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The Relationship Between Agency Problems and Ethical Leadership

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Title:	The Relationship Between Agency Problems and Ethical Leadership
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Author:	Dario Pontiggia and John Politis
Abstract:	Since the start of the recent financial crisis, the salaries of CEO's have constantly made headlines and the issue of management compensation has taken center stage in the public arena. For example, Barack Obama, the US president, is frequently quoted criticizing what he sees as excessive executive pay. Performancebased executive remuneration reflects the prevailing solution to the principal/agent relationship. In order to align executives' incentives to the ones of the shareholders, executive pay has been tied to firm's performance, mostly in terms of equity-based stakes in the firms. This has heightened the responsiveness of top managers' compensation to stock prices. In particular, managers have prioritized short-term profits instead of focusing on long-term opportunities and sustainability. Corporate scandals, reflected in excessive management compensation and unethical practices seems to be acceptable and even legitimate as evidenced by top executives from organizations such as Enron, Global Grossing, Siemens, Qwest, Scandia, and WorldCom, that found to be involved in unethical activities (Carson 2003; Flanagan 2003). Circumstantial evidence suggests that some CEOs who fiddle the accounts are the same individuals who receive exorbitant compensations (Cassidy 2002; Salter 2003). Frey and Osterloh (2005, p.96) argue that these scandals "cannot be overcome by improving variable pay for performance, as selfish extrinsic motivation is reinforced". They go on to suggest that, on the basis of the common pool approach to the firm, the principal/agent relationship can be solved by fostering intrinsically motivated corporate virtue. The objective of this paper is to build upon Frey and Osterloh's (2005) argument by understanding the underlying variables of corporate virtue and by extension the contemporary theories of ethical leadership(e.g. authentic leadership), and build a model that will encompass the agency problems for future empirical investigation. The theoretical model will include authentic leadership and agency problems variables that are believed to have a significant relationship within organizations. **Keywords:** agency problems, authentic leadership, executive compensation, in-trinsic motivation, principal agent