

## Top management motivation in global corporations

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**ABSTRACT.** The article explores economic localization, socialization and development intellectualization processes. The research is focused on the relevant problem implying formation and development of human resources at organizations as a key factor of their competitiveness. Based on generalizing modern theoretical motivational models a comprehensive analysis of the motivation system for top management of corporations within the paradigm of global management has been carried out. Special attention is paid to the phenomenon of global business personification and virtualization, as well as to the formation of new financial and non-financial incentives for top managers. Practices of effective incentives for the contemporary key corporate management actors have been studied. A comprehensive country-based comparative analysis of key tools for financial and non-financial corporate incentives for top managers within the system of long-term, short-term and regulatory criteria and parameters has been performed. Based on summarizing academic studies and empirical evidence of the leading multinational corporations a motivational model for top management of corporations has been grounded and suggested for practical implementation in Ukraine with the said model accounting for the corporations' basic needs, financial status and interests as well as for country-specific and regional features.

**KEYWORDS.** Corporate management, global corporation, top management, motivation, incentives, compensation package.

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## Problem statement

The increased scale of global economic and socio-cultural transformations in terms of post-industrialism along with transition to informational structure of society lead to a radical change in understanding the philosophical essence of the man in a system of relationships that keeps growing increasingly more complex<sup>2</sup>. Analysis of society's social structure based on knowledge, information and intelligence shows the objective tendencies of development and further quantitative and qualitative growth in managerial, professional and technical elite now becoming the core of the new structure of productive resources<sup>3</sup>, in which motivational mechanisms and culture of labour occupy a prominent place alongside creative and intellectual components. However, in the absence of an obvious correlation between the actual level of financial well-being and the real motivation system a new hierarchy of values cherished by a modern man is being actively formed. Striving to meet the basic needs provides potential opportunities for development, but does not result in automatic and immediate making use of a package of social options<sup>4</sup>.

Given that the value system of the man is quite an inert substance poorly subject to modification, the 'absorption' of values is regarded as a long-term transformation process, whereas for introducing new priorities of value requires a certain set of conditions — both economic and socio-cultural, including the opportunity provided by scientific and technological progress to enjoy many material benefits virtually since one's birth<sup>5</sup>. The above statement causes the problem of synchronizing dynamic processes of transforming corporate management systems along with motivational processes in a wide context, with solution to the said problem being particularly important for the developed post-industrial social systems<sup>6</sup>.

Competitive corporate leadership imperatives are also in line with the progressive trends of global development such as socialization, democratization, environmentalization, humanization, while constantly facing the

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<sup>2</sup> According to the Italian sociologist A. Martinelli, the extent and quality of the relationship vary depending on the various manifestations of globalization [*A. Martinelli*. From World System to World Society?// *Sotsys*. — 2009. — No.1 (297). — P. 5. [In Russian]

<sup>3</sup> *Kostina A.V.* Global Information Society: the contradictions of culture development// *Kulturologicheskyi zhurnal*. — 2010. — No.2. — [Electronic resource]. — Access mode: [www.cr-journal.ru/rus/journals/7.html8cj\\_id=3](http://www.cr-journal.ru/rus/journals/7.html8cj_id=3). [In Russian].

<sup>4</sup> *Inozemtsev V.L.* The modern post-industrial society: nature, contradictions, prospects. — M., 2000. — P. 94. [In Russian].

<sup>5</sup> *Inglehart R.* Culture Shift in Advanced Industrial Society. — Princeton (NJ). — 1990. — P. 100, 171.

<sup>6</sup> In systems with industrial economies the utilitarian incentives remain dominant, while the post-materialistic value system coexists well even with a distinct traditionally materialistic one. Quite natural that along with meeting economic problems, the utilitarian incentives no longer play a leading role in human life letting such issues as the need to reconcile freedom and security, justice and responsibility come to the forefront [*Hicks J.* *Wealth and Welfare*. — Oxford. — 1981. — P. 138-139.].

need to optimally combine various institutional, industrial, financial, investment and human resources with those of scientific-technological as well as innovation and intellectual nature<sup>7</sup>. Special attention should be paid to the issue of adequate positioning global individuals within the current economic models. An important role in this regards is vested not only in self-organization, pluralism, informatization, rationalization, education and culture<sup>8</sup>, but also certainly in motivation. Forming a personalized subject<sup>9</sup> based on the culture of an informational society fosters sustainable economic progress and causes considerable variation of the human status hierarchy in terms of making global economic decisions.

Transformation of incentive mechanisms for top management in the corporate management systems recently received considerable attention of both foreign and domestic scientists and practical researchers, including M. Armstrong, R. Richter, J. Stiglitz, J. Tirole, E. Furubotn, O. Hart, R. Henderson, S. Ivanova, G. Milov, S. Roshchin, S. Solntsev, V. Daniuk, A. Kolot, S. Tsybaliuk.

The problem of corporate top management incentives consistency with the interests of shareholders is growing ever more relevant due to global challenges in corporate management related to business virtualization, forming of global networks, global politicization as well as by global instability and turbulence. Global thinking integrates entrepreneurship with innovation and safety of development. At that, corporate management dialectics undermines the motivational differences of the owners and top managers of corporations, while despite the obvious contradictions virtually uniting them in homogeneous groups with similar interests and prevailing value orientation<sup>10</sup>.

In fact, the above serves as grounding of this paper's goal and objectives focused on implementing a systematic approach to the study of global corporation top management motivation by virtue of analyzing the effectiveness of incentive mechanisms depending on both internal and external environmental factors of a corporation.

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<sup>7</sup> *Lukianenko O.* Global individualization subjective disposition transformation / O. Lukianenko // *Business management*. — 2014. — Book 1. — C. 82-102.

<sup>8</sup> *Galkina L.I., Chugunov Ye.V.* The trends of globalization and individualization in the modern world. — [Electronic resource]. — Access mode: [www.rusnauka.com/30\\_NIEK\\_2009/Philosophia/54107.doc.htm](http://www.rusnauka.com/30_NIEK_2009/Philosophia/54107.doc.htm). [In Russian].

