8-2013

Investor reactions to company disclosure of CEO to median employee compensation ratio: An experimental investigation

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ABSTRACT

Section 953(b) of the Dodd-Frank Act, which is yet to be implemented by the U.S. Securities and Exchange Commission (SEC), requires that public companies disclose the CEO to median employee compensation ratio (hereafter, pay ratio). We conduct an experiment with Singapore MBA students to examine how such pay ratio disclosures influence the judgments of non-professional investors. Participants evaluate a hypothetical company given either no pay ratio information (i.e., only CEO compensation as per current SEC regulations) or pay ratio information (i.e., CEO compensation, median employee compensation, and pay ratio, as per Section 953(b)). The company's pay ratio, when provided, is higher than that of a comparative group of companies in the same industry. We also manipulate whether the higher-than-industry pay ratio is due to a lower-than-industry median employee compensation or a higher-than-industry CEO compensation. We find that the higher-than-industry pay ratio reduces perceptions of employee morale, rank-and-file staff attraction and retention, and board effectiveness more when the higher-than-industry pay ratio is due to a lower-than-industry median employee compensation than when it is due to a higher-than-industry CEO compensation. The higher-than-industry pay ratio also reduces perception about the fairness of CEO pay. However, the higher-than-industry pay ratio has no effect on investment potential judgments. Our results are useful to regulators and companies who are contemplating the effects of pay ratio disclosures.

Keywords: Dodd-Frank Act, CEO compensation, median employee compensation, investor judgments

Data availability: Contact the authors.