The ideology of executive bonuses: an historical perspective

Bert Spector
International Business and Strategy, Northeastern University, Boston, Massachusetts, USA and Organizational Behavior, INSEAD, Fontainebleau, France, and
Francis C. Spital
Entrepreneurship and Innovation, Northeastern University, Boston, Massachusetts, USA

Abstract

Purpose – This paper seeks to add historical perspective to the contemporary debate concerning the efficacy of executive bonuses. That debate has become particularly significant in the USA as a result of the recent economic collapse and the federal government's Troubled Asset Relief Program, turning the government – at least temporarily – into a shareholder of numerous companies.

Design/methodology/approach – The article is primarily an intellectual history of an idea: that executive bonuses are required to achieve top performance. The main primary source is two sets of articles from the *Harvard Business Review* from the 1930s and the 1950s. These are supplemented by other primarily and secondary material.

Findings – Arch Patton, a McKinsey Consultant and the most published author in the *Harvard Business Review* during the 1950s, constructed a defense of executive bonuses based on ideology rather than empirical evidence.

Social implications – Constituents of the current debate on executive bonuses should be aware of the degree to which statements of support for efficacy are often presented as universally and exclusively correct which may result in distortion and concealment of real interests.

Originality/value – Despite the ubiquity of executive bonuses, no study has looked at the historical roots of the debate. Agency theory, which is presented as a rational and legitimate argument in favor of such bonuses, fails to address the historical context in which bonuses actually took root in corporate America.

Keywords Agency theory, Bonuses, United States of America

Paper type Research paper

As the US economy seeks its way out of its most profound crisis since the Great Depression, the question of executive compensation has become a flashpoint topic. Emotional, often heated public and political debate has focused particularly on the matter of executive bonuses: monetary rewards layered on top of salaries designed to [...] well, designed to do what exactly?

Completing that thought is itself a matter of considerable contentiousness. Consider the many possibilities:

- Designed to align the actions of executives with the interests of shareholders?
- Designed to attract and/or retain the best talent to industries in crisis?
- Designed to incentivize behaviors that will lead not just to recovery but to sustainable economic health?

Journal of Management History
Vol. 17 No. 3, 2011
pp. 315-331

1751-1348
DOI 10.1108/17511341111141387

- Designed to allow executives to reap significant monetary rewards despite the performance that helped trigger the recession?

With the federal government acting, at least temporarily, as shareholder – not just a stakeholder – in a number of private concerns through the Troubled Asset Relief Program, that debate took on special urgency.

A broader question has been raised concerning the impact of executive bonuses on the performance of companies. Is organizational performance enhanced through the use of bonuses? If so, is that performance enhanced in the short-run at the sacrifice of longer term viability? Have the bonuses become so high as to encourage distorted behaviors on the part of recipients?

The goal of this paper is to add a dimension of historical perspective to the current debate. After all, this is not the first time the matter of executive bonuses has taken on urgency in the national discourse. Through the Great Depression, Second World War, and the early years of the Cold War, executive bonuses generated considerable attention and debate. Even earlier, notably the 1920s, some attention was paid to the matter of executive pay, although certainly not nearly as much as was paid to wages and incentives for labor. It was the decade of the 1950s, with the domination of large, complex businesses – what Sobel (1993) refers to as the age of giant corporations – that executive bonuses became solidly entrenched. With the widespread adoption of these bonuses came a series of rationales for their existence, an argument for why they needed to exist.

An advantage of historical perspective is that it allows us to appreciate the broader context in which assumptions are articulated. Discussion of the efficacy of executive bonuses occurred within a larger political-economic context. During the 1950s, the government imposed wage controls concurrent with the Korean War (1950-1953) and set unprecedentedly high marginal income tax rates. It was also a time when American businessmen joined in the Cold War consensus by proclaiming an urgent sense of threat imposed by Soviet Communism. With free enterprise itself allegedly under attack, the need to attract "the best," and to draw from them their best effort, became not just an organizational imperative but a patriotic duty. The rationale for executive bonuses, in the 1950s, combined self, organizational, and national interest. And it was articulated despite the lack of empirical evidence supporting the assumptions, sometimes even despite the acknowledgement of disconfirming evidence.

This paper does not attempt to attribute motives to those individuals – practicing businessmen, consultants, and academics – who articulated the rationale for executive bonuses. Did they, in truth, believe that America and its way of life would falter in the Cold War confrontation with the Soviet Union absent the benefit of executive bonuses? Instead of attribution, we will analyze their words, most particularly as articulated on the pages of the *Harvard Business Review*. It was, in fact, the Harvard Business School, in partnership with McKinsey & Company, which became the primary voice for the articulation of an ideology of the executive bonus.

Early approaches to executive compensation

In the 1920s, the *Harvard Business Review* launched a series of five articles focusing on the structure of wages within an industrial setting. Within elaborations of "day rates" and "piece rates" lay the suggestion that the twin objective of wages should be first to incentivize worker efficiencies, and second to ensure that the worker received wages "to which the worker is entitled, as dictated by the wage level for his class in the community in which he works." Wages should be "just and satisfactory to both employee and employer." The only extension beyond industrial labor occurred in an article focused on "salesmen," suggesting the utilization of an elaborate structure of contests and rewards to incentivize higher sales. (The articles, which were explicitly presented as a series and did not credit an author, were: "Methods in the setting of piece rates by time study" (*Harvard Business Review*, 1924b), "Methods of wage payment: a critical evaluation" (*Harvard Business Review*, 1924c), "Incentive systems of wage payments" (*Harvard Business Review*, 1924a), "Use of contests among salesmen" (*Harvard Business Review*, 1924e), and "Methods of wage payment: the day wage" (*Harvard Business Review*, 1924d). Quotes are from "Methods in setting of piece rates" (*Harvard Business Review*, 1924b, p. 373) and "Methods of wage payment" (*Harvard Business Review*, 1924c, p. 355)).