<sup>9</sup> Personalization is used to determine the human social identities. In some philosophical definitions these identities can be called sub-personalities. This structure of self-consciousness is a dynamic substructure of a personality characterized by relatively independent existence. The most typical human sub-personalities are those associated with social (family-related or professional) roles played in the real life, such as the roles of a father, a husband, a teacher, a leader, a politician, etc. [Brief Encyclopedia of Philosophy. — M.: Progress, 1994. — P. 277. [In Russian].

<sup>10</sup> *Rokhmanov O.* Owners of big capital as the subject of socio-economic transformation in Ukraine: Monograph / O. Rokhmanov. — K.: Sociology Institute at NAS of Ukraine, 2012. — p. 10, 36-38. [In Ukrainian].

## Main part

In scientific and economic literature motivation is seen as both theoretical and practical concept used to describe human behaviour in a given situation usually associated with work activity in all its manifestations as well as to explain both internal and external causes of such behaviour changes<sup>11</sup>. There is no doubt that the problem of targeting impact on behaviour of people has been worrying humanity long before emergence of the term<sup>12</sup>, however it was only in late IXX – early XX centuries that the search began for effective methods of changing motivational attitudes of employees that would go beyond traditional economic coercion<sup>13</sup>. Today the versatility of the 'motivation' concept underlies consideration thereof in numerous meanings and manifestations: as a characteristic feature of human psychological state and as a process aimed at changing this state or as a sphere of activity that involves developing methods and means of influencing human behaviour.

Notably, actualization of motivational issues is in line with the development of modern management concepts offering common views on the priority of formation, use and development of human resources, as HR management becomes a major subsystem of the overall management system of the organization. The principal difference between human resources and other resources of the organization is that the employee has the consciousness uniting the bodily, spiritual, intellectual and emotional bases with each employee being a unique personality. All persons are different in their own way, while possessing unique inherent traits, will, own interests, needs and goals, whereas also differently reacting to impact of the environment. In addition, work activity occurs against complex intertwining of individual, group and collective interests and goals.

Enhancing the role of educational and innovation components within the organization is becoming a global trend of significant changes in goods and services as regards volume of knowledge used to produce the same, as knowledge of workers, their intelligence, creativity and capability to apply information technologies form the main strategic resource

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<sup>11</sup> Motivational Management: handbook / A.M. Kolot, S.O. Tsymbaliuk. — K.: KNEU, 2014. — P. 19. [In Ukrainian].

<sup>12</sup> The term 'motivation' was first used in 1813 by A. Schopenhauer who understood it as «causality seen from the inside.»

<sup>13</sup> In scientific literature there are a number of approaches to the interpretation of the 'motivation' concept. For a long time it was defined as «... an explanation of internal factors or psychological condition and man's relationship to what should be done or achieved as a result of conduct' [Brief Encyclopedia of Philosophy. — M.: Progress, 1994. — P. 277. [In Russian]. In literature on the psychology the motivation is interpreted as a process of subjective human activity involving selection of behaviour motives, goal and program to achieving the same as an internal human property, a part of human nature connected with interests. In the economic literature the concept of motivation is interpreted from positions of influence by not only internal but also external factors in relation to a person and their interaction encouraging people to carry out activities to achieve personal goals and objectives of the organization with maximum effect.

of the organization. Moreover, today's business has been developing philosophy, according to which a person is not only the main productive resource, but also the highest value and goal of economic development<sup>14</sup>.

Economic science has proved that the organization can count on sustainable development, provided it harmonizes its interests with those of owners and employees. To this end, expectations of the organization and those of its employees should converge to the maximum. German experts estimate that only provided the convergence of expectations reaches 60% or higher, labour productivity in the organization may achieve the desired level<sup>15</sup>.

The element uniting readiness of a person to act (i.e. to produce creative, innovative, successful labour results) with the direct expression of such readiness is a motivational mechanism. A motivated worker is striving to carry out objectives of the organization and thus meet its needs, while deliberately choosing a certain type of behaviour. An effective mechanism for harmonizing expectations of the employee and the organization implies sharing the results of work and rewards provided by the organization based on comparison of the same.

A well-known expert in the theory and practice of organization management D. Carnegie states: «There is only one way... to get anybody to do anything. And that is by making the other person want to do it»<sup>16</sup>. The motivation as a process of influencing people's behaviour and a tool of converging goals of the organization with those of its employees enjoys the leading position in the theory and practice of management.

Top management motivation is specific (Fig. 1) and the problems associated with the motivation of top managers are the most relevant, since their activity is difficult to be rationed or regulated.

The default manifestation of the motivational mechanism under contemporary conditions is the compensation package for top executives of a corporation, which consists of the basic salary, bonuses, rewards, social benefits and incentives, options or a package of shares. In western companies a significant proportion of the compensation for top managers implies long-term payments, the amount of which depends on the capital appreciation of the company (market price of shares) and achievement of long-term goals. It is believed that the higher the level of management, the smaller the share of basic salary in the structure of the compensation package and, consequently, the greater proportion of rewards (bonuses) and stock of the companies (share options). For exam-

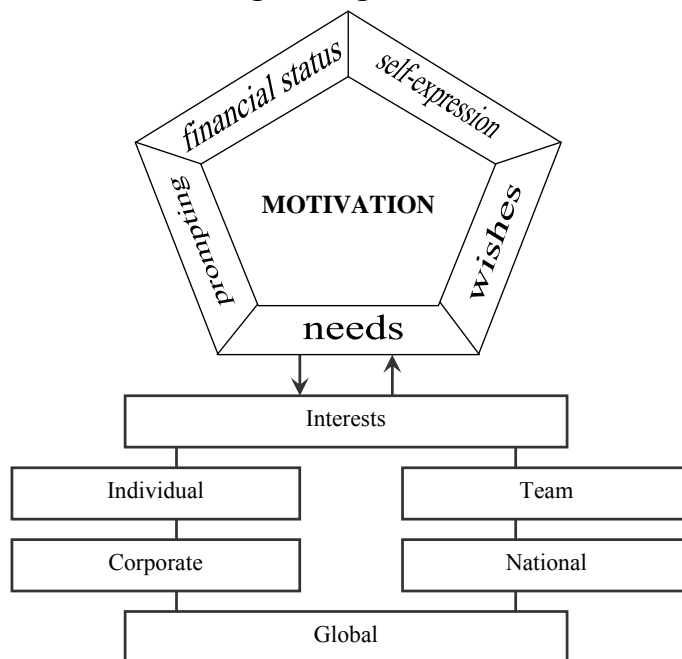
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<sup>14</sup> Motivational Management: handbook / A.M. Kolot, S.O. Tsybaliuk. — K.: KNEU, 2014. — PP. 29-29. [In Ukrainian].

