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CEO Bonus Plans: And How to Fix Them

by Kevin J. Murphy and [Michael C. Jensen](#)

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About the Author



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Abstract

Almost all CEO and executive bonus plans have serious design flaws that limit their benefits dramatically. Such poorly designed executive bonus plans destroy value by providing incentives to manipulate the timing of earnings, mislead the board about organizational capabilities, take on excessive (or insufficient) risk, forgo profitable projects, and ignore the cost of capital. We describe the causes of the problems associated with widely prevalent executive bonus plans, and offer our recommendations for fixing them. We focus on choosing the right performance measure, determining how performance thresholds, targets, or benchmarks are set, and defining the pay-performance relation and how the relation changes over time.

Keywords: [Business Earnings](#); [Competency and Skills](#); [Cost of Capital](#); [Executive Compensation](#); [Risk Management](#); [Performance Evaluation](#); [Projects](#); [Motivation and Incentives](#); [Value](#);

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