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Collaborative Research Center Transregio 224

Economic Perspectives on Societal Challenges: Equality of Opportunity, Market Regulation, and Financial Stability - EPoS

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PRESS RELEASE

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Research: How Executive Pay Harms Corporate Productivity

- **New study shows how compensation affects investment decisions**
- **Manager bonuses lower long-term investments**
- **EPoS Economic Research Centre presents new study**

Bonn, Mannheim, 17.02.2025 – **The compensation managers receive for their performance affects their investment decisions and thus the long-term productivity of companies. Because bonuses are linked to short-term profits, they discourage investments that pay off in the long run. As a result, productivity falls. This has an impact on the economic performance of an entire country, as researchers have now shown for the first time. They argue in favor of compensating managers with equity. The EPoS Economic Research Centre at the Universities of Bonn and Mannheim has published these findings in the discussion paper "Capital (Mis) allocation, Incentives and Productivity".**

"Bonus payments give managers a share in short-term company profits, which is why they often neglect long-term investments," says Matthias Meier of the EPoS Economic Research Centre. "Compensating executives instead with equity options has the advantage that their value increases if the company generates higher profits in the long run. In our view, this is a better way to promote economic performance. They encourage much-needed investments and contribute to overall productivity."

Short- and long-term investments
Typical long-term investment projects are new production facilities, whereas buying new computers and spending on marketing are rather short-term investments. If managers focus primarily on the short term, investment in new production facilities and other long-term projects will be low, creating less value added and reducing productivity. This affects the whole economy.

Policymakers should make long-term incentives attractive
"Managerial compensation is an important factor not only for the development of a particular company, but also for the overall economy," says Meier. "A 35 per cent increase in managers' share of short-term profits reduces gross domestic product by one to three per cent in the long term." Policymakers have a wide range of options for intervening through taxation or accounting rules. Thereby they can influence the attractiveness of different compensation systems and investment incentives. "To promote economic performance, policymakers should establish frameworks that promote long-term incentives in managerial compensation," says Meier.

About the study
In their empirical study, the researchers analyze the impact of new accounting regulations in the USA from 2005 on the compensation of managers and their investment decisions. They study a total of 725 listed companies from various industries between 2000 and 2014.

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The presented discussion paper is a publication without peer review of the Collaborative Research Center Transregio 224 EPoS. Access the full discussion paper here: https://www.crctr224.de/research/discussion-papers/archive/dp637

Find the list of all discussion papers of the CRC here: https://www.crctr224.de/research/discussion-papers.

Authors
Matthias Meier, Assistant Professor of Economics, University of Mannheim and member of EPoS Economic Research Center
Alexander Schramm, Consultant, Munich Re
Alexander Schwemmer, Financial Attaché, Federal Foreign Office of Germany
Jan Schymik, Acting Professor of Economics, University of Mannheim and member of EPoS Economic Research Center

The Collaborative Research Center (CRC) Transregio 224 EPoS
Established in 2018, the Collaborative Research Center Transregio 224 EPoS, a cooperation of the universities Bonn and Mannheim, is a long-term research institution funded by the German Research Foundation (Deutsche Forschungsgemeinschaft, DFG). EPoS addresses three key societal challenges: how to promote equality of opportunity; how to regulate markets in light of the internationalization and digitalization of economic activity; and how to safeguard the stability of the financial system.

Press Contact
econNEWSnetwork
Sonja Heer
Tel. + 49 (0) 40 82244284
Sonja.Heer@econ-news.de

Contact
Matthias Meier
University of Mannheim
m.meier@uni-mannheim.de

CRC TR 224 Office, Marja Eisheuer
phone | +49 228 737926
email | crctr224@uni-bonn.de

www.crctr224.de