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CEO Compensation: A Position Paper

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CEO compensation has been a topic of interest and debate for the past several years. It has been discussed and analyzed in sources such as Fortune Magazine, Businessweek, and a plethora of academic literature. The primary concern is whether or not CEOs are overpaid. Considering the financial performance of a company is the basic determinant of the appropriate compensation for a CEO, many individuals question why most CEOs are paid what seem to be disproportionally high salaries in regards to the financial performance of the firms they lead.

Background Literature

One side of the argument is that CEO compensation is, in fact, too high. This position was formed because CEO compensation is often tied to industry referents, how the industry is doing based on standardized performance evaluations, and not firm referents, such as how the firm is doing in comparison to prior firm performance (Fong, Misangyi, & Tosi, 2010). Another common trend is to base the CEO's salary off of a true labor market economical evaluation, where in real life the market is imperfect (Cote, 2007). Either logic allows for a CEO to be paid an undeserved higher salary if the industry is found to be doing better than the CEO's actual firm.

An additional concern regarding CEO compensation being too high includes the fact that if a CEO possesses self-indulgent personality traits, then they focus less on ethical concerns if they are overpaid (Fong, Misangyi, & Tosi, 2010). Instead, their role as CEO becomes centered upon what will generate further income for the CEO as an individual, and not for the company or its employees as a whole. This has led to multiple cases of CEOs inflating the value of corporate assets to create the illusion of less debt in order to achieve high bonus rates (Posner, 2009).

High CEO compensation is also viewed as a source that generates political turmoil. Many individuals who are not in C-suite positions at companies become upset when it is announced that CEOs are receiving pay raises while their followers are losing their jobs (Henderson, Masli, Richardson, & Sanchiez, 2010). It has been found that the average CEO salary is 400 times that of the average American worker (Cote, 2007). Those against high CEO compensation see this statistic as extremely unfair and believe that companies simply want to "perpetuate the myth of the imperial CEO" (Cote, 2007, p. 80) to subliminally encourage followers blindly follow CEO commands.

There are some weaknesses regarding these viewpoints of CEO compensation. First, CEO salaries are often determined by a firm's stock performance (Kaplan, 2008). Many Boards of Directors realize that the higher the cash compensation percentage in a CEO's salary, the less motivated a CEO will be to produce larger profits for a firm (Mobbs, 2013, p. 691). This logic has resulted in CEOs being compensated according to stock performance. Stock performance is directly linked to a company's success, which can only be achieved if a CEO is doing their job properly. If stock prices rise while a CEO is in charge, then that CEO helped bring the company to those higher prices and deserves a salary increase. For this reason, a typical CEO’s pay has declined or been flat since the early 2000s resulting from the tumultuous economy and numerous recessions (Kaplan, 2008). The inaccurate assumption that CEOs are paid unnecessarily high compensation rates is the result of numerous individuals merely looking at the CEO pay level and not the structure of those compensation plans (Palomino & Peyrache, 2013, p.1302).

It is also extremely rare that CEOs use their position power for disreputable and self-indulgent purposes. In fact, high CEO salaries result in positive benefits more often than negative ones. These benefits include increased motivation levels for the CEO and employees (Walsh, 2009), as well as higher returns on investment for the corporation (Bogle, 2008).

Lastly, although political costs are involved, CEOs are not the only individuals with salaries drastically higher than the average American worker. Hedge fund managers, sports stars, and actors and actresses are all paid extremely high salaries (Bogle, 2008). All of these positions, including C-suite positions, have proportional returns on investment when salaries are considered (Bogle, 2008). Seeing that several corporations have ethically profited with the method of proclaimed CEO overpayment (Bogle, 2008), it appears that any political turmoil is a result of lack of communication. A CEO is in charge of heading an organization, and if the organization is profitable with the CEO that is currently in charge, then the entire company benefits. This includes the CEO’s followers who may be complaining about the CEO receiving a pay raise when others are losing jobs. In fact, the CEO may be receiving a bonus because they were able to lead the organization to increased profits during a recession, when others unfortunately need to be removed from payroll.

