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Business Ethics Research Term Paper

CEO-to-Worker Compensation Inequality

When regarding the growing wealth gap, it is vital to comprehend how income disparities between the highest and median paid employees in corporations indicate that compensation practices, especially in regards to highly paid CEOs, have become both unethical and socially unsustainable. In fact, this issue might not be fully understood by the general population. The statistical reports on CEO-to-worker pay ratios often dwarf the guesses the average person makes about these ratios. Still, even if the full scale of the inequality isn't fully understood, the middle and lower class populace is aware of and feeling the weight of the growing issue. Nick Hanauer (2014), one of the .001%, in an article addressed to his fellow zillionaires, summed up the issue by stating that "…the problem isn't that we have inequality. Some inequality is intrinsic to any high-functioning capitalist economy. The problem is that inequality is at historically high levels and getting worse every day. Our country is rapidly becoming less a capitalist society and more a feudal society." Hanauer (2014) went on to write, "What everyone wants to believe is that when things reach a tipping point and go from being merely crappy for the masses to dangerous and socially destabilizing, that we're somehow going to know about that shift ahead of time. Any student of history knows that's not the way it happens. Revolutions, like bankruptcies, come gradually, and then suddenly." Hanauer's article came out in 2014, but judging by the growing inequality between CEO-to-worker compensation few heeded his warning.

Understanding the Issue

Fully comprehending the data means first understanding what the numbers represent. To calculate a CEO pay ratio, the CEO's compensation is divided by the pay of the median employee (Melin, 2022). A ratio of 3:1 means that a CEO makes three times what the median worker makes. With this in mind, take a moment to guess the CEO pay ratios for Walmart, GameStop and Coca-Cola. Here's a hint: the Economic Policy Institute (EPI) estimates the top 350 firms in the US have CEOs that have, on average, a CEO pay ratio of 351:1 (Johnson-Hess, 2021). Another way of viewing this 351:1 ratio is that it would take a media pay worker 351 years to make the same compensation that the CEO makes in one year. That is over four lifetimes worth of pay, and this is just the *average* CEO pay ratio of the top 350 US firms – *not* the highest. Walmart has a pay ratio of 983:1 with a median employee pay of $22,484, but GameStop and Coco-Cola top that with ratios of 1,137:1 and 1,621:1 (Melin, 2020). When reviewing the ratios, it's imperative to keep in mind that this is a comparison of the CEO pay to the *median* worker pay, so the gap between CEO pay to the lowest tier of worker compensation for the company is much wider.

To further illustrate why the inflated compensation of CEO's is of concern, here's a review of a 2020 Oxfam report that found that 162 billionaires hold the same amount of wealth as the poorest half of the world (Paddison, 2020). Let's put that into further perspective. According to the World Bank, the world population in 2020 was 7,752,840,547. If we divide this in half, that leaves about 3,876,420,273 people. Does that seem right, and, if so, does it seem ethical that 162 people may hold the same amount of wealth as 3,876,420,273 people?

It would be unfair to claim that exorbitant CEO salaries were the only or main reason behind 162 people amassing such wealth. That, of course, would be incorrect, but these inflated salaries do add to this growing problem.

CEO Compensation: Are High Salaries Worth It?

When reviewing the data on CEO-to-worker ratios, it's hard not to wonder why these select CEOs are being paid so much. What extra benefits do companies receive from these high salaries? Are there any benefits? Articles on this topic mention prestige and competing for top talents by offering high compensation, but that still doesn't fully answer the question.

In a 2016 report, Ric Marshall and Linda-Eling Lee (2016) found that between 2006 and 2015 there was actually a negative correlation between high CEO compensation and stockholder returns. In fact, the companies with lower compensation in the bottom half of their data had 60% higher stockholder returns than those with the highest CEO compensation. So, is high CEO compensation more of a prestige element? Does a company pay inflated salaries to CEOs to send a message that they are the best, that they can afford the best, and, if so, does this actually work to skew the views of stakeholders? This is a more difficult question, but a bit of morose research might help shed some light on this answer.

