***Too Much is Not Enough: Incentives in Executive Compensation*, by Robert W. Kolb. New York: Oxford University Press, 2012; xi + 216 pp.; ISBN 978-0-19-982958-3**

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Over the past two decades varied voices have charged that corporate executives receive compensation that is outrageously excessive, generally unmerited, grossly disproportionate to the salaries of other employees, or altogether incompatible with ideals of equality. In 2012, Lawrence J. Ellison, the chief executive officer (CEO) of Oracle Corporation, received total compensation valued at $96.2 million, most of it from stocks and options (Schwartz 2013). That amount *seems* like a lot, and in fact it is: assuming Mr. Ellison worked thirteen hours a day, six days a week, with no holidays, then his hourly equivalent would have been $23,718—not bad!

Such compensation *seems* outrageous. But is it? Immediate responses are not incorrigible and reactions to executive compensation are often uninformed and, therefore, *un*considered. Robert W. Kolb seeks to remedy this lack of understanding and he does so with success. Less an ethical assessment of executive compensation than a primer on its underlying principles, Kolb's nine-chapter volume offers a complete account of how diverse forms and structures of executive compensation seek to incentivize a CEO (and other high-level executives of large corporations) to strive to augment the value of the firm. One of the few business ethicists who knows the mathematics of finance, Kolb illuminates the forms and structures of executive compensation, sets forth their rationales, and lays out the varying ways in which one type or package of compensation may provide incentives to an executive to take a risk on behalf of the firm. In analytical and nuanced detail, and shorn of special pleading or zealous enthusiasms, he distills a wide range of studies into lucid and readable prose so that the reader may understand the theoretical bases and empirical research that support (or counter) claims regarding the efficacy of some form of compensation.

The rise in value of large corporations has tended to track the growth of executive compensation. The executive would seem to have a significant, if not unique, potential to affect the trajectory of a firm. The way to generate the best outcomes is, presumably, to put together the right sort of compensation package, the smallest element of which is the salary. Rounding out the package would be cash or stock bonuses, executive stock options (ESOs), and long-term incentive or bonus plans, as well as pension plans, retirement accounts, departure payments and other assorted perquisites. In the first chapter, Kolb presents these carefully, pointing out how the legal and regulatory framework may affect the structure of contracts.

The compensation of the CEO is set by the board of directors, whose members should act, as agency theory stipulates, as instruments of the principals, the shareholders. In the second chapter, Kolb offers a strong, balanced account of the debate between agency theorists and advocates of the managerial power hypothesis. Kolb

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rightly points out that the managerial power hypothesis—that the CEO has too much sway over the process of setting compensation—shares with the agency theory the thesis that the directors should align the incentives of the CEO with the interests of the shareholders. Closing the chapter with a brief moral assessment of executive compensation, Kolb raises the interesting, and not implausible, consideration that the inegalitarian nature of executive pay may prove compatible with the Rawlsian principle that inequalities may be permitted so long as they benefit the least well-off.

In the third chapter Kolb offers a careful account of how the chief elements of a pay package—salary, bonuses, stock shares, and ESOs—may incentivize a CEO to take risks that maximize shareholder value. With clear and helpful illustrations and charts, Kolb maneuvers the reader through the evidence for incentive effects. Several types of restricted stock give the CEO a reservoir of value in the firm and a potential loss if a risky venture goes awry. To the firm, the cost of granting shares of stock is high, at least compared to issuing ESOs, which give the CEO the right to purchase stock at a specific price, typically the current one, within a specific period of time. Given that an ESO may have a significant vesting period, the ESO functions as a powerful incentive for the executive to stay with the firm and to strive to increase its long-term value.

The middle four chapters set forth detailed examinations of incentive effects and the actual performance of distinct forms of compensation. Turning first to ESOs, Kolb describes the manner in which options are priced, using a lattice (binomial) model to illustrate the varying conditions (exercise price, time until expiration, volatility of share price, dividend rate, vesting period, and so on) that might affect, either singly or concomitantly, the option's value. Kolb describes how the repricing of options—replacing the original ESO with a new option with a lower striking price—might occur. Repricing is not necessarily the underhanded act that it might appear to be; in fact, research suggests it may serve to retain an executive with the firm or provide the executive with incentives to strive for the firm's overall success in straitened market conditions. In chapter five, after pointing out the general linkage between CEO compensation and stock performance, Kolb draws an important distinction: whether or not compensation tracks firm value is distinct from whether the compensation has incentive effects.

