

Three and a half decades ago Jensen and Meckling published their seminal article on agency cost ("[Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure](#)"). They recognised the invidious position in which the modern executive was placed: managing assets that he would almost inevitably apply to his own advantage. Jensen and Meckling were concerned with developing a model that would align the interest of the executive with those of his principals, the shareholders in the enterprise. Their analysis of the inclinations of the modern executive was exceptionally insightful, even if the solution they developed to overcome them, rewarding managers more to align their interests with those of the owners, have not proved to be particularly successful. Greater rewards for the modern executives have just made them more greedy.

To the plethora of risk contemporary investors must now consider a new one: "Executive risk." What are the changes that the manager you employ to husband your assets will simply dissipate it on gambles and his own reward? Unfortunately, it is very. Modern management theory must now address this problem. Jensen and Meckling were on the right track. It is necessary to align the interests of the executive with those of the shareholders, but this cannot be done only by sharing rewards. It is necessary also to share the risk. The modern executive needs to face the consequences of his actions. Until the modern organization develops schemes to do this, there will be no way to avoid the dire consequences of executives risk.

The situation is this: the modern executive is rewarded very well when he succeeds and he is also rewarded when he fails. Reflect for a moment on the executives who have been dismissed recently, from the CEO of BP after the debacle in the Gulf of Mexico, to the CEO of HP after the allegation of sexual harassment. They had either failed or misconducted themselves, but they left their employment highly rewarded. What incentive do they have to behave properly?