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Internal Capital Markets and Firm-Level Compensation Incentives for Division Managers

by Julie Wulf

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Abstract

Do multidivisional firms structure compensation contracts for division managers to mitigate incentive problems in their internal capital markets? I find evidence that compensation and investment incentives are substitutes: firms providing a stronger link to firm performance in incentive compensation for division managers also provide weaker investment incentives through the capital budgeting process. Specifically, as the proportion of incentive pay for division managers that is based on firm performance increases, division investment is less responsive to division profitability. These findings are generally consistent with a model of influence activities by division managers in interdivisional capital allocation decisions.

Keywords: Capital Markets; Executive Compensation; Capital Budgeting; Motivation and Incentives; Profit; Decisions; Resource Allocation; Performance; Investment; Contracts;

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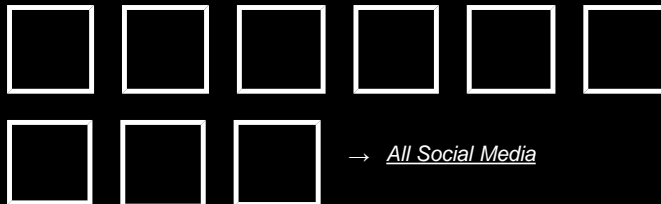
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