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Abstract

We develop a model to illustrate that equity-based compensation for non-executive employees and product market decisions are related. When the product market is competitive and employees have low bargaining power, the unique equilibrium is for each firm's owners to offer equity-based compensation to their employees. In this setting, equity-based compensation leads to a lower wage rate, which makes each firm more competitive with its rival. However, this unique equilibrium is a Prisoner's Dilemma for the firms' original owners. Our results are consistent with several empirical regularities and provide predictions on when firms will offer equity-based compensation to their employees.

JEL classification: G30; J33; J41

Key words: Employee bargaining power, market competition, equity compensation

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