For the decade of the 1920s, the *Harvard Business Review* provided the only significant platform for management discourse. (On the early history of the *Review*, see Khurana (2007).) About 14 years after the opening of the Harvard Business School, Dean Wallace B. Donham launched the *Review* with the goal of providing business executives with the "breadth of view so urgently demanded of business administrators in this century" (quoted in Bates (1942, p. 3)). The *Review's* ambition extended beyond publishing helpful how-to articles on management techniques. From its inception, the *Review* proclaimed its purpose to create what Donham referred to as a "broad executive theory" that would allow readers to "learn effectively from the experience of others" in order to move business beyond an "unsystematic, haphazard, and for many men, a pathetic gamble" (Donham, 1922, p. 1). Harvard University President A. Lawrence Lowell expanded on Donham's desire to codify knowledge by extolling the formation of a business administration profession, one in which practitioners seek not just to "raise the level of the profession" but to "increase its usefulness to mankind" (Lowell, 1923, p. 129).

Several years earlier, executive compensation had attracted glancing attention in a book on profit sharing. Arthur Burritt, Treasurer of the A.W. Burritt Company, made an observation that referred specifically to executives:

> Probably few men employed on fixed salaries, even those occupying managerial and executive positions, are measuring up to the greatest possibilities. Most men are stimulated to this point only by the definite prospect of direct and personal gain (Burritt, 1918, p. 94)[1].

Although the primary focus of Burritt's work was on manual labor, the general sentiment was clear: fixed salaries were not enough to achieve the "greatest possibilities." Some form of "direct and personal gain" would be a required component of an effective compensation scheme. Burritt's observation was an assertion based on beliefs rather than evidence; at least, he presented no data to support it.

The earliest specific attention to executive compensation in the *Review* appeared in a survey of "Trends in personnel administration" published nine months prior to the 1929 stock market crash. The authors of "Trends in personnel administration" noted that the separation of ownership from management created special urgency for attention on executive compensation (Donald and Donald, 1929). That separation, which Berle and Means (1932) called an outgrowth of increasing organizational complexity, raised the question of alignment of interests between the two groups. Bonuses, then, were intended to align the interests of managers and owners in complex organizations (Landry, 1995).

The 1930s, the Great Depression, and controversy

What was a relatively peripheral discussion in the 1920s of executive compensation became, with the Great Depression, a much sharper and deeper concern. Highly publicized stockholder disputes about bonuses paid to executives at Bethlehem Steel, American Tobacco, and National City Bank led the Federal Trade Commission to gather and release figures on executive compensation for the first time. Thereafter, the recently created Securities and Exchange Commission kept those figures current based on the new requirement that public firms file an annual 10-K report. Although the intention of the 10-K requirement was to keep shareholders informed, reverberations were felt in the larger public (Washington, 1942; Wells, 2010). Publications such as *Time* and the *New York Times* regularly reported disclosures concerning executive pay. Fortune (1936) polled Americans in 1936 and found that 54.5 percent thought "officials of large corporations are paid too much for the work they do." Although still highly favored by executives, the depression combined with public disclosure to render bonuses toxic with the public.

The main academic voice against executive bonuses belonged to John C. Baker, a Professor and Associate Dean at the Harvard Business School. Baker used newly available SEC data plus his own survey research as the basis for a series of six articles published by the *Review* between 1936 and 1945 (Baker, 1936a, b, 1937a, b, 1939, 1945). Although Baker reported that he could find little correlation between executive salaries and corporate earnings, he mostly maintained the voice of a neutral observer. Mostly, but not entirely.

In a 1939 piece entitled "How should executives be paid?", Baker lamented both the lack of "guiding principles" in the field of executive compensation and of "definite objectives" in the creation of compensation schemes within large corporations. American Telephone and Telegraph was one of the few companies with an explicit statement of executive pay policy, and even that statement was rather general:

> 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 (AT&T pay policy quoted in Baker (1939, p. 95)).

As general as that statement may have been, Baker took particular note of the disinclination of the AT&T board to pay bonuses to their executives.

Baker took issue with what was, by the end of the 1930s, a trend among corporations to use bonuses to supplement executive wages. Baker could find no valid reason for the reliance on bonuses. He also found that half the companies that used bonuses failed to provide any rationale, even internally. He did not argue against the payment of "substantial formal salaries." Instead, he insisted that salaries – combined with factors such as "pride in the organization," "freedom of action," "title and position," "the opportunity for great public service," "stability," and even "fun" – should, in and of themselves, provide "proper" and "essential" incentive (Baker, 1939, pp. 96, 98).

Any argument that executive bonuses propelled outstanding performance or that the lack of such bonuses undermined the alignment of interests between shareholders and executives was simply unsupportable based on available data. In 1929, Baker noted, CEOs earning a salary with no bonus attached received an average compensation of $80,000. CEOs who received a bonus on top of salaries earned $196,000.

Yet, he found no relation between the use of bonuses and company performance. Baker found little reason to believe it was money well spent.

The era of big business

If the Great Depression created a context that shaped Baker's views, then it could be expected that the end of the depression would reshape that context in a way that could promote alternative views. No serious reconsideration of the structure of executive compensation occurred during the war years during which strict government controls constrained innovation. However, with the end of Second World War came a vastly changed political and economic landscape. In that context, Baker's arguments disappeared. The *Harvard Business Review* paired with a consultant from the nation's largest consulting agency to provide an unambiguous advocacy of executive bonuses.

The immediate impetus for a new advocacy of executive bonuses occurred in 1948, when William Basset, Chairman of the Board of Miller, Franklin and Basset and Member of numerous other boards including Colgate-Palmolive, approached consulting firm McKinsey and Company (Patton, 1961). McKinsey had been founded, in its modern form, in 1939 by Marvin Bowers and grew during the war to be the country's largest and most influential management consulting firm (McKenna, 2006). Basset presented McKinsey with a problem. He worried that one of the companies on whose board he served was underpaying its president, and that this underpayment was depressing the salaries of fellow executives. The result was high executive turnover. McKinsey assigned 40-year-old Consultant Arch Patton to survey securities and exchange data to confirm or refute his suspicion.

