HOW SHOULD EXECUTIVES BE PAID?

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GUIDING principles are particularly needed to direct and control executive payments, since no philosophy or even comprehensive literature exists concerning them. It is the purpose of this study to outline certain of these principles, including what executives expect from corporations and what the methods of rewarding executives may be to secure the desired social results. The significance of such generalizing far transcends the problem of the amounts paid and the methods used in making payments; it is intrinsically an examination of how to reward executives in order to secure and retain successful business leaders—a great social and economic problem. Stated somewhat differently, it is an answer to the question: How can present executive payments be justified? This article is by no means exhaustive or final; it is rather a preliminary review of important factors revealed by numerous careful analyses.

During the last twenty years, many intricate plans have been adopted to solve the problem of paying executives. Few of these plans developed into real solutions; often they brought in their wake more misunderstandings than they solved. The failure to appreciate the true nature of executive compensation and the lack of definite objectives account mainly for the unsatisfactory results. Very few if any cases of actual "skullduggery" and official connivance in executive payments will be found among the large group of publicly owned companies on which this analysis is based, although the belief has existed in certain quarters that such conditions must be prevalent. The contradictions, limitations, and weaknesses, however, of many of these plans can be seen from the following statements concerning them:

1. Certain plans permit large annual cash payments without any definite relationship to executive performance and corporate earnings.
2. Certain plans focus an executive's attention on speculative interests rather than on the immediate problems of his job.
3. Certain plans cause an executive's income to fluctuate so widely from year to year that his standard of living becomes unsettled.
4. Few plans deal satisfactorily with the problems of an executive's retirement or his estate.
5. Only a few plans consider the tax problems faced by many executives today.
6. Few if any plans furnish security—a desire popular today not only with workers but also with executives.
7. Certain plans overemphasize an executive's immediate rather than long-time interest in a company.
8. Few if any plans indicate an appreciation of the nonmonetary satisfactions which an executive desires from his work.

In addition, officers and directors seldom if ever analyze their plans carefully and decide when such plans should be classified as profit-sharing plans, when as incentive or bonus plans, and when as both. This failure to understand the character of their plans has confused both thinking and objectives so much that when certain groups attack profit-sharing and favor bonus payments, careful logic might reverse their position, because in reality they may be defending profit-sharing and condemning bonus payments.

The amounts and the methods used in paying executives are now known, and are available for examination. Why executives are paid present salaries and whether they are paid in the proper way are unanswered questions which demand careful scrutiny. These questions, it must be remembered, are no longer limited simply to directors, officers, and stockholders, but because of the economic importance of corporations, they have great social significance; and if not properly regulated under private corporate management, executive compensation may be controlled by law. Such action would be most unfortunate, because it would restrict rather than encourage initiative, a required quality in any successful executive. Here it seems important to point out that few companies have ever stated definitely their executive compensation policies. The American Telephone and Telegraph Company, the Jewel Tea Company, and a group of others are the exception rather than the rule. The following is a statement of policy issued by the Directors of the Telephone Company in 1934:

> The Board of Directors have fixed the salaries of the executive officers of the American Telephone and Telegraph Company on the basis that it is necessary for the Bell System with its essential service to maintain itself as an institution of opportunity for the best brains and ability in the land.
>
> The Directors feel that the salaries paid are in no way disproportionate to the size and importance of the Company and that they were not before they were reduced. No bonuses have been or are paid. Moreover, the individuals concerned pay anywhere up to one-half of their salaries in State and Federal income taxes.
>
> The Company has to compete with opportunities for talent in all other fields. It is necessary, therefore, to pay management adequately for, unless this is done, the business will not retain or draw to it in the future the ability it needs. If we could get better men by paying more money it would be wise to do so. On the other hand, to have it understood that first-class talent can hope for but relatively poor reward in the Bell System would be the most certain way to breed decay in this great enterprise.

