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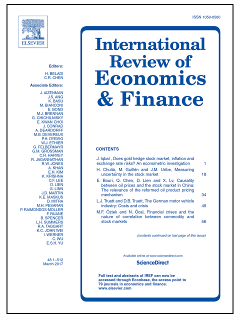

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Divisional Managers' Compensation to Maximize Spillovers and Cooperation

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ABSTRACT

The ability of multidivisional firms to capitalize on their spillover synergies and encourage cross-divisional cooperation can play an important determinant of competitive advantage. We study these issues in an agency framework where headquarters maximize total expected firm returns by providing managers incentives based on firm equity and divisional profits. The resulting incentives serve as a rich alignment mechanism for enhancing total firm returns and provide new insights. An interesting model insight is that, although spillover effects arise spontaneously from own-division effort and incentives are costly to provide, managers with larger spillovers should receive higher equity incentives. The return-maximizing incentives also encourage greater cooperation from managers with riskier divisional performance and have useful implications for leveraging spillover and collaborative capabilities in various organizational forms (e.g., conglomerates, M-form, 'upstream' divisions).

Keywords: multidivisional firms, spillovers, collaboration, divisional managers, equity and profit incentives, M-form, conglomerates.

JEL Codes: D23, C70, M12, L22, G3

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