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Is More Better? Transparency and a CEO's Compensation

By Zachary Nguyen, J.D. Candidate 2017 | November 24, 2014

Employers generally hire the best person for a job at the lowest possible cost while still ensuring a remuneration package large enough to prevent voluntary lateral transfers and hostile talent acquisition. This is especially true for a company's chief executive officer ("CEO"), who serves a dual role of maximizing profits for the company and responding to shareholders' demands. However, the exponential growth in CEO compensation raises concerns over regulating individual corporate governance and promoting collective social policy goals.

External and internal market-disciplining mechanisms – hiring compensation consultants, publicly publishing compensation plans, and news outlets posting "headline-grabbing lists of compensation for chief executives" – exist in part to curb pay rises, expose their enormity, and shame boards. However, a study examining more than 1,000 U.S. companies from 2006 to 2012 has shown that some mechanisms produce just the opposite effect. For example, hiring first-time compensation consultants correlates with a 7.5 percent increase in CEO pay compared to other firms and such companies are less likely to "turn over" consultants the following year.

Two examples exemplified such findings. First, the pay of Michael Dell, founder and CEO of Dell, quadrupled after the company hired compensation consultants in 2011 (though the rise could hardly be called a result of hiring consultants). Second, Public Storage's CEO's pay multiplied after the company hired consultants.

Additionally, permitting a CEO, rather than the board, to hire compensation consultants "led to a 13 percent increase in pay," nearly twice the increase of companies hiring compensation consultants for the first time.

In 2009, the Securities and Exchange Commission ("SEC"), concerned about conflicts of interest and undue influence, required companies to disclose fees paid to compensation consultants. Since many of the consultants also offered other services, the SEC hoped that disclosing fees paid to compensation consultants "might help prevent the consultants from trying to curry favor with management."

However, the study finds that to circumvent SEC-required disclosures, companies hire consultants that do not provide other services and consultancies spin off their compensation consulting division. For example, some Mercer partners started Compensation Advisory Partners and Tower Watson partnered with Pay Governance, a newly created spinoff focusing on compensation consulting.

The result above raises two important, unanswered questions if the goal of companies is to curb CEO's compensation: Is more transparency in CEO pay necessarily good? And is there a more efficient and effective way of curbing that compensation?