Background of the Problem

Before progressing further, it becomes necessary to define various loosely used terms. The term "executive" covers a multitude of men and positions. For this study, it may properly be applied to a wide group of senior and junior corporate officers who devise, direct, and execute corporation policies. Certain companies often divide their executives from other employees by means of some arbitrary wage level, such as salaries of more than $3,000 or $4,000 annually. Other more elaborate attempts are made to classify them by analyzing carefully their various functions. Such fine definition is not required here, and since most classifications are open to serious criticism, little labor and space will be devoted to defending the general definition to be followed. Suffice it to say, the definition used here is also imperfect.

The corporations referred to in this study are mainly companies with widely diffused stock ownership that have securities listed on the New York Stock Exchange. The responsibilities of the executives in these corporations are somewhat different from those directing the few other large and the numerous small, privately owned corporations.

So long as corporations were small, controlled and managed directly by owners, there was little need for concern about executive payments. Those who did think of executives as managers under those early corporate conditions sympathized with them and puzzled over ways of giving them sufficient influence to perpetuate sound management. With the advent of large corporations and diffused stock ownership, the earlier condition changed so rapidly that its shadow remained years after the substance disappeared. Today in large corporations, by virtue of position alone, executives have great powers. Since corporations have the power to influence drastically the lives of many, the problems of executive payments and control become serious ones. Stockholders for the most part are mere receivers of dividends, and even if they understand corporation problems (which most of them do not to any appreciable extent) they probably would still not act promptly or decisively on important questions. One question seems to bestir action on their part, and that is executive payments, particularly when no dividends are paid. About this question stockholders can and have become indignant, and with the ever widening publicity being given to this matter, they will probably become even more conscious of mistakes, inequities, and abuses which may occur.

Absentee ownership in a rapidly changing world adds to the power and importance of corporate executives, and the need is strongly indicated for proper methods of payments, so that executives may receive the proper satisfactions, and society may be permitted to secure what it requires from them and from the corporations they represent. Executive power, derived almost entirely from position, is probably one of the reasons for the relatively few changes in senior management positions.

Executive Motivation

Human desires, like the shape of clouds, may change rapidly, and their outline today may not be recognizable as the same tomorrow, but, nevertheless, back of all the minor changes are fundamental desires and wants. It is with these desires that a general consideration of executive compensation must deal. Some of the fundamental satisfactions desired by executives are given below. No attempt is made to have this section comprehensive. It is necessary, however, as a base for the following divisions of this article. Many of these points have little, if any, connection with dollar payments.

(1) Pride in the organization with which an executive is associated is important. In part, such pride arises from the existence of inspired leadership.

(2) Freedom of action, with responsibility and power, are prerequisites of any executive position.

(3) The opportunity of observing an organization as it functions rewards many executives for the most strenuous work.

(4) Title and position loom large in the minds of many officers.

(5) The financial rewards of executive positions are adequate and even large, and must be gratifying to many.

(6) An executive position carries with it the opportunity of great public service.

(7) Stability of position, a high standard of living, and tenure of office are desired by most men.

(8) Fun and interest in the job inspire many leaders.

Any ranking of these points in order of importance is futile, for they are of varying significance to different executives, possibly changing frequently in importance from day to day for many men. It should be remembered, however, that this list of satisfactions which executives may secure from business cause men to struggle early and late, neglect their families, and even die at an early age.

Methods of Payment

The most widely used methods of paying executives are: (a) straight salary; (b) salary and cash bonus; (c) salary and stock bonus; (d) salary with options or warrants to buy stock; and (e) commissions, frequently with relatively small drawing accounts. Also, many involved combinations of these plans exist. There are only three basic methods of paying executives, however: formal salary, which the American Telephone and Telegraph Company uses; salary with some form of additional compensation, which General Motors Corporation uses; and commission, which the Woolworth company uses. Among a sample group of industrial companies in 1929, two-thirds used the fixed salary method with some form of bonus; by 1936 the number was greatly reduced, and it appeared as if not over one-third of the companies used this form of compensation, although there was a definite tendency to revert to it. The majority of the other companies paid executives a formal salary; very few paid commissions. Among the retail companies studied, changes in the practice of paying executives were not apparent over the period. At least three-quarters of them paid formal salaries with some form of bonus in 1929, as well as in 1936 and 1937.[1]

A critical examination of the two chief methods of rewarding executives is necessary at this point to furnish the background for the main part of this investigation.

