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High CEO-to-worker pay ratios negatively impact consumer and employee perceptions of companies☆,☆☆

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ABSTRACT

CEO pay is at record levels and may affect more than just company bankrolls. Across five studies, we measured consumer (Studies 1 & 2) and employee (Studies 3a & 4) perceptions about a hypothetical company described as having a high (350:1) or low (25:1) CEO-to-worker pay ratio. People indicated being less likely to purchase products and want a job from high-ratio (vs. low-ratio) companies (Studies 1 & 2). Further, global impressions of high-ratio companies were more negative, and these companies were seen as less employee oriented, though not less innovative by both consumers (Studies 1 & 2) and employees (Study 3a), even when controlling for individual compensation levels (Study 3a). Additional results support the possibility that perceived ratio fairness mediated the link between ratio and these judgments (Studies 2 & 3a). Further, using real-world employee ratings, Study 3b found that CEO-to-worker pay ratios are negatively correlated with employee ratings of work-life balance and compensation—findings that held controlling for company size and profits. Finally, we found that the salience of CEO responsibilities moderated the link between CEO ratio and employee perceptions by improving negative perceptions of high-ratio companies (Study 4). Implications and important future directions are discussed. (197 words).

Since 2001, the U.S. president has earned $400,000 annually, while the median American worker salary is approximately $45,000, resulting in a compensation ratio of the president earning about 10:1 compared to the median worker (Office and Compensation of the President, 2001; U.S. Department of Labor, 2016). Meanwhile, CEO-to-worker compensation ratios are at an all-time high. Recent estimates indicate the average ratio in the U.S. ranges from 271:1 to 361:1 (ALF-CIO, 2018; Mishel & Schieder, 2017), largely reflecting an exponential increase in CEO pay over the last several decades. This sharp increase raises important questions about its impact on consumers and employees. Do CEO pay ratios influence consumer evaluations of companies? Do they alter behavior—for example, influencing consumer purchasing decisions? Do they influence how attractive a company is as an employer and do they affect employee well-being? Such questions become all the more salient in the wake of the 2015 Securities and Exchange Commission (SEC) ruling that required all publicly-traded companies to publicly disclose their CEO-to-worker compensation ratios by early 2018, making such ratio information more accessible than ever before (Commission Guidance on Pay Ratio Disclosure, 2017). The present studies aimed to examine the impact of CEO-to-worker compensation ratio information on perceptions of, and behaviors in relation to, companies with relatively high versus low CEO-to-worker compensation ratios.

1. Growth of CEO-to-worker compensation ratios

In 1965, the U.S. CEO-to-worker compensation ratio was 20:1, but it increased to approximately 296:1 by 2013 (Davis & Mishel, 2014). Simultaneously, the average wealth of the top 1% of Americans has tripled since 1980 but has remained stagnant for the bottom 90% (Saez, 2013). CEOs are among the wealthiest individuals in the U.S., and their increasing pay is a driving factor in the widening gap between the top

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1% and other 99%. Growing political and public awareness of economic inequality has increased scrutiny of CEO-to-worker compensation ratios, arousing concerns about their consequences as well as outright discontent.

As early as 1984, Peter Drucker, a well-known management expert, warned that ratios higher than 20:1 were likely to cause resentment and decrease employee morale (Drucker Institute, 2011). Legislation to set boundaries on CEO-to-worker compensation ratios has in fact been attempted. In 1991, Democratic Representative Martin Olav Sabo proposed the Income Equity Act that would have prevented companies from benefitting from tax breaks on salaries and bonuses that exceeded 25 times the lowest paid worker (Wilhelm, 1993). Though the bill never passed, Democratic Representative Barbara Lee has reintroduced several newer versions since 2007 (Pizzigati, 2015). No pay caps have been legislated, though the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in 2010, began outlining regulations for transparency by requiring that publicly-traded companies release their CEO pay, median worker pay, and the ratio between the two. This laid the groundwork for the 2015 SEC ruling requiring all publicly-traded companies to release this information by early 2018 (Commission Guidance on Pay Ratio Disclosure, 2017; Pay Ratio Disclosure, 2015).

2. Implications of CEO-to-worker compensation ratios

How will widening public knowledge of CEO-to-median-worker compensation ratios affect consumers and employees? On the one hand, perhaps most people already have a sense of these ratios and thus the effects of publicly disclosing this information will be minimal. Yet a study by Kiatpongsan and Norton (2014) showed that while the actual average CEO-to-worker pay ratio at the time was 354:1, most Americans estimated that it was 30:1, and indicated a lower ideal ratio of at 7:1. The large discrepancy between estimates and ideals versus actual figures suggests that perceptions of companies, both by employees and consumers, may well be affected by the public disclosure of CEO-to-worker pay ratio information.

