Companies See Benefits In Publicizing Pay Ratios

By RACHEL ABRAMS

While chief executives generally prefer not to say how much more money they make than their typical employee, some have found it advantageous to do just that.

Some companies like Whole Foods, the NorthWestern Corporation and Noble Energy began disclosing the difference between their top executives' pay and their workers' well before the Securities and Exchange Commission issued a rule on Wednesday requiring that the information be made public.

While the exact reasons vary, the companies seem to be united by two common themes: The calculations were easy, and they made the company look good.

"This gives companies the ability to say that they took the high ground, instead of kicking and screaming as so many others have done," said Vineeta Anand, the chief research analyst at the A.F.L.-C.I.O.'s office of investment.

The NorthWestern Corporation, a utility company that provides gas and electricity to customers in Montana, Nebraska and South Dakota, began sharing its C.E.O. pay ratio six years ago, according to Timothy P. Olson, NorthWestern's senior corporate counsel and corporate secretary.

In 2014, the company's chief executive, Robert C. Rowe, earned nearly $2 million — 24 times as much as the median pay of full-time employees. But that is tiny compared to the average for companies in the Standard & Poor's 500-stock index. On average, those C.E.O.s earn 373 times more, according to the A.F.L.-C.I.O. (NorthWestern, though, is considerably smaller, with a market capitalization of $2.5 billion.)

"At a time of high income inequality and questions being raised about social disparities in our country, it gives these companies the bragging rights to say we treat our workers fairly," Ms. Anand said.

In an interview, Mr. Olson said that analyzing the numbers wasn't hard, and the results showed investors how much value they were getting for executive pay compared to NorthWestern's peers. "It is a point of pride," he said.

The company got "no feedback" from shareholders, Mr. Olson said. "My personal opinion is that this is not meaningful to investors."

In that respect, Mr. Olson agrees with many people who oppose the new rules. Businesses say making the calculations is more onerous to the company than helpful to the public.

But Ms. Anand suggested one reason companies like NorthWestern might not have heard from shareholders: The companies hadn't been very vocal about their pay ratios.

"Had they done that, they would have attracted far more attention," she said. "I've been talking about these companies for the last two or three years, but the only time I'm getting phone calls is now."

The ratio may become a persuasive measurement for investors who vote on a company's pay, policies and practices, she added.

Not every company that has made an effort to show the pay gap between workers and their top executives has disclosed everything that the S.E.C. now wants to know. The agency has a specific directive for determining which employees must be compared, and requires total compensation to be accounted for.

But the efforts that companies like Whole Foods have made are still meaningful, according to Dean Baker, the co-director of the Center for Economic and Policy Research, a left-leaning think tank.

"I assume that many of the companies that don't disclose C.E.O.-median-worker pay ratios expect this disclosure to hurt their public image since it is otherwise difficult to see why they would have put up such resistance to the rule," he said in an email.

The requirement announced on Wednesday was provided for under the Dodd-Frank financial reform act passed in 2010.

Whole Foods, one of the most prominent companies to compare its chief executive's pay to that of its workers, has capped total cash compensation at 19 times as much as the average worker. The S.E.C. requires firms to look at

Ahead of a rule to disclose pay gaps of workers and C.E.O.s.

"median" employees, those midway between the highest-paid and the lowest-paid earners.

"I could absolutely see that for a bigger company, this could be a tremendous undertaking," said Sheryl G. Sharry, the chief financial officer at the Bank of South Carolina. The company, which has fewer than 100 employees, does not calculate its pay ratio, but provides the annual compensation for its median employee, who earns about one-fifth as much as the chief executive.

"If this had been something that would have taken days and days of research and pulling things together to calculate, we wouldn't have done it," Ms. Sharry said.

M.B.I.A., the bond insurer, disclosed its median employee compensation in S.E.C. filings for three years, and calculated the pay ratio explicitly for 2010, according to a spokesman, Kevin Brown. But the company stopped, deciding to wait for more clarity in the final rule.

"We haven't had a lot of questions about why we stopped," he said.

RICK WILKING/REUTERS

Douglas McMillon, chief executive of Walmart, makes $19 million a year, including unvested stock grants, to run the company.

America's Confused Approach to C.E.O. Pay

By NEIL IRWIN

Do corporate chief executives make too much money, or too little?

At first glance, it seems like an outlandish question. After all, the ratio of what the chief executives of America's largest companies are paid to the pay of average workers has soared from 20 to 1 in 1965 to more than 300 to 1. Corporate chieftains used to be affluent professionals not unlike doctors or lawyers; now they are among the megawealthy.

On the other hand, the stewardship of large, complex companies is really important, and anyone who cares about the American economy should want the most capable people in charge of them.