Formal Salaries. The formal salary method of paying executives is less complicated than any plan involving bonus payments, and presents one main problem—that of the annual rate of pay. The advantages of this method are numerous, and are often in the nature of objections to other plans. Few officers can afford to gamble for any length of time on low salaries frequently implied in other arrangements. A formal salary is usually considered as payment for time and effort contributed by an executive in performing the duties of his position. Both corporate directors and officers know in advance the amount of the actual payments to be made, and these payments therefore are never unexpectedly large or small because of unanticipated developments. Formal salaries are not affected directly by the rise and fall in a company's earnings, which may be fortuitous and out of the control of officers. Executive duties and functions include planning, foresight, imagination, control, and supervision. All these apply to a span of years rather than to the year in which supplementary executive payments are calculated. Without much effort, one is able to envisage situations arising under which incentive payment plans might cause conflict of long-run and short-run interests in an executive's mind; this possibility does not exist with formal salaries.

Formal salary payments do not stress monetary incentives to the exclusion of all others. Such payments thus may tend to develop a professional rather than speculative attitude among executives toward their work. Also, this method avoids drawing lines of social distinction between individuals, such as "bonus" and "nonbonus" officers, and it is simple to administer, having no "trick," little understood formulae.

[1] John C. Baker, *Executive Salaries and Bonus Plans* (New York, McGraw-Hill Book Company, Inc., 1938).

It should not be concluded that formal cash salary payments without a bonus are low. The median payment in 1929 for presidents among a group of 59 large companies not paying bonuses was $80,000; in 1936, $71,000. The range in cash salary payments to presidents in 1929 ranged from $18,000[2] to $345,000, and in 1936, from $18,000 to $165,000.

A formal salary also has its drawbacks. One disadvantage stressed frequently is its failure to provide any special monetary incentive for extraordinary results. It is true that this method does not have the so-called incentive feature which permits an annual participation in profits, whatever the merits of such participation might be from the incentive point of view. However, the payment of such substantial formal salaries as are indicated above should in itself constitute a real incentive. Furthermore, there is much confused reasoning on the subject of incentives for executives, based on the belief that executives and pieceworkers are motivated and should be paid in a similar way. The duties and functions of executives are plainly different from those of craftsmen, machine operators, and laborers, and any attempt to use similar methods of payments may lead to serious complications. That proper incentives are essential is not denied or even questioned; indeed it is contended that they are of the greatest importance. The contention that such incentives are of a monetary character to a large degree, however, is questioned. There are probably many who will take exception to this, and it runs counter to an early study on profit sharing published in 1918.

> Probably few men employed on fixed salaries, even those occupying managerial and executive positions, are measuring up to their greatest possibilities. Most men are stimulated to this point only by the definite prospect of direct and personal gain.[3]

Another disadvantage frequently discussed is the lack of flexibility in overhead charges because of the fixed character of formal salaries. Prior to 1929 directors frequently said: "We would rather fire a man than reduce his salary." Once salaries are established, it is argued, directors dislike reducing them, not only during a contract period, but also at the termination of a period. This appears to be true, and the pattern of total compensation payments by bonus and nonbonus paying companies varies widely—that for bonus paying companies fluctuating more abruptly than for nonbonus paying companies. However, since the average dollar level of formal salary payments is about the same in the two groups, it is only fair to omit bonus payments in comparing them. Here there is much similarity, with formal salaries in nonbonus paying companies fluctuating even slightly more widely than in bonus paying companies, indicating again great reluctance to reduce the fixed part of total executive compensation. Thus it appears that the curtailment in payments to executives of bonus paying companies is in the "extra" rather than the regular compensation. If wages of workers continue to take on the character of "fixed charges," it is not unreasonable to assume that attempts may be made to bring flexibility into salary payments, through flexible payments to executives. The wisdom of

[2] The low amount was paid to a president who also was a large stockholder.

