

# The Executive Compensation Controversy: A Transatlantic Analysis

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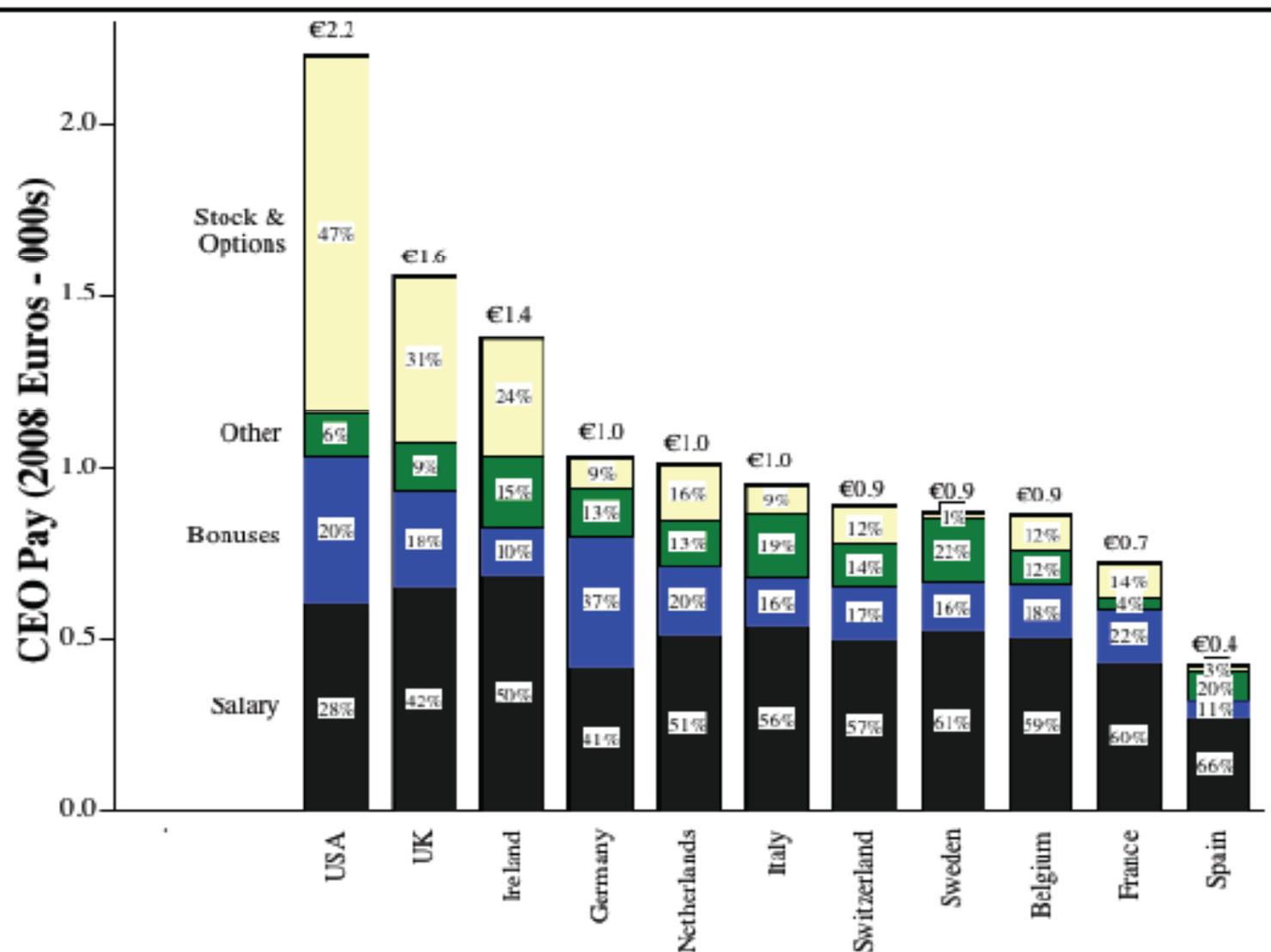
# Summary

- Paper is a great historical discussion of the development of US CEO pay, especially over equity based remuneration
- Treasure trove of basic facts exploiting recent data on CEO pay comparing US to EU
- 3 sections
  - US history 1950 onwards
  - US/EU differences
  - Financial crisis

# Basic Facts

- Median US CEO real compensation
  - 1983-1991 4.3% p.a.;
  - 1991-2001 15.7% p.a.;
  - 2001-2008 1.7% p.a
- CEO compensation in US about twice as large as EU average
- Base salary (and bonus) similar US/EU.  
Differences is in stocks and stock options (see figure 3.1)
  - But a puzzle is why??