The resulting report (which endorsed Basset's concern) led Lawrence Appley, newly installed President of the American Management Association, to undertake a broader initiative. "Sensing that compensation information would be of critical importance in the years ahead," Patton recalled, Appley "committed the AMA to develop an industry-wide survey of executive compensation based on the principles established during Basset's pilot study." As a result, "people suddenly began to talk about compensation in tones louder than a hushed whisper" (Patton, 1961, p. 8). The suddenness with which attention focused on executive pay can be understood within a larger context, shaped in part by actions of the federal government and in part by public attitudes shaped in the early years of the Cold War.

Governmental context

The federal government played a major role in shaping that context through two separate but interrelated sets of policies: wage controls and taxation. Neither was intended to spur the widespread use of executive bonuses. Together, however, they served to provide a context for the advocacy of bonuses.

Wage control policies. During Second the World War, the National War Labor Board worked to alleviate labor-management disputes in an effort to avoid strikes. Wage and price controls constituted just part of the overall effort to mobilize the economy on behalf of the war effort. Wage controls ended with the armistice, but the lull was short-lived. With the outbreak of the Korean War in 1950, Congress granted the President the power "to direct, control, and coordinate" production, manpower, stabilization, procurement, and transport activities on behalf of the war effort (Roberts, 1952, pp. 149-50; for a history of wage stabilization, see Mills (1975)).

The Wage Stabilization Board operated under what was intended to be a tripartite system, with equal representation of management, organized labor, and the public. Wage and price policies were supposed to be coordinated, so that any time a ceiling was placed on prices, wages, and salaries were also to be frozen. Board Chairman George W. Taylor talked about board objectives as not just wage stabilization but also "the preservation of industrial relations stability, the preservation of collective bargaining to the fullest extent, and the fostering of maximum defense production" (Taylor quoted in Roberts (1952, p. 155)). The board and its policies ended with the conclusion of the Korean War in 1953, but by then wage controls had been in effect in eight of the previous 12 years.

Tax policies. The principle of a progressive or graduated tax on personal income became the foundational principle for federal tax system in the USA as an outgrowth of the Progressive Era (Ratner, 1942; Stanley, 1993). During the Great Depression, federal tax policies explicitly sought to achieve wealth distribution. That "Soak the Rich" approach – the term was used by both supporters and opponents of the new deal – led to high levels of opposition from the business community.

Roosevelt's "excessive taxation" was seen as a tool to tame, if not destroy, "big business" and hamper the ability of those businesses to contribute to financial recovery. At least that was a frequently expressed view in business circles (Leff, 1984). Executives often expressed the view that high tax rates were not dampening their own motivation or enthusiasm. The potential damage, instead, lay in the future when progressive income taxes would make it difficult to attract "good people for executive jobs" or "bright young men to an executive career" (Fetter and Johnson, 1952, pp. 44-5; Sanders, 1951).

That particular combination – high income tax rates and wage stabilization policies – created frustration among executives. In 1952, the *Harvard Business Review* published a survey suggesting that while hourly wages had doubled between 1939 and 1950 and the pay for supervisors and foremen had grown by 83 percent, the pay for executive (what the report referred to as "the policy-level group") dropped by 59 percent (Patton, 1951a, b).

Cold War opportunities

In 1952, two Indiana University business professors issued a study of executive compensation, *Compensation and Incentives for Industrial Executive* that noted how the Cold War made "able business leadership [. . .] more vital than ever." The "menace" of Soviet Communism attached increasing importance to effective business leadership: "In these days of tension, our citizens have worried about the preservation of the 'American Way'" (Fetter and Johnson, 1952, p. 5)[2]. McKinsey Consultant Arch Patton offered the same Cold War rationale: management effort is especially critical in a time that mobilization is required in order "to win out against Russia in the end" (Patton, 1951b, p. 35). By pitting free enterprise against Soviet communism, the Cold War offered an opportunity to turn corporate executives into patriotic warriors and executive bonuses into a weapon to defend free enterprise.

Presenting corporate executives as patriotic heroes was not a simple matter in a country where the public held strong reservations about "big business" (as opposed to small, independent business). Suspicion of the motives of big business and the men who directed large corporations ran deep throughout the country's history.

Starting in the 1880s, agrarian populism and urban progressivism explicitly attacked what was held to be a malignant concentration of power within big business (Goodwyn, 1978; Kazin, 1998; McGerr, 2003; Pollack, 1962; Thelen, 1972, 1986; Woodward, 1963). The collapse of capitalism during the Great Depression reinforced a general notion, widely shared among the American public, that "a few rich men and large corporations" wielded an unhealthy amount of power (Gallup, 1972, p. 277).

Public attitudes toward corporations improved during Second the World War. Once business engaged war production, corporations took a proactive role in enhancing their image. Executives "incessantly proclaimed their patriotism and the indispensability of their huge productive capacities," writes Merchand (1998) in his history of American public relations. Even companies still focused on consumer goods "found ways of touting their own sacrifices as they preached wartime sacrifice to the public" (Merchand, 1998, p. 320). The reputation of big business now took on a "fresh luster" as even corporate executives who had initially resisted government entreaties to direct their resources toward the war effort now worked to associate themselves with America's "can do" spirit (Boyer, 1999, p. 68).

In the immediate aftermath of war, Drucker's (1946) nexpectedly popular study of general motors, *Concept of the Corporation*, asserted that the war made the large corporation "the representative institution of American society." The emergence of an apparently robust consumer-based economy helped shape public attitudes. Fueled by pent-up consumer demand created during the Second World War, huge infusions of federal spending on Cold War defense weaponry, and federal anti-trust enforcement that ironically encouraged large-scale diversification, giant complex corporate entities emerged as the defining institution of the postwar economy (Sobel, 1993). The public, claimed Drucker (1946, pp. 3 and 6-7), embraced "the privately-owned, independently managed corporation" which "sets the standards for the way of life and the mode of living of our citizens."