My understanding of CEO compensation is that CEO compensation is not too high. In fact, many CEOs realize if they are underpaid or overpaid (Fong, Misangyi, & Tosi, 2010). Acknowledging these deviations commonly leads to equity-oriented effects (Fong, Misangyi, & Tosi, 2010).

If a CEO considers themselves underpaid, they will quickly leave that organization in search of a more profitable position elsewhere (Fong, Misangyi, & Tosi, 2010). This is because underpayment has been proven to lead to lower levels of job satisfaction for CEOs (Fong, Misangyi, & Tosi, 2010). Therefore, to keep an effective CEO in their leadership position, higher salaries are necessary. If a CEO considers their salary to be excessive, this has been shown to result in that CEO actively seeking to improve firm profitability as the most desirable and fair way to compensate for their salary (Fong, Misangyi, & Tosi, 2010). CEOs who believe they are overpaid tend to pay their followers more, which reduces turnover levels (Fong, Misangyi, & Tosi, 2010). High levels of CEO compensation also increase firm productivity, as the CEO feels the need to establish and maintain prestige for their organization if they are being paid a large salary (Fong, Misangyi, & Tosi, 2010). It is also important to note that these CEOs have higher levels of job satisfaction and tend to stay with the organizations longer as a result (Fong, Misangyi, & Tosi, 2010). This allows the CEO to be able to grow the company over a lengthy period of time, as opposed to leaving after only a quick stay in office.

Higher CEO compensation therefore leads to greater returns for an organization (Bogle, 2008). CEOs view their compensation as both a reward and an incentive to keep the organization profitable and running smoothly (Walsh, 2009). Therefore, it is only natural that there is a strong link between pay and performance (Walsh, 2009).

My Position

I believe my position regarding CEO compensation is the superior side in the debate regarding whether or not CEO compensation is too high. As mentioned earlier, there are several flaws regarding the logic behind the argument that CEO compensation is too high. These flaws consist of inaccurate assumptions of how CEO salaries are determined, the lack of acknowledgement that it is rare to have malevolent and self-indulgent CEOs, and the fact that political costs are unavoidable considering it is impossible to please everyone.

There is a superfluity of logically sound evidence supporting the position that CEO compensation is not too high. CEOs who receive high salaries often are grateful for the opportunity that has been presented to them and are motivated to increase firm performance as a result. Higher salaries encourage CEOs to stay in their positions for longer periods of time, which aids in implementing, managing, and executing long-term goal setting. CEOs with high salaries have also been shown to establish and maintain prestige for their organization, increase the returns for their firm, and pay their followers higher compensations levels as well. All these factors are the advantageous and valuable results that high CEO compensation brings to an organization.

These benefits are not present if a CEO is paid less than what is currently considered by some as excessive compensation. When a CEO is paid a lower salary, they are not motivated and have lower levels of job satisfaction. As a result, the firm sees no profits from that CEO's leadership. In addition, those CEOs often leave after a short stay with that company to find better compensation at a different firm.

Considering the economy has done well with the current system of CEO compensation, and corporate profits have still managed to grow despite recessions (Bogle, 2008), it is logical to continue this system because is working well. There is no reason to change a system that has ultimately managed to continue to generate economic returns (Lussier & Achua, 2013). CEO compensation is not too high, and the elevated compensation levels are in place for a reason. Higher CEO compensation leads to a more motivated leadership force with high levels of job satisfaction. Higher CEO compensation has also been shown to increase firm productivity and profits, generate higher returns on investment, enhance firm prestige, and equate to happier followers with higher pay compensation levels as well. Without the system of high CEO compensation in place these benefits would not be established, and organizations would not be able to employ successful and effective leaders in CEO positions for any lengthy period of time.

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