

[Home](#) > [Journal of Regulatory Economics](#) > [Article](#)

# Founders versus non-founders in large companies: financial incentives and the call for regulation

Original Article | Published: 24 October 2007


Volume 33, pages 55–86, (2008) [Cite this article](#)



## [Journal of Regulatory Economics](#)

[Aims and scope](#) →

[Submit manuscript](#) →

[Darius Palia](#) <sup>1</sup>, [S. Abraham Ravid](#)<sup>1,2</sup> & [Chia-Jane Wang](#)<sup>3</sup>

 411 Accesses  34 Citations [Explore all metrics](#) →

## Abstract

This paper is intended to question some of the premises in the ever increasing calls to regulate executive pay. We focus on founders, and extend Shleifer and Vishny's (1989, *Journal of Political Economy*, 94, 461–488) manager-specific investments model by explicitly modeling managerial effort and pay performance sensitivity. Tests of this model on a data set of large companies, controlling for the endogeneity of managerial compensation, indicate that founders tend to be less responsive to performance incentives and generally more entrenched. At the same time, founders' led firms are more valuable, supporting our predictions. This suggests that for founders, regulation of compensation may not be very effective.



This is a preview of subscription content, [log in via an institution](#) to check access.

### Access this article

[Log in via an institution](#) →

[Buy article PDF 39,95 €](#)

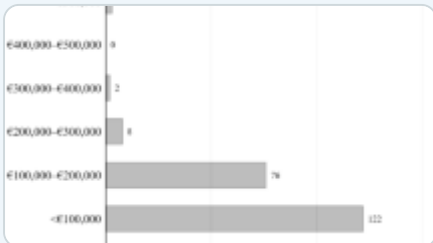
Price includes VAT (Poland)

Instant access to the full article PDF.

Rent this article via [DeepDyve](#)

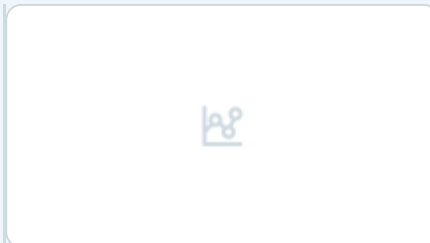
[Institutional subscriptions](#) →

### Similar content being viewed by others



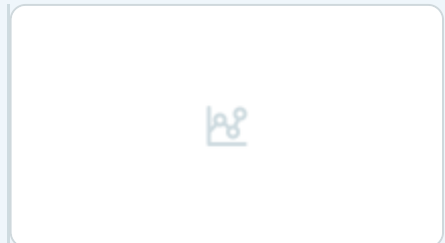
**[Determinants of executive pay in small private firms—initial evidence from Germany](#)**

Article | 04 June 2023



**[What do we know about executive compensation at small privately held firms?](#)**

Article | 07 December 2015



**[A Research Agenda for Examining the Role of Compensation Consultants in the Executive Pay Process](#)**

Article | 11 June 2016

## References

Adams, Renée B., Almeida, Heitor, & Ferreira, Daniel (2003). *Understanding the relationship between founder-CEOs and firm performance*. Working Paper: New York University.

Agarwal Anup, Mandelker Gershon N. (1987). Managerial incentives and corporate investment and financing decisions. *Journal of Finance* 42: 823-837

[Article](#) [Google Scholar](#)

Alsos Gry A., Kolvereid Lars (1998). The business gestation process of novice, serial and parallel business founders. *Entrepreneurship, Theory and Practice* 22: 101-114

[Google Scholar](#)

Anderson Ronald C., Reeb David M. (2003). Founding family ownership and firm performance: Evidence from the S&P 500. *Journal of Finance* 58: 1301-1328

[Article](#) [Google Scholar](#)

Barro Jason R., Barro Robert J. (1990). Pay performance and turnover of bank CEOs. *Journal of Labor Economics* 8: 448-481

[Article](#) [Google Scholar](#)

Bebchuk Lucian A., Fried Jesse M. (2004). *Pay without performance*. Boston: Harvard University Press.