Instead of reviewing performance, what if research focused on how a company was affected if a CEO suddenly and unexpectedly passed away? Timothy Quigley, Craig Crossland, and Robert Campbell did just this in their 2017 report "Shareholder Perceptions of the Changing Impact of CEOs: Market Reactions to Unexpected CEO Deaths, 1950–2009" (Baker, 2019). Consider the impact that a CEO death would have on company stock. If stakeholders truly

believed that this CEO was the best, that the high compensation they were receiving was because of their skill, it would be safe to assume stock prices of the company would drop following the CEO’s death, but that wasn’t necessarily the case. Quigley, Crossland, and Campbell found that since 1990, of the cases they examined 44.3% of the time stock prices rose after the death of a CEO (Baker, 2019).

The presented data only seems to further the question of why do these CEOs receive such high compensation? Perhaps to gain better understanding of the issue, it would be best to look at the process of how CEO compensation is reviewed and approved.

The Board of Trustees and CEO Compensation

In the textbook “Business Ethics: Ethical Decision Making & Cases,” written by Ferrell, Ferrell and Fraedrich (2019), the role of a company’s board of directors is introduced in chapter 2 section 2-5b). According to this chapter, the board of directors serve the wellbeing of common stockholders, and, in such, they appoint the company’s top executives, assume fiduciary responsibility and can be held liable for a firm’s decisions. While stockholders do select members of the board of trustees, this is often done with advice from the company’s CEO. In turn, CEO’s pay packages are often reviewed by members of the board of directors. This, in turn, creates an issue of agency or conflict of interest. A conflict of interested is defined as a situation “when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group” (Ferrell, 2019).

In the article “Reining in CEO Compensation and Curbing the Rise of Inequality,” Dean Baker, Josh Bivens, and Jessica Schieder (2019) point out that although directors on the board can

be voted out through shareholder revolts, it is uncommon. Additionally, proving the strong correlation between CEO's input when electing directors, Baker, Bivens and Schieder (2019) presented that a study by Investor Shareholder Services of director elections in 2012 showed "that 99.6 percent of the 17,081 directors nominated by management were approved." On top of all this, a board of trustee's member is, in general, making around $100,000 a year or $300,000 to $400,000 for those high paid directors, for working about 150 hours (Baker, 2019).

Reviewing this data, one can clearly see how this can lead to poor corporate governance through a lack of oversight due to issues of agency. Corporate governance is defined as "the development of formal systems of accountability, oversight, and control" (Ferrell, 2019). In regards to compensation packages, CEOs and the board of trustees have reason to work in tandem with each other and not diminish the pay of the other. As they are no longer working in the best interest of the stockholder, this creates an issue of agency or conflict of interest. With a lack of power by the stockholders to vote out board of director members, the company loses a significant source of oversight when it comes to the actions of both top managers and the board.

Income versus Wealth

Income and wealth inequality are not one in the same. While income inequality can add to wealth inequality, there are far more aspects to consider when reviewing wealth inequality. In his educational video entitled "How Wealth Inequality Spiraled Out of Control," Robert Reich(2021) explains that "income is what you earn each week or month or year" and "wealth

refers to the sum total of your assets — your car, your stocks and bonds, your home, art — anything else you own that's valuable." Reich (2021) also explains that wealth comes from two sources: income that is saved and inheritance. Those with the highest levels of compensation obviously have the most ability to save. Employees living paycheck to paycheck find it much harder to accumulate wealth. When viewed in a larger span of time, this income inequality also adds to the growing amount of inheritance seen amongst select groups. A 2020 Oxfam report stated that "extreme wealth is a sign of a failing economic system," and went on to add that "about a third of billions wealth exists because of inheritance" (Paddison, 2020). Median to low paid employees have less wealth to pass on via inheritance, but those with high compensation pass on much more. In addition to this, those with higher pay have children with more opportunity for advancement into higher paying jobs, which furthers the cycle of wealth inequality through both income and inheritance.

Economic Downturns Affecting Compensation

The Great Recession

From 2007 to 2009, there was a span of economic downturn referred to as the Great Recession. Government bailouts were granted to companies in 2018, but even with the bailout, the top 20 financial recipients of this aid laid off more than 160,000 employees between 2018 and 2019 (Anderson, 2019). During this time of downturn, when companies were taking bailouts comprised of taxpayer money, one might assume that executive pay would be somewhat subdued. However, of the 20 firms that received the most bailout money, the five top executive officers were granted pay packaged worth a combined total of $3.2 billion –

which works out to about $32 million each (Anderson, 2009). Being paid millions while your company is taking bailout money hardly seems ethically, but it feels as if there was some oversight lacking by the government agency issuing the bailouts. Proper guidelines and restrictions for compensation should have been established and enforced before bailouts were granted. Perhaps assuming companies will take the most ethical approach on their own is faulty.