<sup>15</sup> *Solomanydyna T.O.* Motivation of staff work / Solomanydyna T.O., Solomanydyn V.G.. — M.: UNITY-DANA, 2009. — P. 5. [In Russian].

<sup>16</sup> *Carnegie D.* How to Win Friends and Influence People: D. Carnegie. — M.: Exmo, 2004. — p. 37-38. [In Russian].

ple, in the US a compensation package of a CEO has the following typical structure: 18% — the basic salary, 22% — reward for the annual work results, 60% — benefits from corporate equity participation and bonuses for achievement of long-term goals<sup>17</sup>.



**Fig. 1.** Motivational model for top management of corporations

For top level managers, importance is vested in fair compensation and clear compliance of the salary with the work results achieved. At that, the amount of compensation (bonuses, rewards) top managers should be consistent with the results of the company performance.

A significant portion of the compensation package for top managers implies *social allowances, incentives and benefits*. For example, the list of the most widespread components of social packages offered to top managers by owners of companies in the USA includes *medical examination* (91% of companies offering), *provision of a vehicle* (68% of companies), *consultancy on financial issues* (64%), *provision of an aircraft* (63%), *provision of business class plane tickets* (62%), *membership in elite clubs* (55%), *personal responsibility insurance* (50%), *payment of spouse's transport costs* (47%), *meals in the canteen for*

<sup>17</sup> *Vetuzhskikh E.* Strategy map, a systematic approach and KPI: Tools for executives. — M.: Alpina Business Books, 2008. — P. 114-115. [In Russian].

*executives (30%), home security system (25%), loans with low interest rate or interest-free (9%)*<sup>18</sup>.

Equally important for attracting and retaining competent top managers are the *employer brand, company image, stability in the market and prospects*.

Top managers are interested in work depth, its creativity, authority to solve strategic tasks and employ own potential. This is confirmed by the results of a survey conducted at enterprises in Germany, based on which in the hierarchy of top management motives *varied activity* ranks first followed by the *authority to solve strategic tasks* (ranked 3rd), as well as by *creative work* (ranking 4th), *self-expression opportunities* (ranking 6th place), *social contacts and work with people* (ranking 7th), *opportunity to manage people* (ranking 9th), and *opportunity to influence activity of colleagues* (position 10), *career growth* (position 11), *high income* (position 12)<sup>19</sup>.

Contemporary economic researches focus on the existence of a close relationship between compensation amount of a top manager (Director General) and results of the company performance. In general, while solving this problem the academic literature reflects approaches taken by supporters of the *effective management theory* and the *managerial influence theory*. The latter theory is based on the postulate that the payment to a CEO and structure thereof are largely dependent on the CEO's capability to link actions of the Board members (the Board of Directors) with personal interests<sup>20</sup>, whereas the *effective management theory* implies that the compensation of a CEO and structure thereof are determined by competitive advantages in the market of managerial talent<sup>21</sup>.

In order to analyze the links between performance of the company and the CEO's compensation, the elasticity of the company and shareholders' income has been assessed showing that the change in CEO's income by USD 1 thousand led to an increase in a shareholder's wealth by circa USD 3.25. It was suggested that CEOs were paid similarly to bureaucrats and obviously they acted like ones rather than strived to achieve maximum results for companies. Instead, other researchers proved that the CEO's compensation essentially depended on perfor-

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<sup>18</sup> *Milkovich G. T.* The system of compensation and incentives for personnel / Milkovich G. T., J. M. Newman; translated from English. — M.: Vershyna, 2005. — P. 546. [In Russian].

<sup>19</sup> *Mokhort N.* The problem of motivation in work activities / N. Mokhort // Upravleniye personalom/Human resources. — 2002. — No. 7. — P. 35. [In Russian].

<sup>20</sup> *Bebchuk L. A., Fried J. M.* (2004). Pay without performance (Vol. 278): Harvard University Press Cambridge, MA; *Jensen M. C., Murphy K. J.* (1990). Performance Pay and Top-Management Incentives. *The Journal of Political Economy*, 98(2), P. 225-264.

<sup>21</sup> *Murphy K. J.* (2012). Executive Compensation: Where we are, and how we got there in George Constantinides, Milton Harris, and Ren? Stulz (eds.), *Handbook of the Economics of Finance*: Elsevier Science North Holland. April.

mance results of the company<sup>22</sup>. They point out that the average compensation of a CEO amounts to circa USD 1,000,000, provided the return on investment reaches approximately 7%, whereas CEO's compensation makes approximately USD 5,000,000, in case the return on investment is about 20%. Thus, the average CEO can count on raising own standard annual compensation by USD 4 million, providing the company performance improvement results go from lower than average to above average.

Today's quite common view is that an important characteristic of a CEO, which may affect compensation amount of the latter is the CEO's tenure<sup>23</sup>. This correlation between tenure and compensation amount of the CEO is explained by the following factors. Firstly, as the CEO suggests candidates to be elected members of the Board, he or she may choose candidates loyal to him/herself; so after a certain time, the number of loyal members of the Board increases so that the CEO can easily manipulate them to increase his/her pay because they would owe their positions to the CEO. Secondly, the CEO may eventually gain control over the corporate information system and use it in order to not disclose unfavourable information about him/herself to the Board members (Board of Directors) and the Compensation Committee members<sup>24</sup> or manipulate the agenda of meetings of the Board.

