

CEO Pay Over the Very Long Run

Sharply increasing
compensation for
executives is a relatively
new phenomenon
when viewed over
the past 80 years.

Recent work by economic historians shows us that while CEO pay has risen dramatically since the 1990s, such a trend was all but nonexistent from World War II through the mid-1970s.

Stagnancy While Workers Gain

Imagine coming upon an article in a prestigious business publication titled “Another Decade of Deterioration in Top Executive Pay Compared to the Economy as a Whole.” Other than perhaps on April 1, you would assume that some editor had missed a serious typo. But, this title was indeed accurate and the paper published in *Harvard Business Review* — in 1965 (November-December 1965, pp. 106-118). Its author, Arch Patton, reports data from a set of more than 400 “top managers” from 1953-1964. What is particularly startling is the size of the deterioration relative to the average. In fact, while “the total [nominal] compensation of the average chief executive rose from \$106,700 to \$133,500” over this time period, this “25.1 percent increase reported by top managers was approximately half of the gain of 46.1 percent recorded by hourly production workers during the same period.” Half! In addition, during that time period, the sales of those companies increased 76.6 percent and profits increased 102.6 percent (p. 106).

Interesting Research by Economic Historians

We know from piles of recent evidence that executive compensation has increased rapidly over the past generation. And I have just described some evidence that CEO pay



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was relatively “flatter” in the United States in the 1950s and early 1960s. And, what about over the very long haul? How could we possibly know without a great deal of effort?

Of course, we couldn't know without a great deal of effort, but thankfully, two clever and careful economic historians have done the work for us. Carola Frydman and Raven (Malloy) Saks have a rich and interesting research program on the long-run aspects of CEO pay. One paper from this body of work is “Executive Compensation: A New View from a Long-Term Perspective, 1936-2005” (*Review of Financial Studies*, 23, May 2010, pp. 2099-2138).

Frydman and Saks are careful to construct a consistent sample over time. This was not easy, but they did so by focusing on the 50 largest publicly traded companies in 1940, 1960 and 1990 — creating a sample of 101 companies. For that set, they collected executive pay information for their top executives in every year the data were available in filings with the U.S. Securities and Exchange Commission (SEC) (starting in 1935).

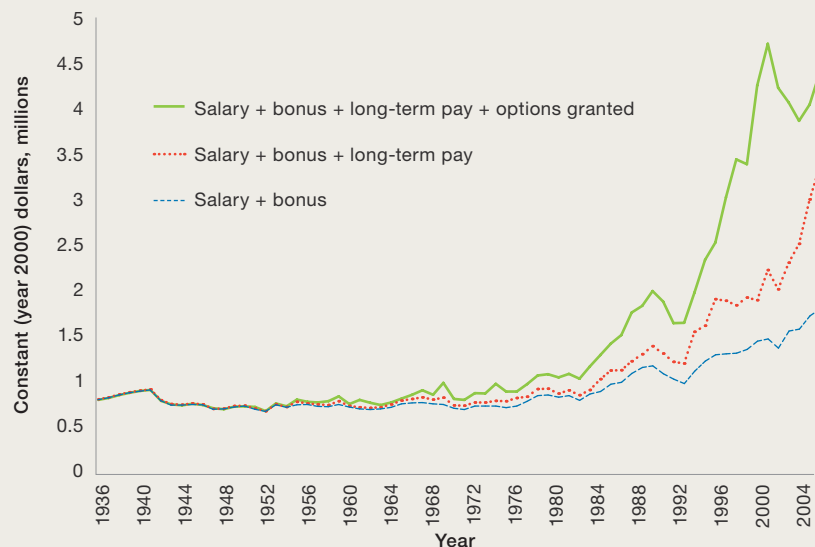
Figure 1 shows that although median CEO pay has increased dramatically since the 1990s (which we knew), it was remarkably flat (in inflation-adjusted terms) for a very long time before that. From the 1930s through the 1980s, three measures of pay (salary plus bonus paid as cash or stock, salary plus bonus plus long-term incentive pay paid in cash or stock, and salary plus bonus plus long-term incentive plus the Black-Scholes value of granted options) were remarkably flat, controlling for inflation. Only by the early 1980s did CEO pay really start to move. In the early 1990s, it really took off. Frydman and Saks noted that the SEC changed disclosure rules in 1992 also in 1942, 1978 and 2006, and they find no evidence that changes in disclosure rules had any meaningful impact on these trends.

Where Will CEO Pay Go Next?

In addition to these results, Frydman and Saks point out that, unlike more recent decades when CEO pay and firm size have grown dramatically in sync, the period from 1940

Figure 1 | Median Executive Pay

U.S. Large, Publicly Listed Companies in Millions of (Year 2000) Dollars



Source: “Executive Compensation: A New View from a Long-Term Perspective, 1936-2005,” *Review of Financial Studies*, 23, May 2010, pp. 2099-2138, Carola Frydman and Raven Saks

to 1975 saw firms grow notably but executive pay stagnate in real (inflation-adjusted) terms. Does this macro story of executive pay match your company's history? How many years of history and data do you have?

As questions around incentive-based compensation and executive pay mix and multiples in the United States and elsewhere continue to be discussed, this should be a lesson that careful collection of detailed data may be painful, but it is also important to expanding our perspective and enriching our understanding. **WS**



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