**Figure 3.1 2008 CEO Pay in the USA and 10 European Countries after controlling for Sales and Industry**



**Note:** The figure compares 2008 CEO pay (in €000s) in each country controlling for firm size (sales) and industry. We regress the logarithm of total compensation on the logarithm of sales and 5 industry and 11 country dummies. For each country, we estimate the pay for a CEO running a hypothetical firm with \$1 billion sales using the estimated coefficient for pay-size sensitivity and that country's dummy variable for a CEO in the largest industry group (manufacturing, energy, and utilities). Countries are sorted in descending order in terms of total estimated pay.

# Issues

1. What is the effect of CEO incentive pay on company performance?
2. Incentive Pay & Financial Crisis
3. The EU/US Gap: what's special about CEO Pay?
4. Policy Implications
5. Other Issues

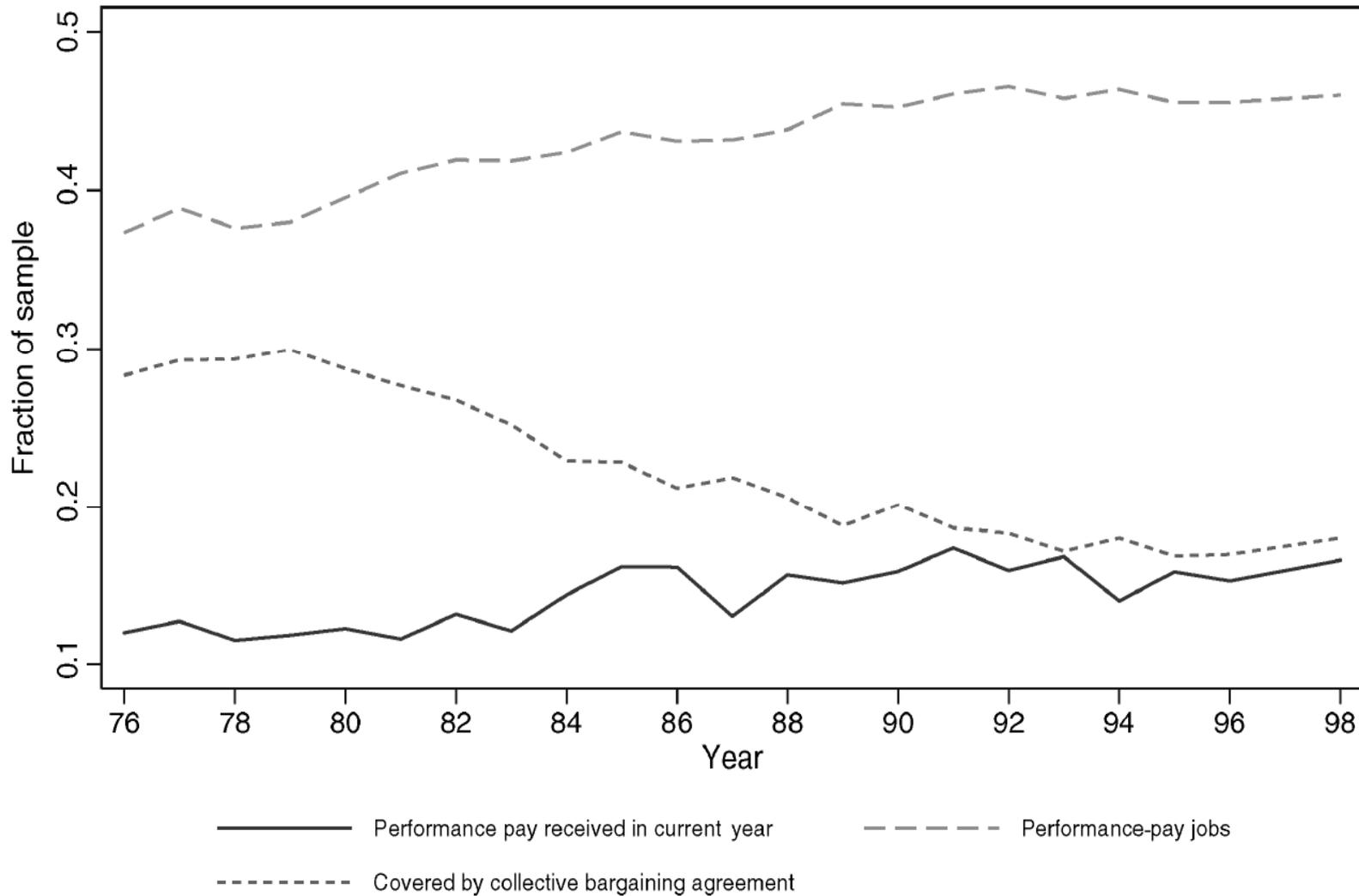
# 1. What is the effect of CEO incentive pay on company performance?

