Marshall & Gordon: Designing an Effective Compensation System (B)
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Case Debrief

The *Chief Executive Officer* is generally the most senior corporate administrator in charge of managing the corporation. As such, this individual is compensated accordingly for their input into the firm. Compensation packages are formulated with 3 objectives in mind:

1. High compensation tends to attract and retain qualified CEO’s
2. The compensation package determines the objectives the CEO is meant to focus on
3. Employees and stockholders throughout an organization closely follow CEO salary

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Case Debrief Cont.

Two major topics of debate concerning CEO salaries have risen to the surface in recent years. These concerns are:

1. The level of CEO salary is too high
   "In 1980, CEO salary was 42 times that of the average worker. In 2000, it was 531 times."

2. How CEO's are paid
   It is easy to point out CEO's whose compensations have been in the millions, even when the corporation suffers a loss
Do you think the fact that most American CEO's are paid so much more than rank-and-file employees suggests that CEO's are overpaid?

NO. Here is why.
There is no average or optimal wage in which to benchmark CEO salary, as such, nothing serves as a valid comparison point to determine whether labor is being sold at the right price. As an alternative it is common to use the price of labor for an "average" worker but considering all other factors, such as, the individual expectations, responsibilities, and skill sets a comparison cannot be fairly made.

The substitution effect can be used to explain supply and demand of labor as well. Briefly, in relation to this case, consider the fact that lower level employee's skills are much more accessible within the labor market, as such, a substitute can easily be found to replace this individual, whereas this is not the case for a CEO.
Japanese CEO's generally receive much lower levels of compensation than CEO's in the United States. Does this imply that U.S. CEO's are overpaid?

"Companies listed on Japan’s stock exchanges paid their chief executives an average of $580,000 in salary and other compensation last fiscal year, PWC estimates, about 16 times more than the typical Japanese worker. Average CEO pay at the 3,000 largest U.S. companies is $3.5 million, including stock options and bonuses, according to the Corporate Library, a research group."
Japanese vs. American CEO's

Similarly to the case where the CEO's compensation is compared to that of a lower level employee, a comparison between a CEO in the United States is very different to that of a Japanese CEO because the playing field is not leveled.

A different culture and economy manifests a different management system and as a result a different compensation package. Whereas American CEO's are performance oriented and emphasize decision making and control. Japanese CEO's are more concerned with the communication process and interdepartmental relations. Remember one of the 3 objectives when creating a compensation package is designing it to compliment the individual's duties, as such an American CEO may be paid more in wages whereas a Japanese CEO may be compensated in other ways. Another fact to consider in regards to labor economics and wage rates is the standard and cost of living in the economy. In short, an American and Japanese CEO have different duties within a company and also function in different labor markets therefore this argument does not validate whether U.S, CEO's are overpaid or not.

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