There is evidence, however, that public attitudes retained at least some of the earlier populist/progressive skepticism. Pollster Elmo Roper founds that there existed a large body of public opinion "which is convinced that business is at best amoral and at worst greedy" (Roper, 1949, p. 171). Popular culture during the period reflected anxieties over the motivations and trustworthiness of business executives while simultaneously accepting the dominance of large corporations (Spector, 2008a, b).

At the very moment that corporate executives found themselves atop the country's economic hierarchy, they were expressing a high degree of insecurity. University of Georgia Professor David McCord Wright took to the pages of the *Harvard Business Review* to suggest that "during the past 50 years the trend of economic thought has been increasingly in an anti-capitalist direction." He worried that "now there is virtually no line of conduct which the businessman can follow without inviting condemnation" (Wright, 1945, p. 393). Ralph Flanders, a US Senator from Vermont, worried that capitalist competition was built on a set of values that seem to be in direct conflict with the spiritual ideals of charity and altruism" (Flanders, 1945, p. 433). And Paul Hoffman, President of Studebaker, suggested that the:

> [. . .] pressing question is not whether capitalism, with its emphasis on individual freedom and opportunity will sweep the world, but whether [. . .] we can maintain it here in our own country" (Hoffman, 1946, p. 21).

Just as the Second World War offered executives the opportunity to proclaim their patriotism, the Cold War offered executives an opportunity to associate their economic self-interest with the role of defending American free enterprise against international challengers. Within that Cold War framework, business leaders asserted their responsibility to both their business and the world (Spector, 2006). By achieving robust financial performance, American corporations could also stand as a roadblock against the spread of Communism. By supporting and encouraging free market values, by fighting the spread of seditious and anti-capitalist points of view, and by opening trade and development with underserved regions in the global marketplace, business leaders could proclaim themselves to be agents of patriotism in a way that also served their more immediate interests.

It was within this confluence of forces – years of wage constraints, high marginal income tax, the growing dominance of large, complex multibusiness corporations mixed with public suspicion of the motives of corporate executives, and a pervasive ideology that seemingly pitted corporate America against aggressive and threatening Soviet Communism – that the Cold War discussion of executive compensation occurred. Although it may have been inevitable, or at least likely, that attention would be paid to the matter of executive pay, what was not predetermined was that the discussion would morph into an unquestioned advocacy of executive bonuses. That particular path was cleared by a second confluence; this one among a consultant, his firm, and the *Harvard Business Review*.

Arch Patton, the Harvard Business Review*, and the rationale for executive bonuses*

A New Yorker who had attended Colgate and the Harvard Business School, Arch Patton leveraged his involvement in McKinsey's assignment from William Basset into a specialization in executive bonuses. Starting in 1951, McKinsey's Annual Survey of Executive Compensation appeared regularly in the *Harvard Business Review*.

The *Harvard Business Review*, a publication of the Harvard Business School filled a unique and significant position in the 1950s. That increasingly popular and influential publication linked academics and practitioners. As a fully owned and operated arm of the Harvard Business School, the *Review* attracted major management theorists from the world of academics and businesses who mingled with economists and other intellectuals with the expressed purpose of influencing the practice of management. (For an analysis of the influence of the *Harvard Business Review* in the postwar years, see Spector (2008a, b).) Within the *Review*, Patton became the most published author of the decade, appearing more often even than Peter F. Drucker[3]. The results of McKinsey's surveys spread from the *Review* to the pages of the nation's leading newspapers.

In his initial *Harvard Business Review* article, Patton called attention to the increasing popularity of executive bonuses: twice as many (40 percent of total) in 1949 as compared to 1945. CEO bonuses ranged from 54 percent of salary at smaller companies to 84 percent at larger ones. Patton made no determination of the factors on which bonuses were based: individual performance, company performance, teamwork, and so forth. Nonetheless, executive bonuses were becoming increasingly popular.

Patton went beyond description to analysis, attempting to explain why companies increasingly structured executive compensation with substantial bonuses. The main goal, he concluded, was to help companies "attract better men," noting:

> The substantial increase in the number of companies offering executive bonuses and insured retirement programs in recent years is one measure of this tendency. Another is the growing list of companies whose policy it already is to pay higher executive salaries than do their competitors in the same industry and, in some cases, even to pay higher salaries than do other industries in their vicinity (Patton, 1951a, p. 64).

Note that the argument that bonuses were required to ensure that managers acted on behalf of the interests of shareholders no longer remained the central justification for those bonuses, at least in the position advanced by Patton.

Later that same year, Harvard Business School Professor Andrew Towl relied on McKinsey's data to support his argument concerning the challenge of attracting "the most able men":

> Few needs are more acute than the need for executives; men who have demonstrated ability to adapt organizations to continued change, men who can keep individual centers of initiative operating, men who can also help give new meaning to life for individuals in our industrial society (Towl, 1951, p. 25).

His article focused on patterns of compensation within companies rather than on efforts to attract "the most able men" from the outside.

Patton's next article exposed his assumptions regarding individual initiative more clearly. "It can hardly be denied that incentives for greater effort on the part of executives would tend to increase a company's chances of success." Although other factors undoubtedly intervene, "the fact remains that *extra* inducements in monetary form – even though taxes may make them more symbols than spendable realities – can be expected to influence and increase a man's output of effort" (Patton, 1951b, p. 35). Executive bonuses, in Patton's formulation, would help produce higher performance.

Asserting "it can hardly be denied" is not, of course, the same as offering empirical evidence. In fact, Patton admitted that "it would be difficult to prove that incentive compensation of executives has been a potent catalyst of successful management." There were a number of high-performing companies for which "incentive compensation at the executive level has been unproductive." He nonetheless articulated his belief in causality. "The fact that the General Motors Corporation is the largest competitive enterprise in the world today may well derive primarily from the company's 30-odd years' experience with incentive compensation" (Patton, 1951b, p. 37). "It can hardly be denied." "May well derive primarily." Patton was not offering either description or analysis; he was acting as an advocate.