- Unclear what authors think about link between incentive pay (e.g. Stock options) and performance of CEOs
- **Positive?**
  - Discussion of Gabaix-Landier (2008)
  - They support move towards more incentive pay in EU
- **Negative?**
  - They explain growth of options to changes in accounting/tax rules rather than to fundamentals
- Would be good to see review of best empirical studies
- Cf. Bloom and Van Reenen (2010) “HRM and Productivity” in *Handbook of Labor Economics IV*
  - Incentive pay appears to have positive link to productivity for ordinary workers

## 2. The EU/US Gap: what's special about CEO Pay?

- In cross section, US inequality is higher than EU at every point of the wage distribution
- In time series US inequality has grown much more quickly than EU countries since 1980
- Most theories suggest something “special” about CEOs: superstars, managerial power, tax/accounting rule changes, etc.
- But how much of this just following same trends as rest of US wage inequality patterns (e.g. skill biased technical change, trade, union decline)?
- Would be useful to examine how different are CEO trends from say evolution of 99<sup>th</sup> percentile, 90<sup>th</sup> percentile, etc.

# Incidence of Performance Pay, US men in PSID, 1976-1998



Source: Lemieux, McLeod and Parent (2009, QJE)

Notes: Male heads of household earning between \$1 and \$100 per hour. Self employed and public sector excluded. 30,424 observations on 3,181 workers. Performance pay in current year=1 if any part of compensation includes bonus, commission or piece rate. Stock options and shares are not included. A performance pay job is one where the worker *ever* receives some performance pay over the life of the job-match.

### 3. Bankers' bonuses & Financial Crisis

- Incentive pay particularly strong in finance. Conyon et al argue that CEO incentives nothing to do with financial crisis. I am not so convinced
- Bell & Van Reenen (2010) show that increase in share of top decile 1998-2008 from 27% to 30%. Mainly to top 1% and most of this (£12bn) was bankers' bonuses
- Banks moral hazard problem. State bail outs provide insurance leading to more risky behaviour (Garicano & Van Reenen, 2010)
- Not just CEOs, traders too. Table 4.1 In 9 largest Wall St banks, 4,793 employees received more than \$1m in bonuses, 800+ more than \$3m. By contrast empirical analysis of banks more affected by crisis looks at CEOs only

# Policy Implications

- I agree that short sighted “punitive” CEO pay regulation bad idea
- But UK one-off 50% tax on bankers justified because bank profits were earned largely because of taxpayer bail out of banking system.
- I am not convinced that moving to US CEO pay would bring improvements in EU corporate performance
- Perverse pay systems are the symptom of moral hazard problem in banking sector. Need to tackle root causes through higher capital requirements, enforced transparency, living wills and reducing bank size
- “If banks are too big to fail they are too big” (Mervyn King, Governor of Bank of England)

# Other Issues

- Cross national comparisons with BoardEx when looking at market cap are difficult because focus is on public firms.
  - But many EU countries (e.g. Germany) relatively small fraction of large firms on stock market.
- If story is that accounting/tax changes drive options & stock this can only explain why EU/US pay gap larger post 1992. US/EU pay gap preceded this, so what causes this long-standing difference?
- Institutional investors associated with higher pay, but what about incentive pay? Aghion, Van Reenen & Zingales (2009): institutions improve performance

# Conclusions

- Great paper – really informative and full of basic facts.  
Well written
- Popular debate revolves solely around “banker bashing” (e.g. Recent UK election) . This paper injects welcome historical dimension and reason
- Next step to look more carefully at economic consequences