Douglas McMillon, for example, makes more than $19 million a year (including unvested stock grants) to run Walmart, a company with 2.2 million employees and half a trillion dollars in revenue. That's a lot of money, no doubt. But 26 Major League Baseball players make more than that. It is a safe bet that the future of the United States economy depends more heavily on how well Mr. McMillon does his job than how well Albert Pujols does his, even if Los Angeles Angels fans might disagree.

All of which helps explain America's confused approach to regulating executive pay, which is embodied in a new rule that the Securities and Exchange Commission approved on Wednesday.

Publicly traded companies will now be required to disclose how much their chief executives are paid relative to their median workers. The idea is that those with particularly enormous pay gaps between their top executives and ordinary workers will face public and investor pressure to narrow them. It might even be enough to make boards think twice about giving their chief executive a raise, or make them more sympathetic to raising pay for the rank and file.

We'll see. But the fact that this is the most significant policy initiative on executive pay of the Obama years — and that it took five years of rule-making purgatory since being initially legislated in the 2010 Dodd-Frank Act — reveals how conflicted public policy remains over why executive pay has risen so drastically and what, if anything, can be done about it.

There are competing (and not necessarily exclusive) theories as to why executive pay has soared so much.

One is that it reflects self-dealing by corporate boards, mutual back-scratching by corporate elites who overpay one another out of some kind of cultural solidarity. Another is that this is a manifestation of winner-take-all effects that are prevalent in the modern economy, where the very best at something earn vast rewards and everybody else is out of luck.

In the first story, high chief executive pay is basically irrational, a fraud upon shareholders and workers alike. In the second story, high executive pay is more or less rational. If you are a director at a major company, it's worth paying tens of millions of dollars a year to get an executive who you expect will increase the company's value by billions. In this telling, Mr. McMillon vastly outearns a typical Walmart cashier for the same reasons that Mr. Pujols vastly outearns a minor-league baseball player.

The Upshot

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Advocates of the new S.E.C. rules generally emphasize the self-dealing story. The Economic Policy Institute notes that chief executive pay has risen even faster since 1979 than overall pay for the top 0.1 percent. And if that's right, then you can imagine subtle regulatory changes like the new disclosure rules mattering. If boards are overpaying chief executives because they are selfish or stupid, exposing their pay practices to the light of day might make some difference.

But things get a great deal trickier if the second story is closer to the truth. If chief executives are receiving eight-figure pay packages because in a modern economy they really are worth that, then boards should ignore whatever public pressure comes their way from disclosure of pay gaps.

And if boards do respond to public pressure and slash executives' pay, publicly traded companies could see an exit of top talent toward privately held companies that don't face similar disclosure rules, potentially making some of America's biggest and most important firms more poorly run as a consequence.

In this version, if you believe that there is something fundamentally unfair about an economy that shifts more and more of the rewards of growth to the ultrawealthy, you would want to deal with it with policies that apply to everyone, not just the chief executives of one subset of corporate America. For example, you could raise the marginal tax rate on income above some high number and use the extra revenue to fund a higher earned-income tax credit that essentially subsidizes the working class. That, of course, would never pass a Republican Congress that is staunchly opposed to higher top tax rates. But it would apply equally to all the winners in the winner-take-all economy, whether they are elite baseball players, heads of public companies or executives of privately held companies.

So, in effect, the conservative argument that high executive pay reflects the market at work implies that fighting inequality requires a more radical set of policy responses than conservatives could ever get behind. And the liberal argument that it is a problem of bad incentives and corporate misdeeds implies that smaller interventions might do the trick, even if many on the left would prefer a more robust set of policies to reduce inequality.

Either way, the five-year drama of the new chief executive pay rule that concluded Wednesday makes this clear: Even small changes to policy around executive pay won't come easy.

S.E.C. Rule to Require Companies to Reveal C.E.O.'s vs. Workers' Pay

From First Business Page

Fifty years ago, chief executives were paid roughly 20 times as much as their employees, compared with nearly 300 times in 2013, according to an analysis last year by the Economic Policy Institute.

"We have middle-class Americans who have gone years without seeing a pay raise, while C.E.O. pay is soaring," said Senator Robert Menendez, the New Jersey Democrat who helped insert the pay ratio rule into the 2010 Dodd-Frank overhaul of financial regulation. "This simple benchmark will help investors monitor both how a company treats its average workers and whether its executive pay is reasonable."

The rule, which the S.E.C.'s two Republican commissioners opposed, does not in any way limit how much a chief executive is paid.

Instead, it requires that public companies take their chief executive's compensation, which is already disclosed annually, and compare it with the median pay for all their other employees.

The drafters of Dodd-Frank primarily intended for the ratio to be used by shareholders, who could apply it when comparing compensation between similar companies. If, for instance, the gap between the pay of the chief executive and the average employee turns out to be far higher for PepsiCo than Coca-Cola, shareholders might press Pepsi to explain the difference.