[Google Scholar](#)

Begley Thomas (1995). Using founder status, age of the firm, and company growth rate as the basis for distinguishing entrepreneurs from managers of smaller businesses. *Journal of Business Venturing* 10: 249-263

[Article](#) [Google Scholar](#)

Berger Philip G., Ofek Eli, Yermack David L. (1997). Managerial Entrenchment and capital structure decisions. *Journal of Finance* 52: 1411-1438

[Article](#) [Google Scholar](#)

Bertrand Marianne, Schoar Antoinette S. (2003). Managing with style: The effect of managers on firm policies. Quarterly Journal of Economics 118: 1169-1208

[Article](#) [Google Scholar](#)

Black Fischer, Scholes Myron M. (1973). The Pricing of options and corporate liabilities. Journal of Political Economy 81: 637-659

[Article](#) [Google Scholar](#)

Brockhaus Robert H., Horwitz Pamela S. (1986). The psychology of the entrepreneur. In: Sexton Donald L., Smilor Raymond W. (eds) The art and science of entrepreneurship. Ballinger Publishing Company, Cambridge

[Google Scholar](#)

Burkart Mike., Panunzi Fausto, Shleifer Andrei (2003). Family firm. Journal of Finance 58: 2167-2202

[Article](#) [Google Scholar](#)

Carland James W., Hoy Frank, Boulton William R., Carland Jo Ann C. (1984). Differentiating entrepreneurs from small business owners: A conceptualization. Academy of Management Review 9: 354-359

[Article](#) [Google Scholar](#)

Carroll Thomas M., Ciscel David H. (1982). The effects of regulation on executive compensation. Review of Economics and Statistics 64(August): 505-509

[Article](#) [Google Scholar](#)

Chevalier Judith, Ellison Glenn (1999). Are some mutual fund managers better than others? Cross-sectional patterns in behavior and performance. Journal of

[Article](#) [Google Scholar](#)

Coles, Jeffrey L., Meschke, Felix, & Lemmon, Michael L. (2003). *Structural models and endogeneity in corporate finance: The link between managerial ownership and corporate performance*. Working Paper. Tempe: Arizona State University.

Core John E., Guay Wayne R. (1999). The use of equity grants to manage optimal equity incentive levels. *Journal of Accounting and Economics* 28: 151-184

[Article](#) [Google Scholar](#)

Defusco Richard A., Johnson Robert R., Zorn Thomas S. (1990). The effect of executive stock option plans on stockholders and bondholders. *Journal of Finance* 45: 617-627

[Article](#) [Google Scholar](#)

Demsetz Harold, Lehn Kenneth (1985). The structure of corporate ownership: Causes and consequences. *Journal of Political Economy* 93: 1155-1177

[Article](#) [Google Scholar](#)

Edlin Aaron S., Stiglitz Joseph E. (1995). Discouraging rivals: Managerial rent-seeking and economic inefficiencies. *American Economic Review* 85: 1301-1312

[Google Scholar](#)

Fahlenbrach, Rüdiger (2006). Founders-CEOs, investment decisions and stock market performance. Ohio State University Working Paper.

Garvey Gerald T. (1997). Marketable incentive contracts and capital structure

relevance. Journal of Finance 52: 353-378

[Article](#) [Google Scholar](#)

Gibbons Robert, Murphy Kevin J. (1992). Optimal incentive contracts in the presence of career concerns: Theory and evidence. Journal of Political Economy 88: 468-505

[Article](#) [Google Scholar](#)

Gompers Paul A., Ishii Joy, Metrick Andrew A. (2003). Corporate governance and equity price. The Quarterly Journal of Economics 118: 107-155

[Article](#) [Google Scholar](#)

Greene William H. (1997). Econometric analysis. Prentice Hall Publishers, Upper Saddle River

[Google Scholar](#)

Guay Wayne R. (1999). The Sensitivity of ceo wealth to equity risk: An analysis of the magnitude and determinants. Journal of Financial Economics 53: 43-71

[Article](#) [Google Scholar](#)

Gujarati Damodar N. (2003). Basic econometrics. New York: McGraw-Hill

[Google Scholar](#)

Hartzell Jay C., Starks Laura T. (2003). Institutional Investors and Executive Compensation. Journal of Finance 54: 2351-2374

[Article](#) [Google Scholar](#)

