Peculiarities Abound:
Capping Management Salaries?

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March 09, 2012

Abstract: *The long standing reservations against disproportionate management salaries evolved to fresh concerns during and after the financial meltdown of late 2008 (e.g. Muehlbert 2009). Since then public discussion is on a new peak centering on finally regulating excessive management remuneration. We ask for justifications for a regulatory cap on management regulation and employ an economic perspective which is reinforced by behavioural considerations. We identify the contracting decision on the management remuneration schemes to be two-dimensional concerning (1) the absolute level of payment and (2) the incentive-compatible proportion. We argue that on the one hand skewed peer group comparisons as presented by Faulkender and Yang (2010) may push the first dimension excessively high while excessive bonuses on the other hand do not reflect a proportionate increase in performance (Ariely et al. 2009) as would be desirable. We do not conclude, however, that management salaries should simply be capped because there is ample reason that such a harsh, impetuous, and inconsiderate policy might backfire. Instead of such a crude approach we advocate prudent regulation which accounts for unintended consequences. Hence we rather propose well-informed measures. These involve, for one, developing a frame for peer group comparisons. For another, well-informed policing also means not hastily relying on yet incomplete (behavioural) research on the relation of incentive and performance in the first place.*

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