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Mind the Gap: Dangers Lurk as Income Disparity Widens
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It has wisely been said that the level of societal development is measured by how well the poorest, most vulnerable members are treated. Based on that criterion, most societies appear to be quite primitive. The gap between the rich and poor is very wide and, despite the serious consequences, continues to widen. An extreme income gap provokes envy, resentment, and tension in a society. According to epidemiologists Richard Wilkinson and Kate Pickett, countries with the greatest income disparity have higher levels of teen pregnancy, infant mortality, obesity, mental illness, drug use, imprisonment and homicide than counties where wealth is more evenly distributed.

A change in worldview is required. We need to understand that we are interconnected and interdependent and then begin to act accordingly. There are sufficient resources, if more equitably distributed, to ensure adequate material goods for all. The challenge is not to treat everyone the same but enable everyone to secure their daily needs with dignity. This change would provide opportunities for those who wish to raise their aspirations from surviving to thriving.

Measuring income inequality is not a precise science. One commonly used measure is the Gini index, a statistical measure developed by Italian statistician Corrado Gini. More specifically, the Gini index is used to indicate how the distribution of family income in a country differs from a proportionate distribution where everyone would have the same income (20% of the population would have 20% of the income, 40% of the population would have 40% of the income, etc.) Using this index, 0 equals perfect equality and 1 indicates perfect inequality (one person has all the income and no one else has any). Using the most recent statistics available, South Africa's index of 65.0 and Brazil's of 56.7 were toward the most inequitable end of the scale and Sweden's of 23 and Norway's of 25 were the two most equitable countries. The Gini for a few other representative counties, around the middle of the range, shows the United States at 45, Russia at 42.3 and China at 41.5.

More important, perhaps, is the recent trend for income inequality. For example, in the United States, the gap between what the top 10 per cent of the population earns and what the remaining 90% receives has expanded sharply for several decades. After rising for a century or more, the real (inflation adjusted) wages of average workers stopped rising during the 1970s. With the aid of new technology the average worker has produced an increasing amount of goods and services yet employers rarely needed to raise their wages in real terms. Shareholders and corporate executives were able to garner an increasing share of the income produced while wages of lower level workers stagnated. The Corporate Library reports that CEO pay at the nation's 500 largest firms averaged about $10.9 million a year – plus another $364,000 in fringe benefits. Today, the gap between the boss and the workers has stretched to levels that many find difficult to comprehend. The Institute for Policy Studies estimated that the average CEO earned about 319 times more than the average worker in 2008, compared to 42 times in 1980.

The issue is not only one of fairness but one of sustainability. When the authors of the highly respected environmental organization, the Natural Step, considered the ecosystem conditions that would be necessary to assure a sustainable global economy, they recognized that irresponsible human behavior was the primary cause of the deteriorating environment. Therefore, they added an additional system requirement to the list of environmental conditions - the ability of human beings to meet their basic needs. This includes everything from safe working conditions to sufficient income to satisfy a person's food, clothing and shelter necessities. People who must focus solely on day-to-day survival have no time or motivation to consider the needs of nature or the long term consequences of their actions. No one can feel well-off or secure if people around the globe are struggling for basic necessities, let alone their personal survival.

While there are many reasons for the inequitable distribution of income, (geography, ethnic, sexual and religious prejudices, transparency and corruption issues, ineffective tax and education policies, greed, etc.) this article focuses on the growing inequities created by excessive executive compensation which in many cases comes down to outright greediness. The dictionary defines greed as an excessive or extreme desire for something, such as wealth, that is more than one's proper share. Those who assume challenging, stressful positions of authority are certainly entitled to fair compensation for their efforts. But according to The National Association of Corporate Directors: "Some executives have accumulated enormous wealth that has little – or even negative – correlation with their contribution to the long-term performance of their companies. In too many instances, executives have received generous pay after periods of undistinguished or worse yet, failing performance." Irresponsible policies that unjustly reward a few people at the top of an organization fuel resentment and hostility and destroy the trust that is essential for an effectively functioning economic system. If greed, in the form of outrageous executive compensation, is not soon addressed, the health and sustainability of the global economy is likely to weaken dramatically. Some of the most flagrant failures in today's compensation arrangements are discussed below.

Incentive compensation is often either too easy to attain or fails to produce results that would warrant extra pay. There has been insufficient attention to the long-term impact of executive decisions or any penalty for future company reversals. As a result, executive incentives overemphasize short-term performance, encourage excessive risk-taking and fail to penalize poor performance. As New York Attorney General Andrew Cuomo has pointed out, banks' compensation plans imposed no penalty for risky activities that fail. He noted, for example, that Citigroup and Merrill Lynch together lost $54 billion in 2008, but paid out nearly $9 billion in bonuses. As a result, many incentive plans have motivated CEOs to put personal financial interests ahead of the long-term interests of their organizations.

Furthermore, poorly designed incentives give CEOs an undeserved win–win position. First, executives have little to risk; they are playing with stockholders' money and the livelihood of their employees. They frequently get bonuses for merely completing a merger (many of which don't work out in the long term) or for raising funds for the business (a normal business activity that deserves no special reward). According to an article in the *Financial Times*, Kraft Foods' CEO was recently given a 41% pay raise to 26.3 million dollars for "exceptional leadership" in the takeover of Cadbury, the UK chocolate company. The pay raise was given despite the fact that Warren Buffet, Kraft's largest shareholder, criticized the deal for being overpriced and not in the company's best interest. And Oleg Deripaska, CEO of UC Rusal, the Russian aluminum producer, received bonus shares worth about $60 million for his role in preparing the company's stock listing in Hong Kong and Paris. The fact that the initial public offering was not particularly well received did not, apparently, negate the worthiness of the extra payout.