In neither this nor any of his subsequent articles published during the 1950s did Patton refer to John C. Baker and his argument against executive bonuses. Because the intended audience for *Harvard Business Review* articles was primarily practicing managers, those articles were only lightly footnoted. Patton's pieces did contain footnotes, sometimes as many as four. However, the footnotes referred exclusively either to his own writing or to the work of other authors using McKinsey's survey data. Even his 1961 book, in which Patton pulls together all of his ideas, contained not a single mention of Baker. Baker's skepticism concerning the value of executive bonuses had been replaced, not by addressing and refuting his evidence but by ignoring him entirely.

The existence of a progressive income tax remained a "nagging problem" for Patton (1953, p. 113). He lamented the loss of "intelligent, aggressive, and 'hungry' management" in postwar America (Patton, 1954, p. 67). He asserted, again without empirical evidence, that modern corporations lacked "old-fashioned initiative." Federal tax policies had replaced incentive with security (Patton, 1954, p. 68). High, virtually guaranteed levels of military and consumer spending further deteriorated entrepreneurial spirit. The:

> [. . .] aggregate result of all these trends have been a gradual atrophy in the decision-making ability of management. There has been a drying up of that priceless source of top-management training – decisions *involving personal risk* about style, pricing, product policy, plant capacity, and so forth (Patton, 1954, p. 69).

The way to overcome that trend, he insisted, was through performance-based incentives.

By the end of the decade, over half of large US companies used executive bonuses plans, and the trend was accelerating. In industries including rubber, textile, automotive, and household appliance, that figure rose to 75 percent (Smyth, 1959). Despite that popularity, the nagging problem of validity persisted, as Patton himself acknowledged. In his 1961 book, Patton (1961, p. 134) reported the results of two surveys:

> In one such study, for instance, the top managements of only one company in seven believed their bonus program was really productive. In another, more than half the companies felt that the problems created by their bonus plan outweighed its benefits.

That acknowledged lack of evidentiary support failed to dampen Patton's enthusiasm. Despite the lack of evidence of efficacy, executive bonuses were increasingly being seen through "industry's growing appreciation" of their "creative power" (Patton, 1955, p. 84).

As the new decade opened, the argument had also become embedded that executive bonuses were required to allow corporations to attract and hold "good men." Writing in the *California Management Review*, Macdonald (1960, p. 25) insisted:

> Business, then, must reward the individual manager in a way that will ensure his willingness to remain with the firm; offer incentives that will attract seasoned executives from corporate enterprise to fill voids in the managerial staff; and create an incentive environment for the younger executive that will sustain his interest toward the day he may succeed to a higher position.

The argument was twofold: executive bonuses were needed to "attract seasoned executives" and incentivize younger executives to stay and grow.

No argument captures the underlying assumptions of the executive bonus advocacy better than a stockholder statement from Du Pont in 1953. Executive bonuses, the statement insisted, were needed to attract "good men, for good men are attracted by incentives" (quoted in Pellegrin and Coates (1957, p. 74)). The tautology inherent in that statement – bonuses are necessary to attract "good men" who are defined by the fact that they are "attracted by incentives" – suggests the degree to which support for bonuses had become deeply embedded in the belief systems of Du Pont executives.

Discussion: embedding the ideology of executive bonuses

Pondering an apparent contradiction – the lack of evidence that bonuses contributed positively to organizational performance combined with executive enthusiasm for such bonuses – John C. Baker concluded that "philosophy" rather than bottom-line thinking lay at the root of such support (Baker, 1939). By the 1950s, that philosophy took on the nature of an ideology. Economists noted that, due to factors such as high taxes and wage constraints, there had been a "substantial relative decline in executive earnings during the last generation" (Roberts, 1956, p. 270). Pressure had built to redress that trend. The question remains: why, in the face of conflicting evidence concerning organizational performance, did that redress take the form of bonuses?

Ideology refers to a widely shared and internally consistent belief system. It provides a value-based lens through which adherents view, understand, and react to external events. As an ideology becomes widely and deeply entrenched in a group or society, it tends to become invisible; that is, group members mistake value-based ideological judgments for empirically based rational judgments. Ideologies justify the actions of adherents by claiming legitimacy. Ultimately, ideologies aspire to be accepted as factual (Anthony, 1977; Althusser, 1961; Bendix, 1956; Burke, 1999; Foley, 2004; Johnson, 1968; Mayer, 2001; Shrivastava, 1986; Walsby, 1946).

In discussions of policy, ideologies can assert a positive influence. By presenting guiding principles, ideology allows people to question prevailing wisdom and popular beliefs (Kinloch and Mohan, 2000). The danger occurs when proponents of an ideology seek to present their views as "universal and exclusively correct" (Kinloch and Mohan, 2000, p. 2). When proponents present subjective as objective, advocacy as observation, and self-interest as mutuality, ideology results in distortions, false consciousness, and the concealment of real interests.

The ideology of executive bonuses – the widely held and deeply shared belief (at least among those discussing and analyzing the matter of executive pay) that bonuses were a necessary component of executive pay – dominated the discourse throughout the 1950s. The skepticism of the 1930s – most notably expressed on the pages of the *Harvard Business Review* by Professor Baker – disappeared. The supportive arguments offered no evidence other than stating and restating beliefs. Regardless of that lack of empirical testing, the belief system remained powerful and influential.

In fact, contemporaneous empirical testing suggested that assumptions underlying the ideology were flawed. For example, a central argument of the ideology was that bonuses were required to attract the best men from outside the company. Evidence suggests that executive mobility during the 1950s was extremely low. "Less than 2 percent change companies in a given year," wrote economist David Roberts, "and the incidence of loss is not associated with compensation or other characteristics of the firm" (Roberts, 1956, p. 271). Roberts (1956, p. 293) concludes that:

> [. . .] there is a serious weakening of the concept of a "market for executives," and accordingly market forces can be expected to exert only a loose constraint over the firm's executive compensation.