[3] Arthur W. Burritt and others, *Profit Sharing* (New York, Harper & Brothers, 1918), p. 94.

such attempts, however, might be questioned.

From an executive's own point of view, there are certain drawbacks to formal salaries. Executives, unless extremely well paid, ordinarily spend on insurance, living expenses, travel, vacations, and the education of their children all or almost all their income. Thus, the building up of an executive's estate for retirement and for his family is exceedingly slow with most men. Bonus payments, it is believed, meet this objection.

Officers also like to own shares in a company for which they work, and possibly should do so, although there are the obvious disadvantages of "too many eggs in one basket" to such a policy. This participation in ownership becomes possible only in a very moderate degree for men who are paid fixed formal salaries.

Difficulties in building up an executive's estate often create sympathy among the executive group, so that it becomes difficult to retire officers long in service whose period of usefulness has passed, and this situation, both from a corporate and from a social point of view, may become exceedingly serious. Dry rot in an organization begins near the head, where amputation is difficult.

Formal and Informal Bonus Plans. Formal bonus or incentive compensation plans vary greatly, although there are threads of similarity running through them. Objectives of about one-half of the plans studied are stated; in the other half, no mention is made of them. When referred to, the objective is generally "to provide an incentive to increase efficient and profitable management." Irrespective of the functioning of bonus plans, their stated objectives are on a high ethical plane, and stress in almost every instance stockholders' welfare and interests. In this discussion, such plans are limited to those providing for the payment of compensation to executives in addition to regular salaries, either by cash or by stock, for the purpose of stimulating initiative and efficiency, and of retaining executives.

The respective merits of bonus and nonbonus payment methods must be studied to understand clearly the significance of both. In examining various bonus plans and the general literature on the subject, one frequently meets arguments favoring such plans. Some of the arguments definitely stated by proponents of these plans may be summarized as follows:

> The greatest incentive for the development of any business is a sense of proprietorship. Under present conditions, with the management generally in an entirely separate group from owners, something like a management bonus plan is essential to insure the same drive and direction to an organization as existed in past generations.
>
> A liberal reward for unusual effort and ability on the part of an officer or employee is returned manyfold to the public and to the stockholders of a corporation.
>
> A bonus plan attracts and holds men of unusual ability in the corporation that pays additional compensation.
>
> Executives give their loyalty and entire attention to a corporation paying substantial bonuses.

None of these commonly advanced arguments favoring incentive compensation plans seems to be either entirely adequate or frank, and all are open to criticism. The last argument, for example, can hardly be accepted seriously. Surely proponents do not wish to imply that they do not believe executives will be loyal and faithful, and spend their full time on the job, when receiving only what can easily be described as a very substantial salary! It is doubtful if the disappearance of bonus payments between 1931 and 1936 in any way affected the work or interest of executives. It is also doubtful whether the largest bonuses ever drove officers to work so hard as did the disappearance of earnings and the fear of corporate failure during the great depression.

The proponents of bonus plans do not advance two arguments which they might well have used. The first is that a corporation may be compelled to adopt such a plan because of the many similar plans being put into effect by other corporations. In periods of prosperity, competition for executives may be exceedingly keen. Another reason for the adoption of such plans might be that if stockholders receive an adequate return on their investment, there is no reason why the officers should not participate in additional earnings. This reasoning views the bonus as a type of profit sharing.

At this point, recognizing both the contributions of executives and the fluctuating and uncertain character of earnings, it becomes necessary to examine one of the premises on which bonuses are based. If a salary is relatively low, and the size of the executive's total salary depends on bonus payments (as it frequently is asserted), then it must be fair and reasonable that a bonus be paid. Many concur on bonus payments for executives, believing that if executives are willing to run a real risk in what the company earns, they also should be rewarded liberally when the company is successful and earnings are large. What happens, however, in actual practice? A study of the salaries of corporation presidents in 1929, when conditions were suitable for this theory to function, brings out several interesting points.

