Researchers say stakeholders respond to voluntary CEO pay ratio disclosures

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Assistant Professor of Accounting Lisa LaViers and colleagues manually inspected the 2018 proxy statements of every firm in the S&P 1500, documenting and categorizing voluntary CEO pay ratio disclosures and analyzing their effect on share prices. Their study, “CEO Pay Ratio Voluntary Disclosures and Stakeholder Reactions,” is forthcoming in *The Review of Accounting Studies*.

In 2018, thanks to a then-new Securities and Exchange Commission disclosure rule, Marathon Petroleum Corp. revealed that CEO Gary Heminger earned 935 times that of the company’s median employee. The eyebrow-raising ratio dwarfed that of refining industry peers like Valero Energy Corp., whose CEO Joseph Gorder earned just 108 times that of its median employee.

But Marathon did more than just report the ratio. It noted that the company was the only refiner with a substantial retail presence and its median employee calculation included thousands of associates at its Speedway convenience stores, many of whom worked only part time. To help shareholders more accurately compare its pay ratio with that of peers, Marathon proposed an alternative ratio that excluded retail workers, resulting in a more palatable ratio of 156 to 1.

Marathon wasn't the only company that supplemented its CEO pay ratio with additional information. Despite bitter and vociferous complaints from industry groups about the adoption of the rule, 65% of firms in the S&P 1500 provided pay ratio disclosures that went above and beyond SEC requirements.

Those voluntary disclosures caught the attention of Lisa LaViers, assistant professor of accounting, whose research focuses on issues related to human capital management and pay transparency.

"I thought it was really unusual that firms were disclosing more than they were required to about their CEO pay ratios given how hard they had fought against having to disclose the number at all," LaViers says.

To better understand the phenomenon, LaViers and colleagues Jason Sandvik and Da Xu manually inspected the 2018 proxy statements of every firm in the S&P 1500, documenting and categorizing voluntary disclosures and analyzing their effect on share prices. Their paper, "CEO Pay Ratio Voluntary Disclosures and Stakeholder Reactions," is forthcoming in *The Review of Accounting Studies*.

Initially proposed as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CEO pay ratio rule was intended to help investors make more informed say-on-pay votes and be better stewards of firm resources. Industry groups claimed the rule was too rigid to be useful to investors and would serve only to shame highly paid CEOs, but it was ultimately enacted by the SEC in 2018.

Perhaps unsurprisingly, the authors found that the firms most likely to provide voluntary disclosures were the ones with the highest ratios. More than 80% of firms with pay ratios higher than 238 supplemented their numbers with voluntary disclosures compared with just 54% of firms with ratios between 0 and 44.

High ratios can be an indicator of low pay fairness, which can lead to reduced firm value. LaViers says one reason firms provided additional disclosures was likely to

mitigate the impact of an unfavorable ratio. Marathon excluded its retail employees, for example, in order to calculate a ratio it argued was more analogous with peers. Similarly, tobacco giant Universal Corp., whose CEO pay ratio was 2,429, explained that its median employee was an unskilled, seasonal worker located in the Philippines. If those low-paid, non-U.S. employees were excluded, the company said its ratio would drop to 206.

Shareholder reaction to voluntary disclosures was mixed. Investors on average had a positive reaction to firms with high ratios that provided firm-specific voluntary disclosures, such as additional information about its median employee or an alternative pay ratio the company said was more meaningful, but investors had significantly negative reactions to firms with high ratios that provided boiler-plate voluntary disclosures, such as a compensation philosophy statement or a general disclaimer about the value of comparing ratios across firms.

“Firm-specific disclosures were likely viewed positively because they’re from firms that had something positive to say,” LaViers says. “These disclosures were voluntary, so if you didn’t have something to say that could make yourself look better, you probably didn’t say anything at all. On the other hand, boilerplate disclosures that were defensive and not very informative were viewed negatively, so investors were seeing through that.”

In the five years since the CEO pay ratio rule was introduced, the gap between CEO and median employee pay has continued to widen, leading some to question the value of the rule. A recent *Bloomberg* Op-Ed called the rule a failed experiment. LaViers, however, has a different take.

“No disclosure is perfect, but this is a good start,” she says. “Requiring firms to disclose their CEO pay ratio made them disclose all the other things we look at in this paper, which provide more context, more firm-specific details and greater understanding of the ratio.

“How you explain and justify pay inequality in your firm matters to stakeholders,” she adds “I think our paper shows that companies who can defend their pay ratios — who can defend their compensation practices and have meaningful things say about it — are being rewarded by investors and firms that have nothing positive to say are being punished.”

Ultimately, LaViers says she hopes the paper can offer insights to regulators as they grapple with the issue of pay transparency.

“It’s a complex area and the SEC knows it’s a complex area, because they’re currently debating what other pay disclosures should be required,” she says. “We hope that this paper can guide some of their understanding about what's actually happening and what’s useful and not useful to investors and other stakeholders.”