The company's debt load (loans) also affects compensation amount of the CEO<sup>25</sup>. It has been proved that relation between the pay amount of top managers and corporate debt load is inversely proportional. When a large proportion of share capital is represented by external debt, the CEO whose interests are closely linked with those of shareholders, have incentives to take on excessive risk. If the CEO's decision leads to profits, shareholders will benefit from it; while otherwise, most of the economic losses will be translated onto the lenders. So, the best compensation package for the top management of companies with high debt load should have little relation to pay of the top managers in order to restrict the scope of the CEO's opportunities to take increased risk. That is why

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<sup>22</sup> Hall B. J., Liebman J. B. (1998). Are CEOs really paid like bureaucrats? *The Quarterly Journal of Economics*, 113(3), P. 653-691.

<sup>23</sup> Deckop J. R. (1988). Determinants of chief executive officer compensation. *Industrial and Labor Relations Review*, P. 215-226.; Hill C. W., Phan P. (1991). CEO tenure as a determinant of CEO pay. *Academy of Management Journal*, 34(3), P. 707-717.

<sup>24</sup> A Compensation Committee implies a collective body in the management system of a corporation, one of the specialized committees formed by the Board of Directors, whose main task is to develop a system of financial and non-financial incentives and types of remuneration, encouraging employees of the corporation, system qualification requirements and corporate standards for personnel, rate schedule etc. A Compensation Committee makes decisions by majority vote of its members, holds periodical meetings as set out in the Regulations on the Compensation Committee usually approved by the General Meeting of Shareholders.

<sup>25</sup> John K., Qian Y. (2003). Incentive features in CEO compensation in the banking industry. *Economic Policy Review*, 9(1).; John T. A., John K. (1993). Top-management compensation and capital structure. *The Journal of Finance*, 48(3). — P. 949-974.



the so-called elevated level of dependence on loans characteristic for banks and other financial institutions leads to lower sensitivity between efficiency and pay of their top managers, as compared to the CEOs of non-financial institutions

Another factor that can affect the level of CEO's compensation is the principle of distributing corporate funds<sup>26</sup>. The analysis of costs for research and development research influencing on the compensation led to a conclusion on positive correlation between the two. Many CEOs strive to cut general expenditures on research and development, as they do not improve current performance of the company, which in turn reduces their compensation component based on the equity. Therefore, Compensation Committees determine a strong positive relation between R&D and compensation based on equity, in order to prevent short-sighted R&D expenditure reduction of the corporation.

Currently, a subject of serious discussions is the question whether the amount of compensation is influenced by the CEO's gender. Many researchers argue that on average the male CEOs earn more than female ones<sup>27</sup>. These researchers created a non-parametric model to assess the impact of top managers' gender indicators and corporate financial performance indicators on the potential compensation amount of the top managers. It has been confirmed according to this model that taking into account such indicators of the company as its size, performance results and the age of top managers, the male top managers earned more than female CEOs, and this was true for all the compensation components except salaries. However, other studies indicate that the difference in compensation between men and women was either due to differences in size or industry sector of the respective firms analyzed, or due to personal characteristics of the CEO (such as, for example, age, expertise, etc.)<sup>28</sup>. Thus, today the researchers have no doubtlessly compelling reasons to speak about gender inequality in terms of top managers' compensation amounts.

It is believed that an important institutional factor that influences compensation amount of a CEO is the Board of Directors and its struc-

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<sup>26</sup> Cheng S. (2004). R&D expenditures and CEO compensation. *The Accounting Review*, 79(2), P. 305-328.; Ryan Jr. H. E., Wiggins III R. A. (2002). The interactions between R&D investment decisions and compensation policy. *Financial Management*, P. 5-29.

<sup>27</sup> Mohan N., Ruggiero J. (2003). Compensation differences between male and female CEOs for publicly traded firms: a nonparametric analysis. *Journal of the Operational Research Society*, 54(12), P. 1242-1248.; Vieito J. P., Khan W. A. (2012). Executive compensation and gender: S&P 1500 listed firms. *Journal of Economics and Finance*, 36(2), P. 371-399.; Mohan N., Ruggiero J. (2007). Influence of firm performance and gender on CEO compensation. *Applied economics*, 39(9), P. 1107-1113.

<sup>28</sup> Bowlin W. F., Renner C. J. (2008). Assessing gender and top-management-team pay in the S&P Mid-Cap and Small-Cap companies using data envelopment analysis. *European Journal of Operational Research*, 185(1), P. 430-437.; Lausten M., Fakultet D. E. (2001). Gender Differences in Managerial Compensation: Evidences from Denmark: Department of Economics, Faculty of Business Administration, Aarhus School of Business.; Bertrand M., Hallock K. F. (2000). The gender gap in top corporate jobs: National Bureau of Economic Research.

ture<sup>29</sup>. The Board of Directors, which is influenced by the CEO may enter into contracts favourable to the latter and this may harm interests of the shareholders. In order to reconcile the interests of shareholders and those of the CEO, independence of the Board of Directors is critically important and therefore national regulators such as the Securities Commissions require that companies applying for listing on stock exchanges have the minimum specified number of independent directors.

An important characteristic determining capability of the Board of Directors to control the CEO's compensation amount is the number of the Board members. For a Board with a large number of members it is sometimes difficult to find a coordinated approach to any problem, including that of determining compensation amounts, which eventually leads to deterioration in the performance of the Board. The Boards large in terms of the number of members also cause the 'free-riding' problem (when individual members avoid responsibility for decision-making shifting the same onto the other members), whereas the CEO may take advantage of such passive members, manipulating them to make decisions bringing him/herself certain benefits<sup>30</sup>. Increasing the number of the Board members creates problems of their internal coordination with each other, while the CEO may use this in his or her own interests. On the other hand, Boards large in terms of the number of members can be more effective, because they allow for wider representation of independent opinions<sup>31</sup>.