On the average, the chief executive in 1929 who received a bonus also was paid a salary within a few thousand dollars as large as a president who was simply paid a fixed cash salary. However, when the bonuses received by this group were added to cash salaries, the median payment averaged about two and one-half times the amount paid to the group receiving simply a formal salary. That is, total compensation to presidents of companies not paying bonuses in 1929 averaged \$80,000, as contrasted to \$196,000 going to presidents of companies paying bonuses. It is difficult to evaluate properly the significance of these wide variations because on this point are focused the different philosophies of executive payments.

Certain weaknesses in general bonus plans are readily apparent, such as the use of total net earnings as a basis for payments and the difficulties in controlling and allocating payments on such a basis because of wide fluctuations in earnings and the possible contributions of various divisions to earnings. Many exceptionally large bonus payments and what are obvious abuses occur unexpectedly because of certain favorable circumstances suddenly affecting earnings. Certain bonus plans have no limit, or such a high "ceiling" that payments under them often have been fantastic and have incurred stockholders' disapproval as well as that of the public. Furthermore, executive duties generally are immeasurable. If an executive's chief contributions are foresight, imagination, and direction, why attempt to pay an executive a bonus which presumes the ability to measure each executive's contributions when that is impossible? In addition, executives have much to do with final earnings figures simply in a technical accounting way. Markdowns, depreciation, and obsolescence are matters of judgment and must be referred to executives for final decisions. One decision may lead to bonus payments, another to no payments. It appears doubtful that any method of paying executives should be used which would cause such conflicts of interest among those to be paid.

Numerous other disadvantages from a corporate viewpoint may be uncovered by a careful study of the detailed functioning of bonus plans. One of the great ever-present dangers in current corporate management is the development of subordinate executives who, because of the methods used in distributing bonus payments, constantly "play safe" to secure their share of any bonus, and thus turn into ubiquitous "yes men." When such executive ossification begins, serious corporate trouble may lie ahead. Corporate success comes through the clash of differing abilities and personalities. Even carefully prepared bonus plans attempting to reward such officers as sales manager, production manager, purchasing agent, and traffic manager on departmental performance, often align one man and his friends against the other divisions, so that chaos rather than cooperative effort is developed. One plan of this character, prepared to avoid "all possible trouble," led to such friction that it was discontinued at the end of the first year of operation.

One executive who has had wide experience with formal bonus plans reports that he never knew one which did not sooner or later lead to trouble and misunderstanding. In his opinion the reason for such frequent failure was that the plans attempted to forecast the future—an impossibility—and when they succeeded, they did so only by chance.

The fundamental qualities of any able executive cannot be either purchased or made to operate by means of bonus or incentive payments, as many plans imply. Society in appraising bonus plans can only conclude that any attempt to pay executives on a monetary incentive basis overlooks, not only the nature of earnings, but the character of executives as well. Total salary and bonus payments above a liberal market rate for similar positions in other corporations probably have less effect or executives than pride in achievement. Ii good judgment and kindred qualities are the most significant elements in executive success, then certain bonus plans may hinder rather than help in reaching the desired goal. It seems fair to conclude that any method of paying executives the results of which are so shadowy and confused may well be questioned, or at least re-examined and reappraised.