This discrepancy likely reflects, at least in part, a psychological aversion toward inequity, which develops early in life. Children younger than 10 show aversion to disadvantageous inequity (e.g., when a peer gets more) as well as advantageous inequity (e.g., when they get more than a peer; Blake & McAuliffe, 2011; Blake et al., 2015; Sheskin et al., 2016), and this aversion continues into adulthood. In economic laboratory games, adults will spend their own money to decrease the amount top earners make and increase the amount low earners make, and this is amplified in settings where inequality between high and low earners is high (Dawes, Fowler, Johnson, McElreath, & Smirnov, 2007). This basic preference for equity suggests that people—both employees and consumers—may well harbor negative perceptions of companies with high CEO-to-worker ratios.

2.1. Implications of CEO-to-worker compensation ratios on employees

Several lines of inquiry speak to the potential impact of high ratios on employee perceptions in particular. Among them, to the degree that high ratios go hand in hand with income inequality, research on the effects of macro-level income inequality suggest negative employee outcomes. For example, high levels of state income inequality have been linked to decreased employee satisfaction (Ahn et al., 2016), high societal income inequality predicts increased hours spent at work (Bowles & Park, 2005), and in countries with higher income inequality, workers report more absences (Muckenhuber, Burkert, Großschädl, & Freidl, 2014). Further, unequal pay systems have been shown to decrease societal motivation in terms of productivity, pride, and participation (Hand & MacLachlan, 2012). Such negative effects of income inequality suggest that high CEO-to-worker ratios may harm employees' well-being and, accordingly, their opinions about the relevant company.

Also relevant is the literature on pay dispersion, a measure of the difference between the lowest paid employees and top management within an organization. This literature offers two opposing theories relevant to the impact of high ratios on employees: tournament theory and equity theory. Tournament theory posits that employees compete against each other for higher pay and positions. As such, larger pay dispersion in a company should increase employee effort and performance due to the allure of the markedly higher pay that comes with higher positions (e.g., Becker & Huselid, 1992; Lazear, 1999). Consistent with this, high pay dispersion has been shown to have positive effects on firm and employee performance (Lallemand, Plasman, & Rycx, 2004; Main, O'Reilly, & Wade, 1993). Most of these studies, however, only consider how the motivation to achieve a top management position, rather than the CEO position per se, leads to competition. Attaining the CEO position is, on the whole, less likely than attaining a top management position, and is likely to be perceived as such. Thus, it stands to reason that any impact of high CEO-to-worker ratios on employees may implicate concerns other than competitiveness—for example, concerns about equity and fairness.

These concerns are the focus of equity theory, which maintains that inequity is felt "when a person perceives that the ratio of his outcomes to his inputs and the ratio of another's outcomes to another's inputs are unequal" (Adams, 1965). Adams points out that an individual might not feel inequity due to his or her salary alone, or even when comparing one's ratio of outcomes to inputs to that of a colleague or superior who indeed has a greater level of input; however, when discrepancies between employee and employer (e.g., the CEO) are vast, feelings of inequity are likely to ensue. Such theorizing is compatible with the findings on inequity aversion noted above. Also consistent here is research that has linked pay dispersion to reduced perceptions of fairness and equity among employees (Petrescu & Simmons, 2008; Trevor & Wazeter, 2006). Such perceptions may in turn undermine job satisfaction and employee motivation. Indeed, studies have shown that pay dispersion and comparison income (a greater difference between an individual's salary and the salaries of similar others) negatively correlate with job satisfaction (Pfeffer & Langton, 1993), and do so above and beyond the positive effects of absolute income (Card, Mas, Moretti, & Saez, 2012; Clark & Oswald, 1996). One study that actually examined CEO-to-worker ratios, rather than pay disperson more generally, showed that a 45:1 ratio was linked to greater employee cynicism compared to a 17:1 ratio (Andersson & Bateman, 1997).

The notion that pay dispersion may arouse perceptions of unfairness and, in turn, reduce job satisfaction, fits core assumptions of equity theory. However, this pathway has not been explicitly tested for pay dispersion in general nor for CEO-to-worker ratios in particular. Also, extant studies speak to decreases in employee satisfaction in general but have not examined the specific perceptions and experiences that likely undergird such global negative outcomes. The present studies aimed to begin filling both of these gaps by examining the impact of CEO-to-worker ratios on specific employee perceptions and experiences, as well as the potential role of employee perceptions of the fairness of these ratios.

2.2. Implications of CEO-to-worker compensation ratios on consumers

What about the impact of CEO-to-worker compensation ratios on consumers? Relatively little attention has been given to this question. One recent exception is a set of studies by Mohan and colleagues (Mohan, Norton, & Deshpandé, 2015; Mohan, Schlager, Deshpandé, & Norton, 2018), grounded in equity theory. Mohan et al. (2015, 2018) showed that consumers report more willingness to pay (or to pay more) for a variety of a company's products when they learn that the company has a low CEO-to-worker compensation ratio compared to a high ratio or when they do not know the company ratio. Further, they suggested this effect was mediated by perceived wage fairness at the company, wherein a high CEO ratio leads to perceptions of low wage fairness and,

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