The principles and processes for setting executive compensation essay sample

Business, Corporate Governance

Agency theory, tournament theory and social comparison theory are the 3 alternative theories that explain the principles and processes for setting executive compensation. Different individuals and groups participate in setting executive compensation. They include compensation consultants, compensation committees, and boards of directors; each play a different role in setting executive compensation. Executive compensation consultants usually propose several recommendations for alternate pay packages they are often employed by large consulting firms. A board of directors represents shareholders' interests by weighing the pros and cons of top executives' decisions. There are approximately 15 members on the board.

They give final approval of the compensation committee's recommendation. Board of directors members within and outside the company make up a company's compensation committee. Outside board members serve on compensation committees to minimize conflict of interest. Compensation committees perform three duties. First, compensation committees review consultants' alternate recommendations for compensation packages. Second, compensation committee members discuss the assets and liabilities of the recommendations. Third, the committee recommends the consultant's best proposal to the board of directors for their consideration.

Under agency theory, shareholders delegate control to top executives to represent their ownership interests; however top executives usually do not own majority shares of their companies' stocks. Shareholders negotiate executive employment contracts with executives to minimize loss of control. Tournament theory casts lucrative executive compensation as the prize in a series of tournaments or contests among middle and top level managers who aspire to become CEOs. According to social comparison theory individuals needs to evaluate their accomplishments and they do so by comparing themselves to similar individuals.

Do you believe U. S. executive are paid too much? Why?

Yes, I strongly believe that U. S. Executives are paid too much. I worked in Corporate America for over 13 years and I felt that executives did little work but reaped huge benefits. I often felt that the worker bees (Average Hourly Employees) sacrificed so much (family time, health) in order for a company to be profitable but were never paid for their value. I feel that wage imbalance is detrimental to the progress and well-being of our society. I feel that the greed of executives are often the main reason for the collapse of a company.

I feel that executives’ salaries are based on perceived value and corruption; whereas the average employee must have a proven or documented skill set and experience. An executive earns 42 times more than an average hourly employee. Most employees don’t earn 20% of the average CEO’s salary. I strongly feel that this problem will continue because the average workers will never voice their opposition. The economy is still recovering so many people are just blessed to be employed although they know they are underpaid.

Describe executive compensation disclosure rules.

Companies that sell and exchange securities on public stock exchanges are required to file a wide variety of information with the SEC, including compensation practices. The SEC is nonpartisan, quasi-judicial federal government agency with responsibility for administering federal securities laws. The Securities Exchange Act of 1934 applies to the disclosure of executive compensation. In 1992 & 1993 the SEC modified its rules pertaining to the disclosure of executive pay.

The SEC rulings have two objectives; to clarify the presentation of the compensation paid to the CEO and the four most highly paid executives and the second is to increase the accountability of company boards of directors for executive compensation and policies and decisions. The SEC rules are presented in tabular and graphic forms, making information more accessible to the public. In 2008 The SEC unveiled additional rules for disclosing executive compensation. In 2009 the SEC chairperson announced further changes in the disclosure of executive compensation in a company’s Summary Compensation Table.