Mr. Barnard in his recent book, *The Functions of the Executive*, summarizes effectively the basic weakness of monetary payments alone:

> The unaided power of material incentive, when the minimum necessities are satisfied, in my opinion is exceedingly limited as to most men, depending almost entirely for its development on persuasion. Notwithstanding the great emphasis upon material incentives in modern times and especially in current affairs, there is no doubt in my mind that unaided by other motives they constitute weak incentives beyond the level of bare physical necessities.[4]

Another problem involved in bonus plans as indicated previously is simply one of nomenclature. After examining certain plans carefully, it appears that those who prepared them, as well as those who approved them, failed to recognize the distinction between bonus

[4] Chester I. Barnard, *The Functions of the Executive* (Cambridge, Harvard University Press, 1938), p. 143.

plans and profit-sharing plans for executives. Indeed several well-known bonus plans, defined and defended as bonus plans, have all the characteristics of profit-sharing plans. As such they might easily be defended; as bonus plans they are illogical, and open to serious criticism. For these reasons, and in the light of sound corporate practice as well as public interest and criticism, most bonus plans should be carefully analyzed to make certain that controversial issues do not develop simply because of the failure to distinguish the many intricate phases of this problem.

Finally, it must be remembered that the reasons for the wide use of formal bonus plans may not lie so much in a carefully developed philosophy as in custom based on faulty reasoning, reinforced by pressure on directors by aggressive executives for a share of earnings when they exist. Any thoughtful observer must not forget in examining these conclusions that they do not suggest rapid or drastic changes in current methods by any one company. The discontinuance of an existing plan in a successful company raises deeper human problems—not in any sense academic—than exist when a corporation contemplates the adoption of a bonus plan.

Before concluding a discussion of these plans, the numerous informal bonus plans frequently used by different companies require consideration. These plans are seldom in writing and often become a tradition. They are generally administered by a bonus or "extra pay" committee, none of the members of which participate in such payments. They have been widely condemned because they fail to be definite, because, in the opinion of theorists, they lack a true incentive feature, and because they permit partiality to creep into the making of payments. In discussing these supposedly unorthodox plans with numerous executives, much support was found for them, often in the form of the usual reasons supporting bonus plans. From an analysis of the various arguments for and against these informal plans three points stand out rather clearly: (1) these plans appear to be more in the nature of profit sharing than the formalized plans; (2) the chief objection to such arrangements is the question of partiality in making payments, often based on inadequate knowledge of an officer's contribution; and (3) the two chief advantages are payments based on hindsight rather than foresight, and the fact that such plans can be discontinued more readily than formal bonus plans.

Any searching comparison of methods of paying executives with their corporate and social responsibilities indicates almost above question that the two not only do not correlate but are at certain points divergent. A liberal competitive cash salary payment without any consideration of an executive's estate or security after retirement is inadequate. On the other hand, plans for giving substantial payments in the form of bonuses over a period of years may tend to divert an executive from his proper objectives, establish false standards of living, create serious tax situations, and be highly demoralizing. Attempts to achieve the same results by means of options, warrants, and stock purchase schemes have similar objections, and might easily fail to furnish the security needed by executives to perform their duties properly. Unfortunately at certain times there may be little connection between the amount of compensation and an executive's contribution to corporate success. One very able executive stated that in 1929 more than at any time in his experience, when total payments to executives were at a peak, many officers were neglecting their jobs, speculating, and forgetting their corporate and social responsibilities so much that such action doubtless had some influence on the depression which followed. Since 1932, on the other hand, it is doubtful whether on the average any group of men ever served society better than executives have.

The Economic and Social Philosophy of Executive Compensation

As discussed earlier, so long as corporations were small and operated or controlled by owners, the economic and social aspects of executive payments were of minor significance. The modern aspects of these questions, however, have developed along with the increase in size and importance of corporations. Therefore, the problem, not only of paying executives properly, but of having a constant and liberal supply of able officers, is of paramount importance at all times. That able executives have failed to appear in certain areas cannot be questioned by those examining American business frankly at the present time, and their absence presents serious economic sore spots. Society requires successful corporate administration, and either this will be secured under present arrangements for developing leadership, or new methods and conditions will appear under which more acceptable types of leadership will develop

The economic and social aspects of payments as made today to executives therefore deserve careful examination. To some extent they are overlapping, making it difficult to separate them into two clearly defined groups. The following aspects are mainly economic.

