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Executive Compensation Is Out Of Control. What Now?

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I cover leadership - people, politics & policy - from a European view.

Executive pay, particularly in the US, continues to dwarf the salaries of the people who work for them. Here are some suggestions to score a more equitable future.

When we hear "wage gap," we automatically think of the "gender gap" between the salaries of men and women. This is a demonstrable problem, but an even bigger one, affecting men and women alike, is the pay gap between executives and the people who work for them.

CEO pay is today so out of kilter with average wages that the negative side effects – demoralization, destroying the sense of community that today's high-performing organizations need – are beginning to outweigh the oft-stated reasons for paying top dollar for executives - such as specialized expertise that will propel a company to the top of the heap.

Management guru Peter Drucker believed the proper ratio between a chief executive's pay and that of the average worker should be around 20-to-1 as it was in 1965. The Economic Policy Institute (EPI), in a report last summer by Lawrence Mishel and Jessica Schieder, shows that CEO pay is and continues to be dramatically higher now. CEO pay in the US peaked in 2000 at $20.7 million (in 2016 dollars), 376 times the pay of the typical worker. In 1995, the CEO-to-worker pay ratio was 123-to-1; in 1989, it was 59-to-1; in 1978, it was 30-to-1; and in 1965, it was, as Drucker's ratio would have it, 20-to-1.

"CEO pay continues to be very, very high and has grown far faster in recent decades than typical worker pay," the EPI authors wrote. "CEO compensation has risen by 807 or 937 percent (depending on how it is measured—using stock options granted or stock options realized, respectively) from 1978 to 2016. At 937 percent, that rise is more than 70 percent faster than the rise in the stock market." A typical worker's annual compensation over the same period rose at the rate of 11.2%.

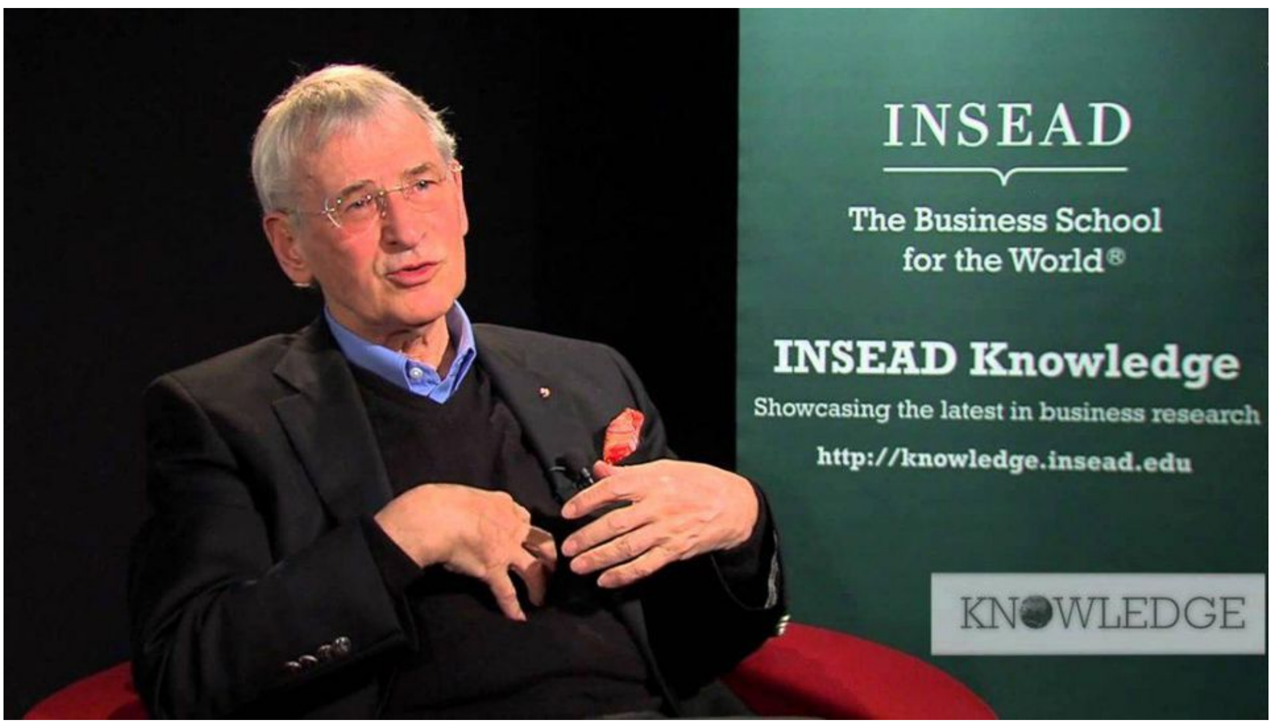
Global Inequity

How does CEO pay stack up globally? According to a December Bloomberg analysis (the Global CEO Index) that used benchmark stock indices in 22 nations, you'll find the highest paid CEOs in these countries in this order US, Switzerland, Netherlands, UK, Canada, Germany, Australia, Spain, Hong Kong and Singapore.

