Phantom Stock and Investment Decisions

ENRIQUE R. ARZAC
Columbia University—U.S.A.

This paper examines the incentive properties of phantom stock. These are non-public shares that give managers participation in the value of the specific subset of activities under their control. These managers cannot be directly motivated by common stock or by options on such stock. The paper provides a theory for the recent adoption of phantom stock in practice and how to design phantom stock to induce desired managerial behavior. It is shown that phantom stock induces agents to take investment decisions consistent with the maximization of common shareholder value independently of the agents' preferences and without requiring the principal to know the probability distribution or the expected value of the free cash flows associated with the investment. This property eliminates the conflict between effort and choice that affect other incentive schemes used in practise. The model allows for early redemption of phantom stock, with the redemption price produced by a bargaining game with guaranteed individually rational outcome. In addition, the relationship between phantom stock and compensation according to economic value added is examined, and implications for the design of value-added compensation schemes with desirable incentive properties are discussed. (JEL G30, G31)

Do PGA Tournaments Have Perverse Incentive Effects?

PAUL M. SOMMERS AND PETER HANS MATTHEWS
Middlebury College—U.S.A.

What motivates individuals to do well? Are financial incentives embodied within tournaments sufficient? Ehrenberg and Bognanna [*JPE*, 1990: 1307-24] find that higher prize levels lead, *ceteris paribus*, to lower scores in the men's Professional Golf Association (PGA) Tour from the 1980's. Following the framework used by Ehrenberg and Bognanno, we find that on the men's 2000 PGA Tour, higher purses contribute to *higher* scores.

There is some reason to believe that the 2000 season is a special case, because of the presence of a "superstar" on the PGA Tour. Tiger Woods participated in 19 of the 44 tournaments in the study's sample, winning nine of them, including three majors. He also finished fourth or better at five others and earned $9.188 million, 94 percent more than his closest rival. When the authors re-estimated coefficients of the benchmark model for the 25 tournaments in which Woods did not participate, the coefficient on tournament prize money remained positive and significant ($p < 0.001$), after controlling for tournament specific factors such as the difficulty of the course and measures of the player's ability relative to his competitors' abilities. Curiously, on the PGA Tour, higher total prize money does not now lead to better (that is, lower) scores. (JEL J33, L83)