PAY COMPARISONS AND TOP-TEAM TURNOVER

Research that will appear later this year in the *Journal of Management* shows that executive turnover is not just a direct function of pay level or comparisons to the external market. Instead, turnover results from horizontal comparison with internal peers and vertical comparison with the CEO. The effects were substantial. For example, having a higher paid CEO made turnover among non-CEO TMT about 12% less likely, and large pay differences within that group made turnover on the team about 46% more likely.

Key Takeaways:

- View the pay of top executives as an overall strategy, not a series of individual decisions.
- Executives respond to comparisons of their pay with that of peers in their own organization, but also with the pay of peers in other organizations and with their CEO's pay.
- Executive turnover is minimized when executive pay is higher than external peers, similar to internal peers, and substantially lower than CEO pay.

Using data on CEOs and the next four highest-paid executives in S&P 500 companies between 1994 and 2008, researchers found that high pay (total short- and long-term compensation) compared to the external market did little to reduce turnover on its own. Larger reductions came from differences between the pay of non-CEO executives and the CEO, which offer the potential of a large prize for the executive chosen as a successor. In contrast, pay dispersion among non-CEO executives increased turnover, since it can induce feelings of inequity and resentment, engender politics, and inhibit trust and camaraderie within the C-suite.

The research team also found more complex relationships among the three comparisons. When CEO pay is much higher than other executives, differences among the subordinates became less important. Also, paying executives above their market value made differences in pay between them and the CEO less impactful on turnover.

Their analysis statistically controlled for aspects of the environment (like industry trends), the firm (like size and ROE), and the CEO (like tenure and whether they were promoted from within). The authors suggest that future research is needed to learn about the attitudes of individual executives, how their personal characteristics might play a role in the turnover process, and how these drivers of turnover may impact firm performance.

Source: Ridge, J. W., Hill, A. D., & Aime, F. (2015). Implications of multiple concurrent pay comparisons for top-team turnover. *Journal of Management*, In Press.