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# How much money is too much for a CEO?

**A study finds overpaying the boss can cost a company more than just dollars, writes RICHARD BLACKWELL**

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The pay packet that Magna International Inc. chairman Frank Stronach collects often raises eyebrows -- last year, he took home a staggering $40.3-million.

But his underlings don't do badly either. Magna's two co-CEOs Donald Walker and Siegfried Wolf collected $19.6-million and $7.8-million, respectively, in 2005. And several other executives' paycheques were well over the million-dollar mark.

How does this largesse among its top executives affect the attitude of those further down the ranks at Magna? It's hard to say, but a new study suggests that overpaying the boss is more than just grist for gossip. It can have damaging effects on a company's financial position, and on the morale of workers at lower levels. The study by three U.S. business professors involved crunching pay data gleaned from all levels of 120 companies over a five-year period. It found that a chief executive officer making too much money can have a dramatic impact throughout an organization.

If a CEO is overpaid -- or underpaid, for that matter -- there will be a similar pattern at lower levels of a company. "The effects of inequity cascade down from the highest job levels through the organization," the report concluded.

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While the effect fades a bit at the lower levels of a company, it's still there, the authors say.

If a CEO is overpaid by an average of 64 per cent, those at the chief operating officer or chief financial officer level will likely be overpaid by 26 per cent, they say. Further down the hierarchy, at the divisional manager level, the overpayment would be about 12 per cent.

Depending on the size of the company, these overpayments could represent tens of millions of dollars. "The bigger the organization, the more expensive it's going to be," said Timothy Pollock, a business professor at Pennsylvania State University and one of the report's authors.

"If the CEO is overpaid by $1-million, and then if everybody at the next level is overpaid by $250,000, and the people at the next level below that are over paid by [several] thousand dollars, times 100 people, it can start to get expensive."

Even when the CEO's pay level is not shared with underlings, there can be problems, the study suggested. That's because an overpaid CEO causes resentment at lower levels, and this translates into high employee turnover. The effects were most pronounced among vice-presidents and general managers.

This resentment can run so deep, the report suggests, that "employees are more likely to leave the company, even if they are overpaid relative to the external market, if the CEO is more overpaid than they are."

While the study looked only at U.S. companies, the results are a warning for Canadian firms as well, compensation experts say.

Brian Gibson, senior vice-president at the Ontario Teachers Pension Plan, said his organization's examination of Canadian companies shows the same pattern. "If the [compensation] philosophy and the pay structure is wrong at the CEO level, it's generally not right in the rest of the company either."

Teachers' biggest concern is when a CEO's pay is out of whack with the financial performance of the company he or she runs.

In a study completed this spring, the pension fund found that this is common, and in many cases there is little correlation between CEO pay and a company's performance. More shocking, it found that companies with mediocre financial performance often had the highest CEO pay levels.

Mr. Gibson also agreed with the U.S. study's conclusion that overpaying a CEO damages the morale of those in lower ranks.

"It's pretty hard to work really hard and give your job 100 per cent every day if you feel that, relative to others, you're being underpaid," he said. "That's a great way to destroy motivation."

Ken Hugessen, principal of Hugessen Consulting Inc. in Toronto, said one reason for the cascading effect of high CEO pay is that executive pay decisions are generally made for a group of people, not just the boss. The board-level compensation decisions "are made for a team of five to 10 people, or [sometimes] even for 50 to 60 people," Mr. Hugessen said. "It stands to reason that, if the CEO pay is on the high side, it'll be higher for others as well."

The impact of overpaid executives depends on the kind of business the company is in, Mr. Hugessen said. For labour-intensive organizations such as consulting firms or software makers, "it can be hugely detrimental to the value of the business." But a capital-intensive organization -- an oil or gas producer, for example -- will not see the same damage to its finances. Still, he said, even in those organizations, overpaid executives "can generate questions about trust and governance."

Mr. Hugessen agreed with the finding that an overpaid CEO can cause dissension among those at lower levels. "There's a general malaise among many managers if a few people at the top are skimming all the [money]," he said, and that bad feeling will inevitably result in departures. But it's not easy clawing back the pay of a CEO, he adds. Boards are loath to take that action, although it can be an easier move if an independent consultant advises them to do so.

Prof. Pollock noted that his study examined raw data collected by a consulting firm more than 20 years ago -- the only available numbers that offered a complete view of salary levels throughout a large number of organizations over five years. With the acceleration in CEO pay in recent years, both the "trickle-down" effect and employee resentment are likely even more pronounced today than the results of the study indicated, he said.



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