Current pay practices encourage abuses as short-term oriented CEOs, hoping to cash in on any appreciation in the company's stock, may cut back on maintenance or customer service or fire experienced higher-paid employees to meet the company's earning expectations. This sends an unsettling signal to other employees and may create a class structure within the enterprise that harms its effective functioning. Management guru Peter Drucker, echoing the view of finance magnate J.P. Morgan, believed that the ratio of pay between worker and executive could be no higher than 20-to-1 without damaging company morale. Several studies have supported this belief. A poll of *Industry Week* subscribers, the majority of whom are managers, revealed that over half felt that soaring salaries at the top had a depressing effect on their morale and productivity. Another study published in the *Journal of Organizational Behavior* found that high levels of executive compensation generated cynicism in white-collar workers. The research further found a correlation between cynicism and tendencies toward unethical behavior. Moreover, the ever-widening gap between CEO and worker pay creates distrust in the fairness of the region's political system. Concentrated economic power often leads to concentrated political power and to policies that benefit the few at the expense of the majority.

Most CEO pay, relative to other employees', is excessive when respective contributions are considered. The decisions made by a CEO are only one of many factors that contribute to a company's success or failure. When the economy is doing well all businesses benefit. When a recession hits, even the most talented group of executives will be unable to reverse the trend. Businesses that sell natural resources, such as oil and gas, do well when the demand for the commodity exceeds the supply and prices are rising. When the opposite is true, there is very little a CEO can do to offset the likely price declines. Weather variability – hurricanes, droughts, earthquakes – can adversely affect a company's prospects regardless of who is running the enterprise. In other words, when external conditions are favorable – weather cooperative, pricing power strong, economy robust – leaders reap the rewards. When conditions turn unfavorable, leaders blame forces beyond their control and load up with stock options that are based on temporarily depressed stock prices.

Most incentives are based primarily on financial measures without regard to other elements of leadership such as creating a transparent, ethical culture that considers the needs of all stakeholders. An inclusive, long-term orientation is essential to ensure a prosperous, sustainable enterprise. The consequences of today's narrowly focused objective – make more money now – go well beyond personal enrichment for CEOs. The drive to reach short-term goals can generate business strategies that devastate employees' personal lives, impair the reputation of the business and severely harm the communities in which the firm operates.

The argument that extremely high pay levels are necessary to attract and retain talented executives who presumably will be able to achieve better-than-average results, is not convincing. As reported in *The New York Times*, officials at some of the five companies which the U.S. government recently bailed out, (GM, Citigroup, AIG, GMAC, Chrysler) and whose pay must now be government approved, fiercely argued that they needed to pay hefty compensation to retain senior executives and allow them to maintain their elevated standard of living. Yet of the 104 senior executives whose pay was set by the federal pay regulator in the past 2 years, 88 executives or nearly 85%, are still with the companies even though their pay was drastically reduced. Why the discrepancy between what officials expected and what actually happened? First, people pursue executive-level jobs for a variety of reasons: the status and influence that come from leading an organization, the fulfillment that comes from creating a successful enterprise and the opportunity to give back and thereby make a contribution to society. Remuneration is just one part of the equation and in many cases it is far from the most important part. Second, extensive research has shown that money and happiness are, at best, very loosely connected. Once basic needs are met, there is little if any increase in happiness as a result of higher levels of income. Recent studies, conducted with the Princeton economist Angus Deaton, suggest that money doesn't necessarily make much of a difference in our moment-to-moment happiness. According to their work, income over about $70,000 does nothing to improve enjoyment of our activities on a typical day.

According to an article in the *Financial Times* by George Akerlof, a professor at the University of California at Berkeley and 2001 Nobel Laureate in Economics, and Rachel Kranston, professor of economics at Duke University, when employees have a positive view of their work and their organization, no performance pay is needed. Most people just do their jobs regardless of whether it is glamorous or well-paying. Nurses, police, firefighters and construction workers, to name a few, make a small fraction of what most CEOs earn yet they endure long hours, unpleasant working conditions, stressful jobs and responsibility for the well-being of many people. Does a surgeon ask for a success fee before performing a medical operation? Why do CEOs and other executives need enormous bonuses to simply do what their job description requires? Business leaders are entitled to fair, even generous, compensation but their contribution to the organization is not hundreds of times greater than that of other company employees. Huge bonuses give stockholders and employees the wrong message – without large incentive pay executives cannot be expected to do their jobs in a diligent, conscientious manner.

A study by an accounting professor at East Carolina University that was published in the *Financial Analysts Journal* looked at pay versus performance at S&P 500 companies during the period 1997-2004. The research found that companies with the highest levels of executive compensation had performance that was no better than that of other companies. In fact, by one measure of performance, the record of companies with the highest amount of compensation was significantly worse than the performance of other companies. The National Association of Corporate Directors (NACD) reports that 88 percent of board members it surveyed say that CEO pay is either too high or somewhat high relative to performance. William McDonough, chair of the Public Companies Accounting Oversight Board and former Federal Reserve Bank of New York President, calls the rise in executive pay "grotesquely immoral."

Annual compensation for top-level executives that often surpasses ten's of millions of dollars - over 300 times what their employees receive - is unjustified and greedy. Such remuneration falsely assumes that executives won't work for less money, that their services are likely to result in superior company performance, that the executives make a disproportionate contribution to the company's success and that extreme incentives won't lead to abuses and short-term, counterproductive thinking. Furthermore, excessive pay demoralizes the company's employees, perpetuates unsustainable cultural values and creates an unstable society in which the rich get richer and the poor get poorer. Reducing the pay differential between top executives and other employees won't, by itself, solve the income inequality gap. But in a world where everything is intimately connected, business leaders must set an example that acknowledges the fact that companies are part of the larger community and they will only do well when all others are doing well.