

The Research Centre of the Faculty of Economics
cordially invites you to a research seminar
on **Tuesday, 31st May 2016 at 1.30 p.m.** in **Executive Conference
Room** at the **Faculty of Economics, University of Ljubljana**

Author: **William Lazonick, University of Ljubljana and the Academic-
Industry Research Network**

Coauthor: **Matt Hopkins, The Academic-Industry Research Network**

will present the article:

"The Mismeasure of Mammon: The Use and Abuse of Executive Pay Data"

»Large publicly-listed companies dominate the U.S. economy. Employment, productivity, and earnings in the U.S. economy depend heavily on the resource-allocation decisions of the CEOs and their senior-executive teams at a relatively small number of very large companies. In principle, the compensation that a senior executive receives provides both *incentives* to allocate corporate resources in ways that can result in corporate success as well as *rewards* for the successful implementation of corporate allocation strategies in previous years. The heavy reliance of U.S. corporations on stock-based executive compensation as both incentives and rewards reflects the dominant ideology that, for *successful* economic performance, companies should be run to “maximize shareholder value.” The problem is that the senior executives of most major U.S. corporations have been incentivized to allocate corporate resources to *extract value* from the companies over which they exercise strategic control, not to allocate resources to create new value by investing in productive capabilities that can generate new innovative products. Through their stock-based compensation, they have been rewarded abundantly for this value-extracting behavior.

A popular indicator of growing inequality in income distribution is the ratio of the pay of the corporate CEO to that of the average worker (CAW). The calculation of CAW has now entered public policy with the SEC's adoption on August 5, 2015 of the "final rule that requires a public company to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees." Our analysis suggests that since the early 2000s fair-value calculations of executive pay have tended to underestimate, often to an enormous extent and especially when the stock market is booming, the amounts of compensation that senior executives actually receive.

In this report, we document this mismeasure of executive pay by explaining the construction of the components of executive pay contained in the Standard and Poor's ExecuComp database. Then we explore when, how, and why this mismeasure of executive pay has occurred. First we focus on the ways in which, after stock prices tumbled in the Internet bust of 2001-2002, senior executives acted aggressively to manipulate their pay. We then turn to the possible reasons why, also in the early 2000s, the predictive power of the Black-Scholes-Merton "fair-value" measures of executive pay broke down. The result from 2003 to the present, with the exception of 2009 when the stock market crashed, has been the divergence of realized-gains and fair-value measures of executive pay. Indeed, this divergence between actual and estimated executive pay has been recognized in public-policy discussion of the "book-tax gap": the fact that U.S. business corporations use different measures of stock-based pay in their statements of operations in their 10-Ks filed with the SEC and their tax returns filed with the Internal Revenue Service (IRS). We contend that, given the type of behavior for which stock-based pay rewards senior executives, the book-tax gap is more aptly described as the mismeasure of mammon.«

You can register for the free seminar by phone (01) 58-92-490, or via e-mail: research.seminars@ef.uni-lj.si by Monday, 30th May 2016.

You can find all information regarding future research seminars on following link: http://www.ef.uni-lj.si/raziskovanje/seminarji_in_konference

We look forward to seeing you!