How limiting CEO pay can be more effective, less costly

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CEOs make a lot of money from incentive pay tied to stock performance. Although such schemes help align executives' interests with shareholders, they are not necessarily the best schemes as compared to schemes that rely on trust between board and executives.

"Ironically, the necessary trust is easier to establish when the alternative of using stock-based pay is less powerful. Our research found that government-imposed limits on contingent compensation make stock-based pay a worse alternative, facilitating superior trust-based incentives," says Ben Hermalin, an economist in the Haas Economic Analysis and Policy Group, UC Berkeley's Haas School of Business,

The paper, "When Less is More: The Benefits of Limits on Executive Pay," forthcoming in the *Review of Financial Studies*, is co-authored by Prof. Hermalin and Peter Cebon, senior research fellow, Melbourne Business School, University of Melbourne.

More information: When Less Is More: The Benefits of Limits on Executive Pay, *Rev. Financ. Stud*. (2014) DOI: 10.1093/rfs/hhu140

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