Some shareholders might even criticize executives at companies with high ratios in the belief that better-paid rank-and-file workers perform more productively.

Corporate performance aside, the ratio will no doubt be seized upon by those who believe that the wages of moderate earners have not grown fast enough.

Economists who study incomes say that ever-expanding executive compensation packages have played a substantial role in increasing the divide between the wealthy and everyone else. Thomas Piketty, a French economist whose best-selling book set off a global debate on inequality, asserted that higher wages for top earners in corporate America had been among the main drivers of the widening income differences in the United States.

"The system is pretty much out of control in many ways," he said in an interview last year.

From the start, the pay ratio rule was a source of controversy.

Though the rule seemed to merely require a somewhat simple calculation, the S.E.C. took a long time to finish it, going to great lengths to listen to the concerns that corporations expressed about the costs and complexity of the rule.

The delay frustrated supporters of the rule. Senator Elizabeth Warren, Democrat of Massachusetts, for instance, sent a sharply worded letter in June to Mary Jo White, chairwoman of the S.E.C., complaining about how long the rule was taking.

Ms. White, on Wednesday, said in a statement said that the rule was "both flexible and faithful to the terms and objective of the statute." She joined the two Democratic commissioners in voting for it.

JONATHAN ERNST/REUTERS

Mary Jo White, the Securities and Exchange Commission chairwoman, voted for the new rule, which takes effect in 2017.

Some analysts said that companies were not wrong in underscoring the potential costs of the rule. While corporations have advanced payroll systems that would seem to make it relatively simple to calculate a median wage, they said that the rule required companies to make new calculations for workers across the globe.

In addition, the final median number will be in financial statements, which means companies need to ensure it is accurate.

"Calculating this figure is definitely not trivial," said Robert J. Jackson Jr., a professor of law at Columbia.

He said that the number might nevertheless be useful. "Management will have a more systematic understanding of what their employees earn — and that might be very beneficial, both for investors and for the public," he said.

Some labor union researchers, however, said that the agency appeared to give up too much ground in the final rule.

"There are definitely weaknesses that we are concerned about," said Heather Slavkin Corzo, director of investment at the A.F.L.-C.I.O.

The rule takes a relaxed approach in several areas.

When calculating the median employee pay figure, the rule allows companies to choose a statistical sampling of its employees, rather than an actual survey of all its workers. In addition, companies can exclude up to 5 percent of their employees who are not in the United States.

The rule also lets companies make a so-called cost-of-living adjustment — reflecting that lower wages in some places can buy the same goods and services as higher wages in other places — which would most likely increase the median employee pay figure. Still, companies applying the adjustment would also have to disclose the ratio without the adjustment.

And companies can calculate the median pay of employees on any date within the last three months of its fiscal year. Selecting the right date could result in the company leaving out many lower-paid seasonal workers.

"It allows the company to identify workers based on a snapshot," Ms. Slavkin Corzo said.

The first disclosures of the ratio will most likely start to appear in filings in early 2018. Before then, opponents of the rule may try to overturn the rule in the courts. Daniel M. Gallagher, one of the Republican commissioners who voted against the rule, said at Wednesday's meeting of the commission that it "may be the most useless of our Dodd-Frank mandates."

The Center on Executive Compensation, which represented large corporations in lobbying against the rule, noted on Wednesday that shareholders in the past had generally voted against proposals that required companies to disclose pay ratios.

"Only a small segment of shareholders, primarily unions, certain pension funds and social activists, are likely to use the pay ratio to drive their own narrowly tailored agendas," the center said in a statement.

DealBook Online

BAXTER STAKE Daniel S. Loeb's Third Point disclosed that it had amassed a stake of roughly 7 percent in Baxter International, the medical products maker, and was seeking two seats on the board. (Including both stock and options, the hedge fund owns nearly 10 percent of Baxter's shares, a position worth more than $2 billion.) Baxter, which makes devices like intravenous pumps and dialysis systems, represents one of the bigger targets to date for Mr. Loeb, above.

MICHAEL J. de la MERCED

TRADING GAINS Société Générale said its profit rose 25 percent in the second quarter, bolstered by gains in its equity trading business as markets remained volatile in the quarter and by robust activity in its mergers and acquisitions advisory business. Société Générale also said that it was aiming to reduce its costs by 850 million euros, or about $931 million, by the end of 2017. *CHAD BRAY*

'REAL CHALLENGES' Standard Chartered said its profit declined 37 percent in the first half of the year, as it reshapes its business under William T. Winters, its new chief executive. The British bank, which generates most of its earnings in Asia, said that its first-half results were hurt by currency fluctuations, exits from several businesses and lower valuations on loans. *CHAD BRAY*

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