The Pandemic

In late December of 2019, people in Wuhan China began to become ill. On March 11 of 2022, Covid-19 was declared a global pandemic. To help stop the spread of the disease shutdowns were enforced. Nonessential businesses couldn't open, and many people found themselves jobless. Uncertainty and fear left the economy shaken.

The full impact of the pandemic wasn't necessarily felt evenly throughout the corporate world though. For instance, 11,000 people at a hospital chain called Tenet Healthcare were furloughed during the pandemic, even though the company reportedly made $399 million in profit (Gelles, 2020). Boeing was having a particularly bad year in 2020 with both the pandemic and the grounding of the 737 Air Max after two deadly crashed; these reasons were what led to the layoff of 30,000 workers (Gelles, 2020). David Calhoun, Boeing's chief executive, even took a pay cut, taking only $269,231 instead of $1.4 million, but, because of stock awards, he was actually compensated over $21.1 million (Gelles, 2020). Many companies in the travel and entertainment industry found themselves at a loss during the pandemic. Walt Disney laid off 28,000 employees from theme parks, and Walt Disney's Chairman, Robert A. Iger, had his pay

slashed in half, but it still remained rather high at $21 million (Gelles, 2020). Cruise lines and hotels were especially hard hit. The Norwegian Cruise Line lost about $4 billion and furloughed 20% of their staff, but Frank Del Rio, Norwegian Cruise Line chief executive, received double his pay so that his compensation was $36.4 million (Gelles, 2020). Chris Nassetta, chief executive of the Hilton, was compensated $55.9 million in 2020, even after the company lost $720 million and laid off about 25% of the staff (Gelles, 2020). When the loss was felt so deeply by those at the bottom of these companies, it is easy to see how these inflated compensation packages that remained at the top could become a source of frustration and resentment.

So, how is this ethical to pay executives so much when companies are running at a loss? Even for those companies that saw a gain, is it really ethical to maintain high executive compensation while employees are being laid off – even more so, is it ethical to lay off employees while seeing this gain? The pandemic, of course, made some decisions difficult. Layoffs were more complicated as there was the added variable of 'can we keep our employees and customers safe from this disease.' Still, whatever the reason for the layoff, the growing disparity between those at the top and those at the bottom of the company certainly widened with the pandemic.

Possibly Solutions & Conclusion

Having reviewed the data, it is clear to see how income disparities between CEOs and median paid employees in corporations indicate that compensation practices are unethical and socially unsustainable, but there is work being done to lessen this gap in income.

Senator Bernie Sanders and Senator Elizabeth Warren presented a bill in 2022 that would increase the tax rate for companies depending on how much more their executive officers were making over the companies' typical employee (Melin, 2022). Companies paying their executives between 50 to 100 times what the typical employee made would see a tax increase of .5%, and those companies paying executives 500 times or more what the typical employee made would see a 5% tax increase (Melin, 2022). This bill could be a step in a very positive direction for reining in executive pay. If the company governance isn't coming into play to establish ethical guidelines for executive compensation, maybe government involvement needs to happen.

How can companies have true oversight if there are so many issues of agency among the board of trustees and top executives? Thanks to the 2011 Dodd-Frank Act, section 951, shareholders are allowed to vote on CEO compensation, and there has been growing opposition to weighty CEO pay since that time (Landis-Weaver, 2020). Still, it seems that CEO compensation in some companies remains questionably high. Moving forward, it would be nice to see Senator Sanders and Senator Warren's bill pass, increasing taxes for those companies paying executives over 50 times what their typically employee makes, but it would also be beneficial to see work done to make stockholder involvement in voting on executive compensation packages carry more weight. While I'm not clear on how this should be worked into the corporate governance, it seems there is certainly a lack of oversight at the top that needs adjustment. Perhaps adding a stronger voice to the stockholders would do just that.

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