Some researchers also believe that the age of the Board members is a critical factor that correlates with efficiency of the Board<sup>32</sup>. In their view, the age of directors is positively correlating with the compensation of CEOs, because as the Board members age, they lose opportunities to effectively manage compensation of the CEO. There is a strong link between the age of the Board members and compensation of the CEO<sup>33</sup>. This is explained by a higher probability of older members to be elected to the Board because of their good relations with the CEO and

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<sup>29</sup> Core J. E., Holthausen R. W., Larcker D. F. (1999). Corporate governance, chief executive officer compensation, and firm performance. *Journal of Financial Economics*, 51(3), P. 371-406.

<sup>30</sup> Eisenberg T., Sundgren S., Wells M. T. (1998). Larger board size and decreasing firm value in small firms. *Journal of Financial Economics*, 48(1), P. 35-54.; Sanchez-Marin G., Baixauli-Soler J. S., Lucas-Perez M. E. (2010). When much is not better? Top management compensation, board structure, and performance in Spanish firms. *The International Journal of Human Resource Management*, 21(15), P. 2778-2797.; Steiner I. (1972). *Group processes and group productivity*. New York: Academic.

<sup>31</sup> Pearce J. A., Zahra S. A. (1992). Board composition from a strategic contingency perspective. *Journal of management studies*, 29(4), P. 411-438.

<sup>32</sup> Core J. E., Holthausen R. W., Larcker D. F. (1999). Corporate governance, chief executive officer compensation, and firm performance. *Journal of Financial Economics*, 51(3), P. 371-406.; Ozdemir O., Upneja A. (2012). Board structure and CEO compensation: Evidence from US lodging industry. *International Journal of Hospitality Management*, 31(3), P. 856-863.

<sup>33</sup> Ghosh C., Sirmans C. (2005). On REIT CEO compensation: does board structure matter? *The Journal of Real Estate Finance and Economics*, 30(4), P. 397-428.

the top management members. The older members have no incentive to create and develop their reputation since they already have an established one. The opposite opinion implies that there is no significant correlation between the age of the Board members with either the total amount of CEO's compensation or CEO's salary regarded as one of the compensation's components.

Some researchers express two hypotheses concerning tenure of the Board members. According to the *expert hypothesis* a longer tenure should lead to better performance of the company due to more comprehensive experience and competence. On the other hand, according to the *management friendliness hypothesis*, a longer tenure possibly leads to the formation of close relationships between the Board members and the CEO, while the Board of Directors can therefore act in the interests of the CEO and contrary to the interests of shareholders<sup>34</sup>.

While agreeing with *management friendliness hypothesis*, it can be suggested that the Board members having a significantly longer experience of working at the Board (20 years or more) are about twice as likely to become affiliated with the top management while having more chances of being represented at the committees on appointment and compensation. Consequently, the CEO receives more pay, especially when he or she also acts as the Chairman of the Board.

In general, current approaches to determining the compensation amount for top managers at corporations comprise a number of conditions and characteristics associated with both the objective results of company performance (increased company value, profitability of assets, general profitability, flexible adjusting to legislation changes, etc.) and subjective factors of the CEO's personality such as age, experience, tenure, competence, degree of influence.

The fundamental principle of corporate management is the principle of executive bodies' accountability to the shareholders and the Board of Directors. Thus, the main role in supervising the activities of executive bodies should be vested exactly in the Board of Directors. In international practice, one of the important tools of such supervision by the Board of Directors implies establishing an adequate system of evaluating and remunerating the top managers. As practice shows, the world's leading corporations realize the importance of this management tool, while their evaluation and remuneration systems generally allows effective streamlining the efforts of the executive bodies to implementing long-term objectives of business development for the benefit of its owners. The difficulty of developing an adequate evaluation and remuneration

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<sup>34</sup> Byrd J., Cooperman E. S., Wolfe G. A. (2010). Director tenure and the compensation of bank CEOs. *Managerial Finance*, 36(2), P. 86-102.; Vafeas N. (2003). Length of board tenure and outside director independence. *Journal of Business Finance & Accounting*, 30(7-8), P. 1043-1064.

mechanism is conditioned by the fact that it is affected by the objectively existing *agency problem* in the corporation: the manager is by all means striving to increase own compensation, while the owner(s) strive to reduce the costs of paying for the services of hired top managers.

Given the importance of effective top management motivation, the implementation of this task in many of the world's corporations is entrusted to the special body established by the Board of Directors, which, as already mentioned is named the Compensation Committee or, for example, the Committee on Appointments and Compensation. We would like to emphasize that establishment of such a committee is recommended by codes (principles) of corporate management in many countries as well as by the OECD Principles of Corporate Governance [46]. It is recommended to establish such a committee consisting of independent directors or at least to be headed by an independent director. The CEO or the Board members can not be appointed as the Committee members. The tasks the Committee is to be entrusted with are as follows: 1) *development of a remuneration policy and the remuneration system*, the main objective of the latter being creation of added value by setting appropriate incentives for directors and top managers; 2) *development of criteria* by which remuneration of the Board members, CEO and heads of principal divisions of the corporation is to be determined; 3) *monitoring coherence* of the corporate remuneration policy and the remuneration system applied by the company as well as with the corporate strategy and financial position of the company and situation in the labour market; 4) *supervising* execution of the Shareholders' Meeting decisions concerning remuneration of directors and top managers as well as disclosure of information on the fees and compensation payments, including the materials provided to the general meeting of shareholders<sup>35</sup>.

The corporate *remuneration policy* establishes common rules for the development of specific criteria and forms of remuneration. For example, the management remuneration policy of *New Zealand Telecom* company comprises the following principles: 1) the level of remuneration for managers remains at the level affording to attract talented professionals; 2) the remuneration for managers depends on specific results achieved, both short- and long-term ones; 3) the remuneration for top managers should be comparative with the remuneration for shareholders (dividends or differences in share prices); 4) the total amount of remuneration depends on the overall performance of the company and its solvency<sup>36</sup>.

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<sup>35</sup> Kuznetsov M.Ye. Organization of the remuneration system for top managers of the corporation.— [Electronic resource]. — Access mode: [gaap.ru/articles/.../](http://gaap.ru/articles/.../). [In Russian].