To contain the proper balance of incentives, a compensation package must combine, typically, some combination of restricted stock and ESOs, along with a salary. In chapter six, Kolb appeals to a large body of scholarship to explain both the theoretical and the empirical evidence for the best mix of instruments to incentivize an executive to undertake appropriate risks. In the case of ESOs, "The entire issue of the best exercise price for creating the right incentives proves to be quite difficult" (112). Towards the close of the chapter Kolb discusses, briefly, the financial crisis of 2007–2009, noting how "There is a strong consensus that the structure of executive compensation in the financial services industry played a significant role in causing the financial crisis" (118). However, against this consensus and in response to Kolb's discussion, one might contend that compensation was, at best, only a factor, less causal than symptomatic. Moreover, the sort of risk-taking allegedly arising from that compensation could not have occurred absent the Fed-

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eral Reserve's policy of inflationary expansion, itself a condition for systemic risk and speculation, including the very run-up in stock prices that enriched so many executives (cf. Dowd & Hutchinson, 2010). Kolb hints at another problem: "If the financial crisis of 2007–2009 proved anything, it showed conclusively that the U.S. government views some firms as too critical to be allowed to face the prospect of bankruptcy" (119). That the federal government has shown, via this crisis, that "implicit guarantees" are explicit (120), is a conclusion whose normative basis should remain debatable. Such guarantees may generate rather than diminish risk-taking. (In his recent, comprehensive account [Kolb 2011], Kolb makes it clear that there was no single cause to the most recent financial crisis.)

In chapter seven, Kolb turns to specific management activities and decisions, including, for example, whether particular compensation instruments, such as bonuses, lead to short-term decision-making and, more interestingly, whether the issuance of ESOs tends to dispose executives to stock repurchases rather than the issuance of dividends. Throughout the book, Kolb directs us to the responsibilities of the board of directors to secure the right mix of incentives and to exercise vigilance. After all, incentives may incline an executive to actions harmful to the firm and to shareholders, a fact indicated by the title of chapter eight, "Perverse Incentive Effects." For example, a CEO might seek to falsify the record date of an ESO or to misstate revenues so as to meet an earnings threshold and, thereby, garner a bonus. Another form of deception is backdating an option. For years it appeared as if a stock's price would rise subsequent to the issuance of an ESO. The explanation for this peculiar sequence of events lies, as Kolb recounts, in the deceptive practice of issuing an option once a run-up in price occurs, then backdating that option so as to register a lower price.

As these illustrations confirm, incentives may misfire, but that is not the end of the story. In the last chapter, Kolb offers an overall assessment, concluding that executive compensation generally encourages CEOs to take risks that they would otherwise avoid without the incentives, though he also admits that "bad behavior is fairly widespread" (159). Nonetheless, without any controlled experiment it is difficult to appraise the effects of incentives against any purported scenario in which no incentives operate. Yet there is this "litmus test": "Do Stockholders Like Incentive Pay?" (160). To this query research attests that, indeed, shareholders do appreciate incentive compensation, a fact relevant to any moral justification of the forms and structures of compensation.

To the question of whether anything might encourage both "lower levels of compensation and better corporate performance for each dollar of executive pay" (161), Kolb responds that the performance of boards of directors should be strengthened. Even though companies have explicit and laudable compensation principles and practices, these require effective application. Kolb suggests three ways of ensuring that boards exercise greater attentiveness and responsibility to their fiduciary duties: fewer board members should be appointed by the CEO, terms of service should be extended, and board members should, in general, not be CEOs or hold other directorships. The structure of a board should help *incentivize* directors to perform their ethical responsibilities.

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This is an excellent book. Anyone who wishes to analyze, criticize, or comprehend executive compensation must consult it. Through careful analyses, Kolb reminds the business ethicist that "risk" is not a four-letter word and that incentives matter, especially for the CEO whose functions are as entrepreneurial as they are administrative. Kolb's volume also renders clear the varying ways in which a board of directors must seek a balanced compensation package that provides sufficient incentives but no undue risk. To do so, a board must refer to prevailing patterns of compensation and employ theoretical and empirical guidelines, but there are no tidy algorithms. Knowledge and judgment remain essential.

All true enough, one might say, but Kolb's investigation assumes that the corporation is to be managed for shareholders and not, as the *normative* stakeholder thesis contends, for parties who have an interest in or are affected by the corporation. Perhaps so, but this does not vitiate Kolb's analyses or the value of the volume. In point of fact, it is difficult to imagine a set of incentives for a CEO who must attend to employees, customers, suppliers, *and* shareholders. What would be the criterion for excellent performance in such a scenario? This question signals one reason for adopting the shareholder perspective, but there are others, including that incentives agreeable to shareholder theory are themselves compatible with the basis of contract—voluntary consent. Even when the compensation of an executive (or athlete or movie star) seems outlandish, it is worth recalling its genesis in consensual agreement.

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