Using a different yardstick to measure the pay gap (CEO pay compared to per-capita GDP adjusted for purchasing power parity) the order is slightly different: US, India, UK, South Africa, Netherlands, Switzerland, Canada, Spain, Germany and China.

The Index also shows that CEOs in the U.S. are paid much more than their peers abroad, and the gap between their compensation and that of average American workers is wider than in other countries: "CEOs of the biggest publicly traded U.S. companies averaged $14.3 million in annual pay, more than double that of their Canadian counterparts and 10 times greater than those in India…while Norway and Austria have among the smallest margins."

A prominent leadership professor at the INSEAD Business School in Fontainebleau, commenting about executive pay, claims, "As things stand now, many CEOs earn more in a single workday that the average worker makes in an entire year."



(Fontainebleau, France) Manfred Kets de Vries, INSEAD Distinguished Clinical Professor of Leadership Development & Organizational Change, in an INSEAD Knowledge video interview. INSEAD KNOWLEDGE

Writing in INSEAD Knowledge, Manfred Kets de Vries, Distinguished Clinical Professor of Leadership Development & Organizational Change, opines, "Many people view the CEO compensation game as an important bulwark of capitalism.

Although this may be true, inflated CEO pay scales are also a sign of impending rot. While capitalism has many positives (in light of the alternatives), free market ideas in unrestrained forms have serious dysfunctional effects on society." He points specifically to high turnover rates and low employee morale, which can give a company low marks in competitiveness, creativity and innovation.

Two Pay Myths Debunked

In his article, Kets de Vries explodes two myths justifying high CEO pay, as follows:

"Myth 1: CEOs need high pay to motivate them to exceptional performance. If CEOs were not paid so well, they would not work as hard.

Reality: High achieving CEOs will work hard whatever they are paid.

"Given our understanding of human motivation," he writes, "the kinds of people interested in the corporate game tend to be high achievers. And most CEO-types fall into this category. From my experience working with these people, they will work hard regardless of salary It's very unlikely that cutting CEOs' pay would affect the bottom line."

Myth 2: Large CEO salaries reflect market demands for a CEO's unique skills and contribution to the bottom line.

"According to this argument, talented CEOs possess impressive but very scarce leadership skills," Kets de Vries believes. "Generous pay packages merely represent the market forces of supply and demand. If there was an oversupply of people with such unique qualities, market forces would bring their salaries down."

Reality: CEOs are not that exceptional and it's almost impossible to measure their singular contribution to the bottom line. .. most CEOs aren't that exceptional. Rare are those who have the impact of a Steve Jobs or a Bill Gates.

Both Kets de Vries and the EPI have ideas for correcting the imbalance, without propelling CEOs out the door or threatening executive performance. Both are depend directed more at policy makers than business leaders:

Kets de Vries suggests taking a hard look at how a company deals with existing tax codes – certainly an issue today in the US. ”Compensation decisions are often attempts at finding ‘creative’ ways to maneuver through a maze of tax regulations,” he writes. “In this case, the government needs to play an important role. For example, implementing higher marginal income tax rates at the very top would have a dampening effect on large compensation packages.”

He also suggests governments set high corporate tax rates for firms that have very high CEO-to-worker compensation ratios. This does not seem likely anytime soon in Trump’s Washington, but European countries might buy in.

Are Policy Changes The Answer?

The EPI’s agrees that reinstating higher marginal income tax rates at the very top and setting corporate tax rates higher for firms that have higher ratios of CEO-to-worker compensation are key to fixing the wage gap.

They also suggest:

• Remove the tax break for executive performance pay.

• Allow greater use of ‘say on pay,’ by giving a firm’s shareholders the right to vote on top executives’ compensation.

While such policy changes might be unpopular in some political and corporate corners, the timing for such change seems propitious. For example, the EPI report shows “The CEO-to-worker pay ratio dropped to 197-to-1 by 2009 in the wake of the financial crisis, rose to 299-to-1 by 2014, and has declined since 2014.”

It’s too soon to tell if this trend is the beginning of a downward trend in CEO compensation. Is it a sign of our times, when greater transparency is demanded and therefore such inequities are highlighted and publicly questioned? Or is CEO compensation simply being weakened because it is closely tied to stock prices – which are currently weakening as the markets slump?

The state of the global economy today, coupled with increasing consumer awareness of pay inequity may ultimately bend the political will to correct the situation. At least the debate may shift the corporate focus. As Kets de Vries writes, “It’s timely that the next generation of CEOs thinks more creatively about the challenges corporations face in building sustainable businesses.”

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I have spent more than four decades as an international broadcast journalist covering most major international new events since 1980 throughout Western and Eastern Europe and the Middle East for outlets such as ABC News, PBS, AP Broadcast, and CNBC. I have held bureau chief ... MORE