<sup>36</sup> Kuznetsov M.Ye. Ibid.

Another important task to be solved by the Board of Directors' members of the committee is *determining criteria* according to which remuneration to the corporate executive bodies is carried out. Currently, this issue is addressed by three basic approaches to establishing the company's management incentive system<sup>37</sup>. The *first approach* being a traditional one implies establishing a certain level of remuneration depending on the competence, position and responsibilities of the manager, despite tasks entrusted to him by the owner. The approach is most typical of state-owned enterprises or those where the manager is also the owner and where no agency problem arises. Additional incentive in this case is achieved by virtue of different types of privileges.

The *second approach* implies focus on results while being aimed at motivating the manager to meet objectives and results beneficial to the owner. At that, the result can be measured both qualitatively and quantitatively. As the basis for evaluation the figures which the manager can directly and personally influence are chosen.

The *third approach* implies focus on business value and as the basis for evaluation uses establishment of mechanisms for increasing owner's interest in the company's capitalization. This method is based on the use of different types of option programs offering incentives to the key workers of the company by granting them the right to purchase shares of the company under certain conditions. At that, there are several types of options: 1) fund options granting the right to purchase company shares at a certain price (strike price) during a fixed period of time; 2) discount options granting provide for setting the strike price below the current market price, but imply certain restrictions on transactions involving shares of the managers; 3) premium options setting the strike price higher than the current market price; 4) index programs setting the option price depending on the sectoral or market index.

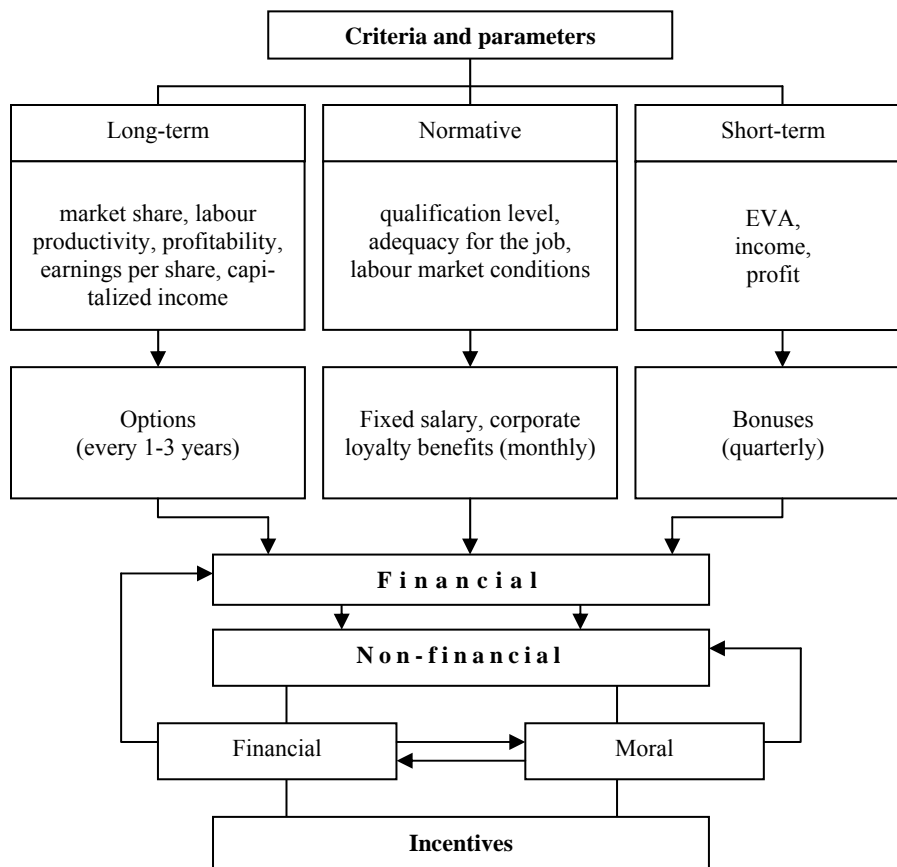
The universal internationally standardized system of top management incentives at corporations is shown in Fig. 2.

Recently, the *balanced scorecard* methods came into wide use, providing for consideration of a system of indicators much more wider as compared to the traditional one and reflecting the main factors that affect long-term competitiveness of a company<sup>38</sup>. As a rule, the following areas of corporate activity are considered: 1) finance (reflecting the interests of financially interested groups, especially shareholders); 2) relationships with customers (reflecting key needs and expectations of customers needed to attract them and achieve the necessary financial results); 3) internal processes (reflecting the processes playing a key role

<sup>37</sup> Kuznetsov M.Ye. Ibid.

<sup>38</sup> Solonenko Ye. Balanced Scorecard System: an assessment tool or a way to implement the strategy?— [Electronic resource]. — Access mode: [www.hr-portal.ru/...](http://www.hr-portal.ru/) [In Russian].

in implementation of the company's competitive advantages); 4) innovation, staff and infrastructure development (reflecting characteristics of the body of knowledge, skills, experience and other intangible assets necessary for implementation of the company's competitive advantages).



**Fig. 2.** System of corporate top management incentives

When comparing the total remuneration amount of the top management to the company's financial state and the situation on the labour market, the Compensation Committee should take into account both internal factors (such as financial state, the level of pay to other employees, the level of promoting competition among employees, restriction of the income diversification opportunities, CEO's influence) and external factors (industry, the level of risk at which the company operates, the complexity of the organizational structure, including the scale of the en-

terprise, diversity of products, intensity of research activity, geographical diversification, state of the labour market).