Another central argument of the ideology was that extra incentive compensation would increase the success of a company. Roberts (1956, p. 271) also found that:

> [. . .] executive compensation is related significantly to [. . .] corporate size. Its relationship to the level of profit is superficial and disappears when the influence of size on both compensation and profit is taken into account.

Empirical research published at the same time as Patton's advocacy showed no relationship between extra compensation and the success of a company as measured by profit. Other research, though published in the year following Patton's book, again found that there was a valid relationship between sales and executive incomes, but not between profits and executive incomes (McGuire *et al.*, 1962).

What was the response of the proponents of the executive bonus ideology to these empirical results? It was the same as their response to the earlier work of John C. Baker. They were ignored.

An example of this triumph of belief over evidence may be found in other contemporaneous research that supported John C. Baker's argument that the most readily identifiable effect of bonus payments to executives was to increase their total compensation. Roscow (1953) reported in the *Harvard Business Review* that, in his study of small companies, those companies that paid incentive bonuses to their presidents ended up paying 35 percent more total compensation to them, primarily because 95 percent of those companies that paid bonuses also paid salaries equal to or more than comparable firms. Roscow could report no relationship between bonuses and profit because he did not have sufficient profit data. He did report the results of another study, with a small dataset, that showed no relationship between profit and bonuses; bonuses in fact increased whether profit increased or decreased. So, Roscow did not have sufficient data to investigate the question. The only data he could find showed no relationship. Yet, Roscow felt compelled to assert that he believed that profit must, in practice, "be recognized as a significant factor" in determining bonuses.

Over this time period, we see the dominance of ideology over relevant empirical research. That ideology rested on a number of frequently articulated assumptions, and future advocates of executive bonuses would make the same assumptions:

- Salaries were an insufficient mechanism to coax the "greatest possibilities" from executives, regardless of how well paid they were through salary.
- High levels of compensation for executives were fair given their high level of responsibility in increasingly complex and important organizations.
- High levels of executive compensation generally and bonuses particularly were required to attract and retain the "best men."

Ultimately, the assumption is that bonuses are required to achieve peak performance from both the individual executives and the corporations for which they worked.

The current context of the discussion

Since the 1970s, agency theory has applied an academic framework for understanding the tension noted decades earlier by Berle and Means (1932) created by the separation of ownership and management. Principals (i.e. investors) and agents (i.e. managers) were engaged in a constant struggle to align interests and behaviors. Asymmetries between principles and agents concerning risk, information, and goals – the so-called agency problem – could be addressed by incentives and monitors. (For a review of agency theory and its critics, see Eisenhardt (1989).) Although agency theory does not require that incentives be in the form of compensation, advocates frequently settle on incentive pay systems as a requirement of alignment.

What was largely an academic debate over the efficacy of agency theory and its advocacy of executive bonuses became, with the financial meltdown and resulting global crisis, a front-page controversy. Proponents continued to insist that bonuses were necessary to attract the best talent while doubters expressed outrage over the use of government bailout money to pay "excessive" bonuses. Even the current Editor of the *Harvard Business Review* acknowledged the "deafening outcry" that was raised over post-bailout bonuses (Ignatius, 2010, p. 12).

Warnings about the potential damage caused by executive pay generally and executive bonuses in particular had been building for several decades prior to the crash. Shortly before his death, Arch Patton himself offered a *mea culpa*. According to the *New York Times*, Patton responded with the word "guilty" when asked if his surveys had contributed to "skyrocketing" executive pay (quoted in Canedy (1996)).

In 1988, Patton declared, hopefully, that the "executive pay boom" was over. He acknowledged his own role in promoting the phenomenon and added:

> Executive compensation has soared to unprecedented heights during the last few decades. But something seems to be seriously wrong with the part money plays as a reward for executive performance. Companies that have endured for generations are breaking apart because executives earning millions of dollars a year cannot agree with their colleagues on how to earn millions more. Raiders seize control of companies to make fabulous profits for themselves, often eliminating thousands of jobs and devastating communities in the process. Senior managers are taking companies private so they can stop paying federal taxes, sell off product lines, repay some of the new operation's huge debt, and go public again in a few years to collect multi-million dollar windfalls (Patton, 1988, p. 154).

What Patton did not do, however, was question his basic assumption concerning the value of executive bonuses. The problem, he insisted, was with implementation – "management assuming that all of its executives were above-average performers" – rather than the structure.

Academics continue to investigate the relationship, if any, between CEO pay and company performance. The conclusion of two recent meta-analyses is that there is little empirical support for the assumption that more money for executives drives improved company performance (Tosi *et al.*, 2000; Dalton *et al.*, 2003). The issue frequently raised in academic studies is the implementation of bonuses rather than the underlying rationale.

Occasionally, a lone voice will question the fundamental assumptions of bonuses, as did Henry Mintzberg in a *Wall Street Journal* op-ed piece. "The problem isn't that they are poorly designed," insisted the McGill University management professor. "The problem is that they exist" (Mintzberg, 2009, p. A12). It is unlikely that this or any other single argument will be convincing.

The pro-bonus arguments – particularly that executive bonuses are needed to drive higher organizational performance – have recently been muffled by the near collapse of the global financial industry, an industry that relied heavily on bonuses. The criticisms, however, are typically focused on "excessive" bonuses; that is, the amount of the bonus rather than the idea of a bonus.

Despite pressure from the federal government to rein in those bonuses, however, there are indications of a return to pre-collapse practices (Cash, 2010). With history as a guide, we can assume that bonuses will continue to be common practice. We can also predict that we will again hear the argument that such bonuses are required to insure that executives act in the best interest of the enterprise. As we analyze the debate, and participate in it ourselves, it is useful to keep in mind that no matter the frequency and fervor with which assumptions are articulated, the question still remains: are the assumptions fact based or are they statements of a deeply felt, widely shared, yet untested ideological belief?

