International Inequalities Institute

Do Firms Manage Pay Inequality?

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Inequality has become one of the political concerns of our age. The French economist Thomas Piketty has drawn attention to the increasing inequality of labour income which he attributes to two things: the growing gap between college graduates and school leavers and the rise of the very highly paid "super manager". The second of these is the focus of this paper. We have identified a change in management pay practices that occurred in or around the mid-1980s which we associate with the decline in what the business historian Alfred Chandler called "managerial capitalism" as firms have become, in the words of the economic sociologist Gerald Davis, "financialised" and "managed by markets". The period before this change in managerial pay practices we describe as "administered inequality". The period after the change we call "outsourced inequality".

The story of administered inequality is essentially a story about internal labour markets or "ILMs". ILMs were governed by administrative rules and procedures; jobs tended to be filled by internal promotions and transfers, and pay was set according to an internal matrix with differentials determined by custom and practice. ILMs whether for manual, white collar or managerial employees, rationalised hierarchies and crucially provided a way of legitimising degrees of inequality which tended to compress pay disparities. They also prioritised the internal coherence of hierarchies over market mechanisms for pay-setting. Two pay-setting devices in particular were common in managerial corporations prior to the mid-1980s: collective bargaining, which tended to compress differentials, and job evaluation, whereby the relative size of jobs was determined within an organisation, typically using a points system which provided the basis for an equitable grade and pay structure. Both devices tended to exert limits on intra-firm inequality.

From the mid-1980s onwards, senior managers were increasingly rewarded on capital market measures and not by the evaluation of job inputs. A growing proportion of senior executive pay came to be delivered in the form of stock options and other types of share-based incentives. At the same time, given the collapse of collective bargaining, many lower-paid workers had increases in their incomes pegged to changes in the statutory minimum wage. In these circumstances, administrative processes for the firm to regulate intra-firm equity gave way to capital market influences in such a way that the firms typically no longer control inequality within their boundaries using administrative devices. We describe this situation as “outsourced inequality”.

To illustrate outsourced inequality, between 2000–2015 the median *total earnings* of FTSE 100 CEOs increased from £962,145 to £4,052,000, an annualised growth rate of 10.1%. During this period median CEO *salaries* grew from £538,000 to £927,000, an annualised increase of a much more modest 3.1%. At the same time the annualised growth in the retail prices index was 2.8% and the annualised increase in the average nominal earnings of all employees was 3.0%. The ratio of median total earnings of FTSE100 CEOs to UK national average wages increased from 59:1 in 2000 to 161:1 in 2015. Thus it can be seen that the significant increase in the median total earnings of FTSE 100 CEOs over and above average nominal earnings is substantially attributable to the pervasive use of share-based incentives in the period after the mid-1980s, as well as an increase in annual cash bonuses.

We have focused on within or “intra-firm” inequality both because this shows a pattern of long-term increase and because high executive pay has become a matter of public and governmental concern. It is noteworthy that the period we have covered includes the financial crisis of 2008-2009, which might have been expected to impact negatively on the pay of super-managers. To illustrate our argument we have chosen measures which are publically available in the UK. Our conclusions have implications for managerial practice, corporate governance, and government policies which are intended to moderate top-pay.

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