Empirical studies of compensation packages for top managers of multinational corporations revealed major changes in their overall structure and size. Over the past 30 years in Western countries the average amount of cash payments to CEOs has doubled, and the total compensation (including benefits from option programs) increased by 4 times. However, not always is the increase in compensation payments due to the improved performance of the company. For example, in the 2000s, compensation of the top management of US corporations decreased by 7% while company profits reduced by 35% and the value of shares decreased by 13%, whereas the total amount of remuneration paid to the top management increased by 7%<sup>39</sup>. Along with a significant increase in total remuneration amount a tendency toward increasing the portion of compensation based on shares was revealed<sup>40</sup>. Despite the series of corporate scandals and the 2008-2009 crisis, which enhanced critical attitude of the society to increasing the share of long-term incentive compensation primarily associated with incentive programs based on shares the same is observed in the post-crisis period: in 2010, the share of long-term remuneration in the aggregate remuneration of top managers in the US increased by 7.3%, whereas in Europe — from 25% to 34%<sup>41</sup>.

Generalization of arguments to the growth of total remuneration to top managers allows to determine the following factors:

– firstly, the effect of the *agency theory*, according to which the optimal amount of incentives provided to the top managers increases their marginal productivity. Thus, the traditional model of agency relationship links a more expected compensation with increasing risks and efforts of the top managers caused by stronger stimuli. Accordingly, changes in the remuneration of top managers of the 1990s are regarded as completely logical in terms of agency relationship model<sup>42</sup>;

– secondly, changes in the labour market of managerial personnel: when supply of qualified top managers capable of managing large and complex companies is relatively inelastic, thus increasing the marginal cost of labour services offered by the managers and at equilibrium leading to an increase in their remuneration<sup>43</sup>;

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<sup>39</sup> Kuznetsov M.Ye. Organization of the remuneration system for top managers of the corporation. — [Electronic resource]. — Access mode: gaap.ru/articles/.../. [In Russian].

<sup>40</sup> Conyon M. Executive Compensation and Incentives // Academy of Management Perspectives, 2006. Vol. 20. No.1. P. 25-44.

<sup>41</sup> Milov G. Russians are the most expensive // Vedomosti. 2011. No.198 (2964). October 20. [In Russian].

<sup>42</sup> Zenkevich N.A., Katkalo V.S., Klemina T.N., Medvedev P.G. Evolution of modelling incentive contracts with top managers of the companies // Bulletin of St.Petersburg University. — ser. Management, 2012. Issue 1. — P. 3-10. [In Russian].

<sup>43</sup> Conyon M. Executive Compensation and Incentives // Academy of Management Perspectives, 2006. Vol. 20. No.1. P. 25-44.

– thirdly, changes in the relative importance of the general and company-specific human capital comprising managers refers to G. Becker's *human capital theory*<sup>44</sup>. At that, the general human capital comprising managers refers to the knowledge in managing financial or human resources which are valuable and can be transferred from one company to the other, while the knowledge, skills and capabilities of the managers regarding, for example, suppliers are treated as valuable only within a particular company, that is regarded as specific and non-transferable human capital. The selection between external and internal candidates in terms of global competition is shifting in favour of the first, leading to increased levels of remuneration. Moreover, active enticement of effective managers is often accompanied by paying certain 'bonuses for signing of the contract' to them.

– fourthly, increased control over their activities by the Board of Directors<sup>45</sup>, when the increase in proportion of independent directors intensifies activity of the Board as regards monitoring the top executive management and provides for a stimulus to a fairer work as well as causes increased efforts to be compensated by the increased levels of remuneration;

– fifthly, modification of corporate strategies associated with rapid technological and environmental changes. Since top managers are free to choose a strategy, they can for the purpose of gaining personal benefits choose between those strategies implementation of which depends largely on their work. In fact, in a turbulent environment and under conditions of significant information asymmetry in terms of corporate strategy, this approach to compensation packages may prove optimal for shareholders.

Currently, corporate management is implemented based on two basic approaches to studying relation of the agency problem to remuneration of corporate top managers: *optimal contract approach* and *managerial power approach*. These approaches are not considered as alternatives, although researchers do recognize existence of quite serious differences between them<sup>46</sup>.

The first approach implies that drafting of contracts governing remuneration of top managers is regarded as one of the tools if not for resolving, then for substantial easing of the agency problem. In other words, the principal (shareholder, owner) is striving to draft a contract

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<sup>44</sup> Murphy K. J., Zbojnik J. Managerial Capital and the Market for CEOs. University of Southern California, 2003. Unpublished manuscript.

<sup>45</sup> Conyon M. Executive Compensation and Incentives // Academy of Management Perspectives, 2006. Vol. 20. №1. P. 25-44.

<sup>46</sup> Conyon M. Ibid; Bebchuk L., Fried J. Executive Compensation as an Agency Problem // Journal of Economic Perspectives. 2003. Vol. 17. №3. — P. 71-92.



prompting the agent (top manager) to take decisions and steps maximizing the company value for the principal on the long term basis.

As emphasized in<sup>47</sup>, the *optimal contract* is not the perfect option, but the best of those that could be drafted in order to prevent opportunism of top managers in its various manifestations. At that, agency costs can not be eliminated entirely: the owners (shareholders) in this case assess the marginal benefits of implementing this contract against marginal losses associated therewith. Harmonizing the interests of owners and top management can in this case be of both explicit and implicit nature: the obvious harmonizing occurs when remuneration and the wealth of top managers are related to those of the company owners through transfer of shares to the first, or granting share options and restricted shares. The implicit harmonizing can be achieved by stipulating interrelation between remuneration payable to top managers of (e.g. bonuses based on the company annual performance) and company performance indices, such as profitability<sup>48</sup>.

Peculiarity of applying the *managerial power approach* is that remuneration of top officials is considered not only as a tool to solve the agency problem, but also as part of the problem itself. In their theoretical studies, researchers relied on empirical data dating back to the 1990s that did not confirm relation between remuneration of the top officials and the company performance indices, which was hard to explain from the point of view based on the previous model. It is argued that top managers have real opportunities to influence formation of their compensation package while increasing the latter, leading eventually to their receiving the so-called compensatory rent. The result of such actions implies emergence of ineffective compensation schemes, which, on the one hand, negatively affect performance of the company by significantly increasing costs, and on the other hand, weaken incentives of the top managers to take decisions and steps that lead to an increase in wealth of the owners (shareholders). Market forces and the possibility of damaging reputation of the top officials resulting in revaluation of their human capital in the labour market of managerial personnel are thus considered as insufficient to prevent substantial deviation of the compensation contracts from the optimal ones. The *managerial power approach* may imply such practices as interaction of top managers with the Board of Directors (such as introduction of 'insiders', who would facilitate decision-making in the field of remuneration to the favour of the top managers), involvement of advisers on remuneration issues who would justify amounts of the existing compensation packages of the top

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<sup>47</sup> Conyon M. Executive Compensation and Incentives // Academy of Management Perspectives, 2006. Vol. 20. №1. P. 25-44.