(1) The primary justification for permitting executives to hold positions of great responsibility and power and to pay them liberally lies in their promotion of the true economic interests of society. These objectives are in general to furnish desirable goods and services at reasonable prices, to make profit which will compensate the owners of the business for the capital employed and the risks assumed, to provide a means of livelihood for members of the working organization at adequate rates, to perpetuate a company's existence through the maintenance of its solvency and by keeping its products and services abreast of the times, as well as to assure the necessary supply of able management. If these objectives are not furthered under present corporate setup, then it becomes difficult to justify present rewards.

(2) Since men with the necessary abilities and talents are scarce, the payments may be high and the spread in such payments wide. American corporations, particularly the large ones, are anxious to secure competent men and are well able to make substantial payments for them. Justification of executive payments therefore lies chiefly in paying the market or competitive rate for the required men.

(3) Whatever method is used in paying executives, it must not be a burden on any company or society, and it must not *per se* jeopardize payments to stockholders. Furthermore, methods should be so adjusted from time to time that they would harmonize with business conditions and current social philosophy.

(4) Financial reward must be adequate to secure able men, hold them, and remove them from economic pressures, in both the present and the future, and permit them to maintain their group standards of living.

(5) The direct and indirect effects of any plan for paying executives should not be contrary to sound economic policies. For example, payment should not be made to any executive or group of executives that would disrupt the morale of other executives and employees or affect public opinion adversely. Such a condition does not lead to corporate success.

(6) Payments should be coordinated with executive responsibilities and duties, and should not distract an executive from his proper functions. For example, plans closely related to annual earnings fail to recognize that an executive's most important job is to plan ahead, while he may be rewarded liberally for immediate profit. If avarice should be such a great incentive as some argue, then an executive's attention might be diverted from his most important tasks.

These aspects are mainly economic, but certain others have profound social significance.

(1) Executives should be rewarded so that they would be interested in general welfare problems, such as building up communities and developing them into decent places in which to live.

(2) Rewards and opportunities should foster and preserve an executive's self-respect and individual freedom of action, and stress the development of high intellectual and moral standards. They should be such as to attract executives who realize the public responsibilities of their posts. They should stress the professional rather than the speculative character of their positions.

(3) The use of any method of paying executives stressing exclusively financial incentives would highly demoralize over a period of years any group of men, however highminded they might be. Prior to 1910, executives worked for the approval of their peers and contemporaries. This underlying incentive in executive work is still powerful, though some think it was forgotten in the late 1920's.

(4) Senior officers of leading corporations should realize that the adoption of any important policy, particularly one affecting executives, may have social repercussions because corporations as well as individuals are imitative. Thus, the type of compensation plan used by one company with or without ill effects may be adopted by many other companies and lead to serious abuses and results. Since few institutions hold such exposed public positions as leading corporations, they are being constantly judged. Consequently mistaken policies or policies abused by less important companies may lead to public condemnation of all such practices and vicious attacks on similar though conservatively administered ones.

(5) Executive payments should be adjusted from time to time, so that they harmonize with business conditions, earnings, and current social philosophy. If this is not done, then in periods of distress as in 1932 and 1933 executives become objects not of sympathy and pity but of envy, a dangerous and exposed position.

Guiding Principles and Conclusions

The burden of this analysis indicates definitely that the guiding principles in any plan for paying executives should stress the demands of society from business, as well as rewarding investors and meeting the needs and satisfactions of executives. This statement suggests, in brief, that executives should be paid by corporations so that (1) they would have as few present and future financial worries as possible; (2) they should be influenced by the method of payment in a professional rather than in a speculative direction; (3) they should receive other satisfactions than simply financial ones; (4) they should have corporate standing which would foster individual freedom of action and high social, intellectual, and moral standards.

The above points must be interpreted liberally. If it is true—as frequently stated—that the pace in business for certain types of leaders (for example, sales managers) is so intense that they may be "burned out" by the time they are 55, then society must approve and corporate directors devise methods of payments which will take care of these men when their period of usefulness is over. They cannot be carelessly cast aside.