Hermalin Benjamin E., Weisbach Michael S. (1991). The effects of board

composition and direct incentives on firm performance. Financial Management  
20: 101-112

[Article](#) [Google Scholar](#)

Himmelberg Charles P., Hubbard Glenn R., Palia Darius (1999). Understanding the determinants of managerial ownership and the links between ownership and firm performance. Journal of Financial Economics 53: 353-384

[Article](#) [Google Scholar](#)

Holderness Clifford G., Kroszner Randall S., Sheehan Dennis P. (1999). Were the good old days that good? Evolution of managerial stock ownership and corporate governance since the great depression. Journal of Finance 54: 353-384

[Article](#) [Google Scholar](#)

Holmstrom Bengt (1979). Moral hazard and observability. Bell Journal of Economics 10: 74-91

[Article](#) [Google Scholar](#)

Holmstrom Bengt (1982). Moral hazard in teams. Bell Journal of Economics 13: 324-40

[Article](#) [Google Scholar](#)

Holmstrom Bengt (1999). Managerial incentive problems: A dynamic perspective. Review of Economic Studies 66: 169-182

[Article](#) [Google Scholar](#)

Houston Joel F., James Christopher M. (1995). CEO compensation and bank risk: Is compensation in banking structured to promote risk taking? Journal of Monetary Economics 36: 405-431

[Article](#) [Google Scholar](#)

Hubbard Glenn R., Palia Darius (1995). Executive pay and performance: Evidence from the U.S. Banking industry. *Journal of Financial Economics* 39: 105–130

[Article](#) [Google Scholar](#)

Jensen Michael C., Murphy Kevin J. (1990b). Performance pay and top-management incentives. *The Journal of Political Economy* 98: 225–264

[Article](#) [Google Scholar](#)

Johnson W. Bruce, Magee Robert P., Nagarajan Nandu J., Newman Harry A. (1985). An analysis of the stock price reaction to sudden executive deaths: Implications for the managerial labor market. *Journal of Accounting and Economics* 7: 151–174

[Article](#) [Google Scholar](#)

Joskow Paul L., Rose Nancy L., Shepard Andrea (1993). Regulatory constraints on ceo compensation. *Brookings Papers on Economic Activity, Microeconomics* 1: 1–72

[Article](#) [Google Scholar](#)

Kim Moshe, Maksimovic Vojislav (1990). Debt and input misallocation. *Journal of Finance* 45: 795–816

[Article](#) [Google Scholar](#)

Kole Stacey R. (1995). Measuring managerial equity ownership: A comparison of sources of ownership data. *Journal of Corporate Finance* 1: 413–435

[Article](#) [Google Scholar](#)



Loderer Claudio F., Martin Kenneth (1997). Executive stock options and performance tracking faint traces. *Journal of Financial Economics* 45: 223-255

[Article](#) [Google Scholar](#)

McConnell John J., Servaes Henri (1990). Additional evidence on equity ownership and corporate value. *Journal of Financial Economics* 27: 595-612

[Article](#) [Google Scholar](#)

Mishra Chandra S., McConaughy Daniel L. (1999). Founding family control and capital structure: The risk of loss of control and aversion to debt. *Entrepreneurship, Theory and Practice* 23: 53-64

[Google Scholar](#)

Morck Randall K., Shleifer Andrei, Vishny Robert W. (1988a). Characteristics of targets of hostile and friendly takeovers. In: Auerbach A.J. (eds) *Corporate takeovers: Causes and consequences*. University of Chicago Press, Chicago

[Google Scholar](#)

Morck Randall K., Shleifer Andrei, Vishny Robert W. (1988b). Management ownership and market valuation. *Journal of Financial Economics* 20: 293-315

[Article](#) [Google Scholar](#)

Morck, Randall K., Strangeland, David A., & Yeung, Bernard (1998). Inherited wealth corporate control and economic growth: The Canadian disease? NBER Working Paper 6814.

