



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

Department of Accounting

“Ethics, Agents’ Choices and Incentive Contract Design”

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Venue: OLD.3.21

Abstract

We test a model that directly tests the effect of social norms or what we call ethical work climate (EWC) on both agents’ actions and senior managers’ choice in designing incentive contracts. We assess whether embedding ethical values within the ‘fiber’ of the firm influences agents’ action choices, namely the degree of shirking and accounting manipulation. We then consider the incentive contracting choices senior managers make in response to the EWC. Based on a sample of 550 managers our findings show that ethical values prevalent in a work unit do influence agents’ action, namely if the focus of the ethical work climate is ‘on self’ agents will shirk and misdirect their effort in the form of increased accounting manipulation. In contrast, when the social norm is to focus ‘on others’, agents exert more effort. Senior management, when observing ethical work climates which ‘focus on self’ will increasingly use costly aggregated performance measures that capture the joint performance of multiple work units in an effort to promote between-unit cooperation.