Executive Compensation: Set by the Market or the Government?

ISSUE: Should the government regulate and cap the amount of compensation that CEO's receive, or leave it for the market to determine?

CEO's of most companies listed on the S&P 500 average an annual salary that is 354 times greater than the typical American worker (Liberto). Arguments around the topic of executive compensation have been around since business began. SEC Chairman William Donaldson states that, "One of the great, as yet-unresolved problems in the country today is executive compensation and how it is determined" (Wagner).

Currently, the market mainly sets CEO compensation. This means that there is no cap on how much a CEO can earn. If a company requires a quality CEO, they have to pay what the market is demanding in order to ensure that they can provide a competitive salary to a qualified candidate. This is the main reason that many CEO's are paid so much more than the average worker--companies need to secure the talent that will help their companies succeed (Kay and Putten).

The government is attempting to regulate CEO compensation through caps on pay and ceilings on the ratio of CEO pay to employee pay. Perhaps the most pertinent government action that influenced executive pay is what is known as the pay czar. President Obama cut pay for the top five executives at many companies that received government aid under the Troubled Asset Relief Program. Still in effect for these companies is the $500,000 salary cap for executives (Dennis). Although this cap may seem reasonable, many critics state that it will inhibit these companies from obtaining the kind of quality CEO they need to begin the improvement process. President Obama also signed the Dodd-Frank Act July 21, 2010 in response to the recent recession. Companies are now required to collect a *Say on Pay* vote from their shareholders to determine executive compensation every three years. This Act also requires companies to disclose CEO-to-worker pay ratios (Dodd-Frank Act: Executive Compensation and Corporate Governance Provisions).

The main debate that exists today about CEO compensation involves the issue of whether the market should set CEO compensation or if the government should regulate and cap it. Supporters of the market setting CEO compensation believe that governmental regulation will harm businesses in the end. Not having the ability to offer a CEO a competitive salary will result in companies not being able to obtain and keep the talent they need. Supporters of this side also believe that American businesses are not built to have “one size fits all” regulations (Fuller). Companies need to be able to reflect their different strategies through different compensation approaches. A Representative of Delaware summarizes this side of the debate perfectly: “[The government regulations will] take away the rights of individual companies to conduct business as they see fit” (Fuller).

Supporters on the other side of the issue believe that the government should continue to implement regulations that cap and regulate CEO compensation. Many people believe that excessive executive compensation takes money away from the business—and, therefore, the economy. Overpayment of CEOs may be, “a misuse of shareholder resources and a potential source of poor morale” in employees (Key Metrics Series: Internal Pay Equity). Supporters also believe that many CEOs determine their own—potentially excessive—salaries by using their power over the Board of Directors, which implies that the market has no bearing on determining salaries. They also believe that there should be strict “pay-for-performance” regulations to ensure that poor-performing CEOs are not compensated as if they performed well.

The great-unresolved problem of determining CEO compensation effects many stakeholders. If the market sets CEO compensation, abuses may occur. However, if the government regulates and caps CEO compensation, companies may not be able to retain a quality executive.

There are two sides to every issue:

1. The market should determine CEO compensation to ensure that companies can provide a competitive salary offer to CEO’s.
2. The government should regulate and cap the amount of compensation CEO’s can receive.

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