CEO-to-employee pay ratios are lower than popularly thought, according to study

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For the vast majority of United States commercial banks, the ratio of CEO-to-employee pay is substantially lower than the levels popularized in the financial media, according to a forthcoming study by accounting experts at Rice University and the University of Houston (UH). The study's findings carry special relevance in advance of this spring's proxy season, when America's publicly traded corporations hold their annual meetings to vote on company business, including CEO compensation.

In addition, the Securities and Exchange Commission (SEC) is expected to decide soon on a proposed rule that would require most companies to disclose the median annual total compensation of an employee, the annual total compensation of the CEO (which is already available under existing compensation disclosure rules) and the ratio of CEO-to-employee pay.

Widely reported estimates suggest that recent compensation of CEOs was about 20 times as much as the typical worker in the 1950s, rising to 42-to-1 in 1980 and 120-to-1 in 2000. In 2013, the ratio stood at 204-to-1 for the S&P 500, with the average of the top 100 companies at nearly 500-to-1, according to a 2013 Bloomberg Businessweek report cited by the study.

"In our study, we document that the gap between CEO and employee pay is likely much smaller for most firms than the perception ingrained in the financial and popular media," said Karen Nelson, the Harmon Whittington Professor of Accounting at Rice's Jones Graduate School of

Business. "By providing a more complete understanding of pay ratios across firms, our findings inform the ongoing policy debate on pay disparity. Although focusing on a single industry potentially limits generalizability, there is no reason to believe that the distribution of pay ratios in the banking sector is systematically lower than in other sectors, particularly given the concerns raised about banks' compensation practices that partly motivated the Dodd-Frank Act and the SEC proposal."

Nelson co-authored the paper with Brian Rountree, an associate professor of accounting at the Jones School, and Steven Crawford, an assistant professor of accounting at UH's C.T. Bauer College of Business.

The paper leverages the unique compensation data available for the banking sector to provide some of the first large-sample, company-specific evidence on CEO-employee pay ratios and their relation to subsequent firm performance, risk and shareholder advisory votes on executive compensation packages (for example, "say on pay"), according to the paper's authors.

The study's sample consists of 10,581 observations of U.S. commercial bank holding companies for the period 1995-2012. For the vast majority of firms in the sample, pay ratios were substantially lower than the levels popularized in the financial media and policy debate. In fact, the mean (median) ratio of 16.58-to-1 (8.38-to-1) was well within the upper bound of 25-to-1 suggested by respected management consultant Peter Drucker. At the 90th percentile, the pay ratio was still a relatively moderate 32.86-to-1. Within the top decile, however, pay ratios rose rapidly to a maximum of 821.17-to-1. These findings stand in stark contrast to widely publicized prior statistics, which include only the largest companies in the economy (typically the S&P 500).

"Our study has the advantage of providing timely evidence on pay ratios before the SEC issues a final rule and hence in an environment where firms are less likely to engage in strategic behavior designed to influence the reported ratio," Nelson said. "For example, firms may change their compensation practices once the pay ratio disclosure is required or take advantage of permitted flexibility in the rule to calculate a ratio that obfuscates the CEO-employee pay gap."

The authors' ratio was based on average employee pay, whereas the SEC proposal requires companies to use the median. "However, the purpose of this paper is not to examine the specifics of the SEC proposal per se, but rather to provide relevant new evidence on an issue that has been debated both in practice and the academic literature," the authors concluded.

More information: "The CEO-Employee Pay Ratio": papers.ssrn.com/sol3/Delivery. … ctid=2529112&mirid=1

Provided by Rice University