

Dollars & Sense

EXPLORING THE HIGH STAKES OF CEO PAY

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In the 1980s, the average chief executive officer (CEO) was paid nearly 50 times the salary of the average company employee. Since then, CEO remuneration has increased drastically, reaching ratios of nearly 362:1. Gurupdes Pandher's current research explores the contributing factors that have caused CEO compensation to reach such record-breaking levels.

A variety of aspects affect executive compensation, including: increase in stakeholder bargaining power, increase in strategic firm uncertainty, a rise in the company's expected performance, a decline in interest rates, a rising stock market, and the hiring of more risk-averse CEOs. Pandher's research develops a CEO-stakeholder compensation model that provides predictions on how CEOs' equity and salary compensation respond to such factors.

According to the stakeholder perspective, corporate management is a mediating hierarchy that balances the nexus of claims from various stakeholders: owners, stockholders, employees, alliance partners and customers, all providing resources to and demands from the company.

"This stakeholder framework for analyzing CEO compensation takes into account the important institutional reality that shareholders depend on the CEO and his top management team for corporate decision-making," says Pandher. "At the same time, management must also take into account the claims of all salient stakeholders. My research studies the

formation of CEO compensation in this context."

The proposed framework allows the CEO some ability to shape the size of compensation, especially when the firm is profitable and has a surplus of funds beyond those required to meet the claims of all stakeholders. At the same time, the model reflects an important political feature of corporate governance, as the compensation regime maximizes managerial pay while minimizing management's exposure to external and internal threats.

According to Pandher, "management's responsibility to provide shareholders their required investment return helps maintain the firm's value in the market and provides little reason for shareholders to sell company stock or organize against management to change the CEO and board. Similarly, satisfying the claims of other primary stakeholders allows the firm to continue functioning in a competitive environment where the bargaining power of important firm stakeholders needs to be incorporated in managerial decision-making."

Pandher's analysis surrounding the interactions of CEO compensation is of vital importance to the business world at large. "This research is applicable to a great number of companies. Hundreds of millions of dollars are at stake. It is an issue of how to model managerial decision-making."

