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Abstract

The author, using 1981 s, investigates whether the sensitivity of managerial compensation to corporate performance in one year is positively related to corporate performance in the next year. Accounting-based measures of performance yield only weak evidence of such an association, but economic and market measures yield stronger evidence. Payment of an incremental 10% bonus for good economic performance is associated with a 30 to 90 basis point increase in the expected after-tax gross economic return in the following fiscal year; and payment of an incremental raise of 10% following a good stock market performance is associated with a 400 to 1200 basis point increase in expected total shareholder return.

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