Notes

1. The Harvard Business School's first Dean, Edwin Francis Gay, was listed as a contributor to this book.
2. If the public truly worried that Soviet Communism posed a clear and present threat to the "American Way," it did not express that concern in the numerous Gallup polls taken in 1952. Americans worried, instead, about inflation, employment, government spending, taxes, and how to end the increasingly unpopular Korean War (Gallup, 1972).
3. Drucker's first *Harvard Business Review* article appeared in March 1950. Throughout the decade, the *Review* published five Drucker articles. In that same span, Patton articles appeared nine times. When Patton died in 1996, he had published 27 articles in the *Review*. Drucker, who lived until 2005, published over 40 times in the *Review*. From Business Source Premier search conducted January 2010.

References

Althusser, L. (1961), *For Marx*, Verson Press, London.

Anthony, P.D. (1977), *The Ideology of Work*, Tavistock Publications, London.

Baker, J.C. (1936a), "Executive compensation compared with earnings", *Harvard Business Review*, Vol. 14, Winter, pp. 213-24.

Baker, J.C. (1936b), "Executive compensation policies of small industrial companies, 1928-1936", *Harvard Business Review*, Vol. 16, Summer, pp. 466-80.

Baker, J.C. (1937a), "Compensation of executive officers of steel corporations", *Harvard Business Review*, Vol. 15, Summer, pp. 473-85.

Baker, J.C. (1937b), "Operating expenses and executive compensation policies of investment companies, 1929-1935", *Harvard Business Review*, Vol. 15, Summer, pp. 337-51.

Baker, J.C. (1939), "How should executives be paid?", *Harvard Business Review*, Vol. 18, Autumn, pp. 94-106.

Baker, J.C. (1945), "Payments to senior corporate executives", *Harvard Business Review*, Vol. 59, February, pp. 170-84.

Bates, G.E. (1942), "Twenty years", *Harvard Business Review*, Vol. 21, Autumn, pp. 1-4.

Bendix, R. (1956), *Work and Authority in Industry*, Wiley, New York, NY.

Berle, A.A. and Means, G. (1932), *The Modern Corporation and Private Property*, Macmillan, New York, NY.

Boyer, P.S. (1999), *Promises to Keep: The United States Since World War II*, 2nd ed., Houghton Mifflin, Boston, MA.

Burke, H. (1999), *Meaning and Ideology in Historical Archaeology*, Kluwer Academic, New York, NY.

Burritt, A.W. (1918), *Profit Sharing: Its Principles and Practice*, Harper, New York, NY.

Canedy, D. (1996), "Arch Patton, 88: devised first survey of top executive pay", *New York Times*, November 30.

Cash, E. (2010), "Federal report faults banks on huge bonuses", *New York Times*, July 23.

Dalton, D.R., Daily, C.M., Certo, S.T. and Roengpitya, R. (2003), "Meta-analysis of financial performance and equity: fusion or confusion?", *Academy of Management Journal*, Vol. 46, pp. 13-26.

Donald, W.J. and Donald, E.K. (1929), "Trends in personnel administration", *Harvard Business Review*, Vol. 7, January, pp. 143-5.

Donham, W.B. (1922), "Essential groundwork for a broad executive theory", *Harvard Business Review*, Vol. 1, October, pp. 1-10.

Drucker, P.F. (1946), *Concept of the Corporation*, John Day, New York, NY.

Eisenhardt, K.M. (1989), "Agency theory: an assessment and review", *Academy of Management Review*, Vol. 14, pp. 57-74.

Fetter, R.B. and Johnson, D.C. (1952), *Compensation and Incentives for Industrial Executives*, Indiana University Press, Bloomington, IN.

Flanders, R.E. (1945), "The moral dilemma of an industrialist", *Harvard Business Review*, Vol. 23, Summer, pp. 433-41.

Foley, D.K. (2004), "Rationality and ideology in economics", *Social Research*, Vol. 71, pp. 329-42.

Fortune (1936), "Fortune quarterly survey IV", *Fortune*, April, pp. 104-222.

Gallup, G. (1972), *Gallup Poll: Public Opinion, 1935-1971.Vol. II, 1949-1958*, Random House, New York, NY.

Goodwyn, L. (1978), *The Populist Moment: A Short History of the Agrarian Revolt in America*, Oxford University Press, New York, NY.

Harvard Business Review (1924a), "Incentive systems of wage payments", *Harvard Business Review*, Vol. 2, July, pp. 474-80.

Harvard Business Review (1924b), "Methods in the setting of piece rates by time study", *Harvard Business Review*, Vol. 2, April, pp. 373-6.

Harvard Business Review (1924c), "Methods of wage payment: a critical evaluation", *Harvard Business Review*, Vol. 2, April, pp. 355-61.

Harvard Business Review (1924d), "Methods of wage payment: the day wage", *Harvard Business Review*, Vol. 3, October, pp. 99-103.

Harvard Business Review (1924e), "Use of contests among salesmen", *Harvard Business Review*, Vol. 2, July, pp. 480-9.

Hoffman, P.G. (1946), "The survival of free enterprise", *Harvard Business Review*, Vol. 25, Autumn, pp. 21-7.

Ignatius, A. (2010), "Staying ahead of the game", *Harvard Business Review*, Vol. 88, May, p. 12.

Johnson, H.M. (1968), "Ideology and the social system", *International Encyclopedia of the Social Sciences*, Vol. 7, pp. 76-85.

Kazin, M. (1998), *Populist Persuasion in American History*, Cornell University Press, Ithaca, NY.

Khurana, R. (2007), *From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession*, Princeton University Press, Princeton, NJ.

Kinloch, G.C. and Mohan, R.P. (Eds) (2000), *Ideology and the Social Sciences*, Greenwood Press, Westport, CT.

Landry, J. (1995), "Corporate incentives for managers in American industry, 1900-1940", *Business and Economic History*, Vol. 24, Fall, pp. 13-17.

