

Own-Company Stockholding and Work Effort Preferences of an Unconstrained Executive

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Abstract

We develop a framework for analyzing an executives own-company stockholding and work effort preferences. The executive, characterized by risk aversion and work effectiveness parameters, invests his personal wealth without constraint in the financial market, including the stock of his own company whose value he can directly influence with work effort. The executives utility- maximizing personal investment and work effort strategy is derived in closed form, and a utility indifference rationale is applied to determine his required compensation. Being unconstrained by performance contracting, the executives work effort strategy establishes a base case for theoretical or empirical assessment of the benefits or otherwise of constraining executives with performance contracting.

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