Of first importance in creating a situation in which the above proposals might thrive is a careful study of most executive jobs, the responsibilities involved, and the type of men needed to fill them. With this goes the need of a constant review of the success of subordinate executives, thus holding out constantly the chance of promotion and the assurance that no individual will be forgotten, wherever located. This does not mean frequent change for all executives—many would not want it—but it does assure opportunity for merited advancement. It would, however, remove the often expressed cynical criticism among young officers that executive promotion and payments go to those near the home office.

Finally, it must not be overlooked that the selection and compensation of men cannot be separated. The methods and amounts used in paying executives exercise a profound influence on the type of men drawn to a specific task.

The above specifications suggest that executives should receive, as financial compensation, substantial annual payments so high that they would attract the ablest men to follow an arduous executive career. The amounts paid should be set by competition, the size of the company, and social approval. Retirement pay of substantial amounts, in the form of pensions, annuities, or contracts, also would be needed to develop a feeling of security among executives. This arrangement might prove too costly—more than companies could afford unless bonus or profit-sharing payments or their equivalent were discontinued or became the company's contribution to such a fund.

The rather casual reference to retirement pay is not simply theory. Recently numerous large and small companies which have tried various bonus plans in past years have studied and adopted for their officers simple cash bonus plans with proper limitations and this proviso: one-half to be paid in cash and the other half in an annuity purchased from life insurance companies. The annuity with no strings attached becomes part of each executive's estate. Barker Bros. Corporation of California, for example, has just submitted to stockholders a somewhat similar plan for executives. The agreement is not only a pension plan but also in the nature of a profit-sharing plan (so the announcement reads), since after 1939 the corporation contributes 2½% of net profits and the participating executives 5% of their annual salaries to the trust. These plans aim at the solution of many of the fundamental problems involved in executive payments. Care, however, should be observed that abuses do not develop in them. Danger signs have already appeared in several instances.

It should also be remembered at all times that corporate success will come only through securing and retaining the proper executives, and removing others with proper safeguards. Retirement pay should permit the development of both of these policies. Doubtless at the present time change in executive personnel would occur more rapidly if proper retirement plans were available.

It is an obvious truth that business conduct at a given time must conform closely with public thinking or be harassed and seriously handicapped. Nowhere in business affairs is this more true than it is of executive payments. One reason lies in the prevalent belief that senior executives in particular have far more to do with their own salaries and bonuses than do directors or stockholders, a situation which existed in previous years when business units were much smaller. This belief may be near the center of much of the public criticism of executives and executive payments today.

Another cause of much misunderstanding is the failure of businessmen and economists to have developed a simple and understandable set of guiding principles for executive payments. Such principles doubtless, when devised and accepted, will have a pervasive influence on directors, executives, and methods of payment. Also such theorizing will either justify or fail to justify executive payments and methods used. It must be remembered that in this period of the world's history, it is difficult for executives to have and to hold substantial executive payments and power, unless they can be adequately justified.

Any study of the proper method of paying executives must consider what society and corporations demand from executives and what the rewards should be to secure the desired results. Justification of all payments must be based on sound economic and social principles. Under such a rule payments need by no means be niggardly. The contribution of the executive group can be so large that society will approve very substantial payments. However, on such a basis, with reward for the executive goes, not only responsibility, but also the requirement of adequate results.

Financial rewards are by no means the only ones leading to able executive management and corporate success. Indeed this problem of able executive management is so intimately associated with the question of executive motivation that the relationship between the two should be kept constantly in mind. Other rewards, after a certain level of payments is reached, are exceedingly potent and should be studied and used. An awareness of human desires indicates a larger problem than one of financial reward, and these phases of the question have been almost entirely neglected. Industrial society has apparently gone mad in an attempt to pay for everything with dollars, a thing which cannot satisfactorily be done.

There is no single final answer to the problem of how much to pay executives or what methods should be used; probably the nearest approach to it is an enlightened and opportunistic group of directors facing these problems honestly, directed by a set of guiding principles and a willingness to change methods and amounts as such changes appear desirable.