozick, R. (1973). Distributive justice. *Philosophy and Public Affairs, 3*(1), 45–126; Rawls, J. (2001). *Justice as fairness*. Cambridge, MA: Belknap Press of Harvard University Press; and Cohen, G. (2001). *If you're an egalitarian, how come you're so rich?* Cambridge, MA: Harvard University Press.

The economics of fairness is explained in Baumol, W. (1986). *Superfairness: Applications and theory*. Cambridge, MA: MIT Press.

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Author Index

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Subject Index

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