Leff, M.H. (1984), *Limits of Symbolic Reform: The New Deal and Taxation, 1933-1939*, Cambridge University Press, Cambridge.

Lowell, A.L. (1923), "The profession of business", *Harvard Business Review*, Vol. 1, January, pp. 129-31.

McGerr, M.M. (2003), *A Fierce Discontent: The Rise and Fall of the Progressive Movement in America*, The Free Press, New York, NY.

McGuire, J.W., Chiu, J.S.Y. and Elbing, A.O. (1962), "Executive incomes, sales and profits", *American Economic Review*, Vol. 52, pp. 753-61.

McKenna, C.D. (2006), *The World's Newest Profession: Management Consulting in the Twentieth Century*, Cambridge University Press, Cambridge.

Macdonald, J.G. (1960), "A struggle to reward good executives", *California Management Review*, Vol. 2, Spring, pp. 25-33.

Mayer, T. (2001), "The role of ideology in disagreements among economists: a quantitative analysis", *Journal of Economic Methodology*, Vol. 8, pp. 253-73.

Merchand, R. (1998), *Creating the Corporate Soul: The Rise of Public Relations and Corporate Imagery in American Big Business*, University California Press, Berkeley, CA.

Mills, D.C. (1975), *Government, Labor, and Inflation: Wage Stabilization in the United States*, University of Chicago Press, Chicago, IL.

Mintzberg, H. (2009), "No more executive bonuses!", *Wall Street Journal*, November 30, p. A17.

Patton, A. (1951a), "Current practices in executive compensation", *Harvard Business Review*, Vol. 29, January, pp. 56-64.

Patton, A. (1951b), "Incentive compensation for executives", *Harvard Business Review*, Vol. 29, September, pp. 35-46.

Patton, A. (1953), "Executive compensation: tax gimmicks vs. incentives", *Harvard Business Review*, Vol. 31, November/December, pp. 113-9.

Patton, A. (1954), "Old-fashioned initiative for modern enterprise", *Harvard Business Review*, Vol. 32, July/August, pp. 67-73.

Patton, A. (1955), "Building on the executive compensation survey", *Harvard Business Review*, Vol. 33, May/June, pp. 84-90.

Patton, A. (1961), *Men, Money, and Motivation: Executive Compensation as an Instrument of Leadership*, McGraw-Hill, New York, NY.

Patton, A. (1988), "The executive pay boom is over", *Harvard Business Review*, Vol. 66, September/October, p. 154.

Pellegrin, R.J. and Coates, C.H. (1957), "Executives and supervisors: contrasting definitions of career success", *Administrative Science Quarterly*, Vol. 2, March, pp. 506-17.

Pollack, N. (1962), *Populist Response to Industrial America*, Harvard University Press, Cambridge, MA.

Ratner, S. (1942), *American Taxation: It's History as a Social Force in Democracy*, Norton, New York, NY.

Roberts, B.C. (1952), "Wage stabilization in the United States", *Oxford Economic Papers*, Vol. 4, July, pp. 149-62.

Roberts, D.R. (1956), "A general theory of executive compensation based on statistically tested propositions", *Quarterly Journal of Economics*, Vol. 70, May, pp. 270-94.

Roper, E. (1949), "The public looks at business", *Harvard Business Review*, Vol. 27, March, pp. 165-75.

Roscow, J. (1953), "Executive compensation in small companies", *Harvard Business Review*, March, pp. 55-63.

Sanders, T.H. (1951), *Effects of Taxation on Executives*, Division of Research, Graduate School of Business Administration, Harvard University, Boston, MA.

Shrivastava, P. (1986), "Is strategic management ideological?", *Journal of Management*, Vol. 12, pp. 363-77.

Smyth, R.C. (1959), "Bonus plans for executives", *Harvard Business Review*, Vol. 37, August, pp. 66-74.

Sobel, R. (1993), *Age of Giant Corporations: A Microeconomic History of American Business, 1914-1992*, Greenwood Press, Westport, CT.

Spector, B. (2006), "The *Harvard Business Review* goes to war", *Management and Organization History*, Vol. 1, August, pp. 273-95.

Spector, B. (2008a), "'Business responsibilities in a divided world': the Cold War roots of the corporate social responsibility movement", *Enterprise and Society*, Vol. 9, June, pp. 314-36.

Spector, B. (2008b), "The man in the gray flannel suit in the executive suite: corporate movies of the 1950s", *Journal of Management History*, Vol. 14, pp. 87-104.

Stanley, R. (1993), *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913*, Oxford University Press, New York, NY.

Thelen, D.P. (1972), *New Citizenship: Origins of Progressivism in Wisconsin, 1885-1900*, University of Missouri Press, Columbia, MO.

Thelen, D.P. (1986), *Paths of Resistance: Tradition and Dignity in Industrializing Missouri*, Oxford University Press, New York, NY.

Tosi, H.L., Werner, S., Katz, J.P. and Gomez-Mejia, L.R. (2000), "How much does performance matter? A meta-analysis of CEO pay studies", *Journal of Management*, Vol. 26, pp. 301-39.

Towl, A.R. (1951), "Patterns of executive compensation", *Harvard Business Review*, Vol. 29, July, pp. 25-36.

Walsby, H. (1946), *Domain of Ideologies: A Study in the Development and Structure of Ideologies*, Social Science Association, Glasgow.

Washington, G.T. (1942), *Corporate Executives' Compensation*, Ronald Press, New York, NY.

Wells, H. (2010), "'No man can be worth $1,000,000 a year': the fight over executive compensation in 1930s America", *University of Richmond Law Review*, Vol. 44, pp. 689-769.

Woodward, C.V. (1963), *Tom Watson: Agrarian Rebel*, Oxford University Press, New York, NY.

Wright, D.M. (1945), "Business and the radical indictment", *Harvard Business Review*, Vol. 23, Summer, pp. 393-414.

Corresponding author
Bert Spector can be contacted at: b.spector@neu.edu