ABSTRACT

"How regulatory authorities should supervise firms" is a question that received attention from scholars in different research fields. One prominent theory on this topic is the theory of responsive regulation, which suggests that authorities should differ supervision based on the firms that they supervise, and that supervision is most effective if it is aligned with firms’ motivations. For responsive regulation to work, it is fundamental to assess whether certain types of firms or individuals respond better to certain types of supervision. Building on this theory, I study whether firms are more compliant and responsive to regulatory supervision if they have economic motivations to do so. I specifically examine firms’ time horizon, and the use of incentive compensation as these firm characteristics are associated with economic motivations. Using a unique dataset provided by the Dutch financial market supervisor, the Authority for Financial Markets, I observe that long-term oriented firms are more compliant than short-term oriented firms, and smaller firms that use incentive compensation for front-office employees and managers are, on average, less compliant. Furthermore, I find evidence that long-term oriented firms respond better to supervision: they respond better to (i) feedback instruments in self-regulation, and (ii) a supportive regulatory attitude in official communication of the regulatory authority. The main implication is that authorities can use the differences in firms’ economic motivations to (i) ex-ante have expectations which firms are more (or less) likely to comply and respond to supervision, (ii) decide which firms to supervise more (or less) intrusively, and (iii) decide which regulatory attitude to signal in communication with the firms that are supervised.