<sup>48</sup> Murphy K. Executive Compensation // Handbook of Labor Economics. 1999. Vol. 3. — P. 2385-2563.

officials, existence of hidden forms of compensation and large-size payments received by the top managers in case of dismissal or retirement (including even the so-called 'golden coffins', i.e. payments received by relatives of a deceased top manager) .

We would like to note that according to the *managerial power approach* the wide-spreading of option programs is inconsistent with the *optimal contract model*. The traditional *agency relationship model* implies that the market component of the company performance should not be taken into account while forming compensation packages, as actions of the top officials do not affect the market. Since while providing share options this fact is ignored, top managers receive significant 'incidental benefits'.

In general, contemporary compensation payments in corporations are likely the result of simultaneous action by both market forces streamlining efforts of the top managers to maximize the company value for shareholders and the top managers' influence on the decision-making processes concerning their remuneration.

## Conclusions

1. Motivation as a process of influencing people's behaviour and a means for harmonizing goals of both the organization and employees takes one of the leading places in the modern theory and practice of staff management. The high level of staff motivation is a factor for creating sustainable competitive advantages of the organization, which is fully consistent with modern economic concepts based primarily on the human capital in the format of sustainable development criteria.

Today it is impossible to effectively manage the company and provide a high level of competitiveness without effective motivational mechanism for managing labour behaviour of the employees. Only through formation of a fair compensation package comprising fair salary and decent remuneration, as well as due to creating proper working conditions, the atmosphere of respect and trust along with considering individual needs of employees and top managers can high labour efficiency and loyalty to the company be expected.

2. Contemporary approaches to determining the compensation of top management at corporations comprise a number of conditions and characteristics associated with both the objective results of company performance (increased company value, profitability of assets, general profitability, flexible adjusting to legislation changes, etc.) and subjective factors of the CEO's personality such as age, experience, tenure, competence, degree of influence) as well as with organizational features of activity carried out by the corporation's managerial bodies such as the

General Meeting of Shareholders, Board of Directors, Special Committees within the structure of the Board. While considering the external and internal factors of both the mission and strategic objectives of the company, the Board of Directors determines the ratio of portions forming the compensation package of top managers, i.e. the fixed salary depending on the actual duties and responsibilities of top managers and on the labour market situation, which usually does not exceed 50-60%, and another variable depending both on the short- and long-term performance indices.

3. The modern doctrine of the corporations' activity implies participation of the Board of Directors in establishing the remuneration system for the executive bodies with the said participation being one of the most important instruments of controlling the activities of top management. Recommendations set forth in the international standards in the field of corporate governance regarding the general principles of developing the system of remuneration for top managers imply that these issues should be governed by a separate special committee of the Board of Directors, such as the Compensation Committee chaired by an independent director and submitting proposals on the general policy in the field of incentives for the top management.

4. In terms of determining the CEO's remuneration it is quite important to consider the following: specific features of the company (its scale, profitability, debt load, etc.), features of the Board of Directors (composition, number of members, average age of the latter, etc.), CEO's personal characteristics (age, tenure, gender); industry sector in which the company operates; corporate investment policy (e.g. in the field of research and development). At that, historical performance indices of the company and debt load correlate positively with the CEO's compensation amount.

5. Despite ongoing debate about the amount and dynamics of remuneration for top managers of major corporations, two basic approaches to solving the agency problem in terms of remuneration are currently applied. The first approach, known as the *optimal contract model*, is largely regulatory in nature and the most common today. Drafting of contracts governing remuneration of top managers, is regarded as one of the tools if not for resolving, then for substantial easing of the agency problem, when the principal (shareholder, owner) is striving to draft a contract prompting the agent (top manager) to take decisions and steps maximizing the company value for the principal on the long term basis. In terms of the *managerial power model* it is argued that top managers have real opportunities to influence formation of their compensation package while increasing the latter, leading eventually to their receiving the so-called compensatory rent. The result of such actions implies

emergence of ineffective compensation schemes, which, on the one hand, negatively affect performance of the company by significantly increasing costs, and on the other hand, weaken incentives of the top managers to take decisions and steps that lead to an increase in wealth of the owners (shareholders). The *managerial power model* and the *optimal contract model* are not alternative, while the existing corporate compensation agreements simultaneously reflect performance of both market forces stimulating the efforts of top managers to maximize value for the shareholders and the influence of the top managers on decision-making regarding their own remuneration amount.

6. The system of long-term incentives proves effective, provided the top managers are actually able to independently make necessary strategic management decisions and prove directly responsible for the company performance results. For middle-tier managers more effective motivation could be implemented by means of tools such as granting percentage of value added in case of the manager's successful participation in creation thereof in terms of the company's return on assets. Thus, employees, including top managers, who have made a significant contribution to the company offer examples of the desired behaviour and a model of corporate culture. Therefore, the options are seen as rewards for the already manifested performance, though depending on the willingness of the owners, but providing clear guidelines for other employees as well as creating a comfortable working climate for companies.

7. An important field for further research regarding development and implementation of the new incentives systems implies the need for selection of methodology, forms and procedures for implementing programs of long-term incentives for top managers along with considering qualitative changes in the environment of activities carried out, which is becoming increasingly unstable while exposed to high risks and showing numerous signs of turbulence, that in turn, requires new creative approaches in developing corporate strategies supported by the latest design of organizational structures. An unbiased analysis is needed also for the phenomenon of individualization and personalization of the global business, as well as for its functionally subjective transformation and the critically growing role of the top management.

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