Murphy Kevin J. (1985). Corporate performance and managerial remuneration: An empirical analysis. *Journal of Accounting Economics* 7: 11-42

[Article](#) [Google Scholar](#)

Murphy Kevin J. (1986). Incentives, learning, and compensation: A theoretical and empirical investigation of managerial labor contracts. Rand Journal of Economics 17: 59-76

[Article](#) [Google Scholar](#)

Palia Darius (2001). The endogeneity of managerial compensation in firm valuation: A solution. Review of Financial Studies 14: 735-764

[Article](#) [Google Scholar](#)

Palia Darius (2000). The impact of regulation on CEO labor markets. RAND Journal of Economics 31: 165-179

[Article](#) [Google Scholar](#)

Palia Darius, Lichtenberg Frank (1999). Managerial ownership and firm performance: A re-examination using productivity measurement. Journal of Corporate Finance 5: 323-339

[Article](#) [Google Scholar](#)

Perez-Gonzalez Francisco (2001). Does inherited control hurt firm performance? Working Paper. New York: Columbia University

[Google Scholar](#)

Perry Tod, Zenner Marc (2001). Pay for performance? Government regulation and the structure of compensation contracts. Journal of Financial Economics 62: 453-488

[Article](#) [Google Scholar](#)

Rajgopal Shivaram, Shevlin Terry (2002). Empirical evidence on the relation

between stock option compensation and risk taking. *Journal of Accounting and Economics* 33: 145-171

[Article](#) [Google Scholar](#)

Roth, Philip L., & Stewart, Wayne H. (2000). *Risk taking propensity as a distinctive entrepreneurial characteristic: A meta-analytic review*. Mimeo. Clemson: Clemson University.

Rubenson George C., Gupta Anil K. (1996). A contingency model of founder tenure. *Entrepreneurship Theory and Practice* 21: 21-35

[Google Scholar](#)

Hyun-Han Shin, Stulz René M. (1998). Are internal capital markets efficient?. *Quarterly Journal of Economics* 113: 531-552

[Article](#) [Google Scholar](#)

Shleifer Andrei, Vishny Robert W. (1986). Large shareholders and corporate control. *Journal of Political Economy* 94: 461-488

[Article](#) [Google Scholar](#)

Shleifer Andrei, Vishny Robert W. (1989). Management entrenchment: The case of manager-specific investments. *Journal of Financial Economics* 25: 123-139

[Article](#) [Google Scholar](#)

Smith Clifford W., Watts Ross L. (1992). The investment opportunity set and corporate financing, dividend and compensation policies. *Journal of Financial Economics* 32: 263-292

[Article](#) [Google Scholar](#)

Stein, Nicholas (2001). The age of the scion. *Fortune* (April): 121-128.

Villalonga Belen, Amit Raphael (2004). How do family ownership, management, and control affect firm value Working Paper. Cambridge: Harvard Business School

[Google Scholar](#)

Wooldridge Jeffrey M. (2002). Econometric analysis of cross section and panel data. Cambridge: MIT Press

[Google Scholar](#)

Yermack David (1995). Do corporations award CEO stock options effectively? *Journal of Financial Economics* 39: 237-269

[Article](#) [Google Scholar](#)

Zhou Xianming (2001). Understanding the Determinants of Managerial Ownership and the Link Between Ownership and Performance: Comment. *Journal of Financial Economics* 25: 2015-2040

[Google Scholar](#)

## Author information

---

### Authors and Affiliations

**Rutgers Business School, Newark and New Brunswick, 111 Washington Street, Newark, NJ, 07102, USA**

Darius Palia & S. Abraham Ravid

**Johnson School of Management, Cornell University, Sage Hall, Ithaca, NY, 14853, USA**

S. Abraham Ravid

## Corresponding author

Correspondence to [Darius Palia](#).

## Rights and permissions

---

[Reprints and permissions](#)

## About this article

---

### Cite this article

Palia, D., Ravid, S.A. & Wang, C.J. Founders versus non-founders in large companies: financial incentives and the call for regulation. *J Regul Econ* **33**, 55–86 (2008). <https://doi.org/10.1007/s11149-007-9042-z>

Published

24 October 2007

Issue Date

February 2008

DOI

<https://doi.org/10.1007/s11149-007-9042-z>

### Keywords

[Founder](#)

[Management compensation](#)

### JEL Classifications

[G32](#)

[G34](#)

Search by keyword or author



## Navigation

Find a journal

---

Publish with us

---

Track your research

---

