Is executive compensation becoming one-size-fits-all?

Although standardization in CEO pay can enhance simplicity and transparency, it can also come with trade-offs.



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CEO pay is becoming increasingly standardized in both salary levels and structures, in an

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often overlooked trend in executive compensation practices.

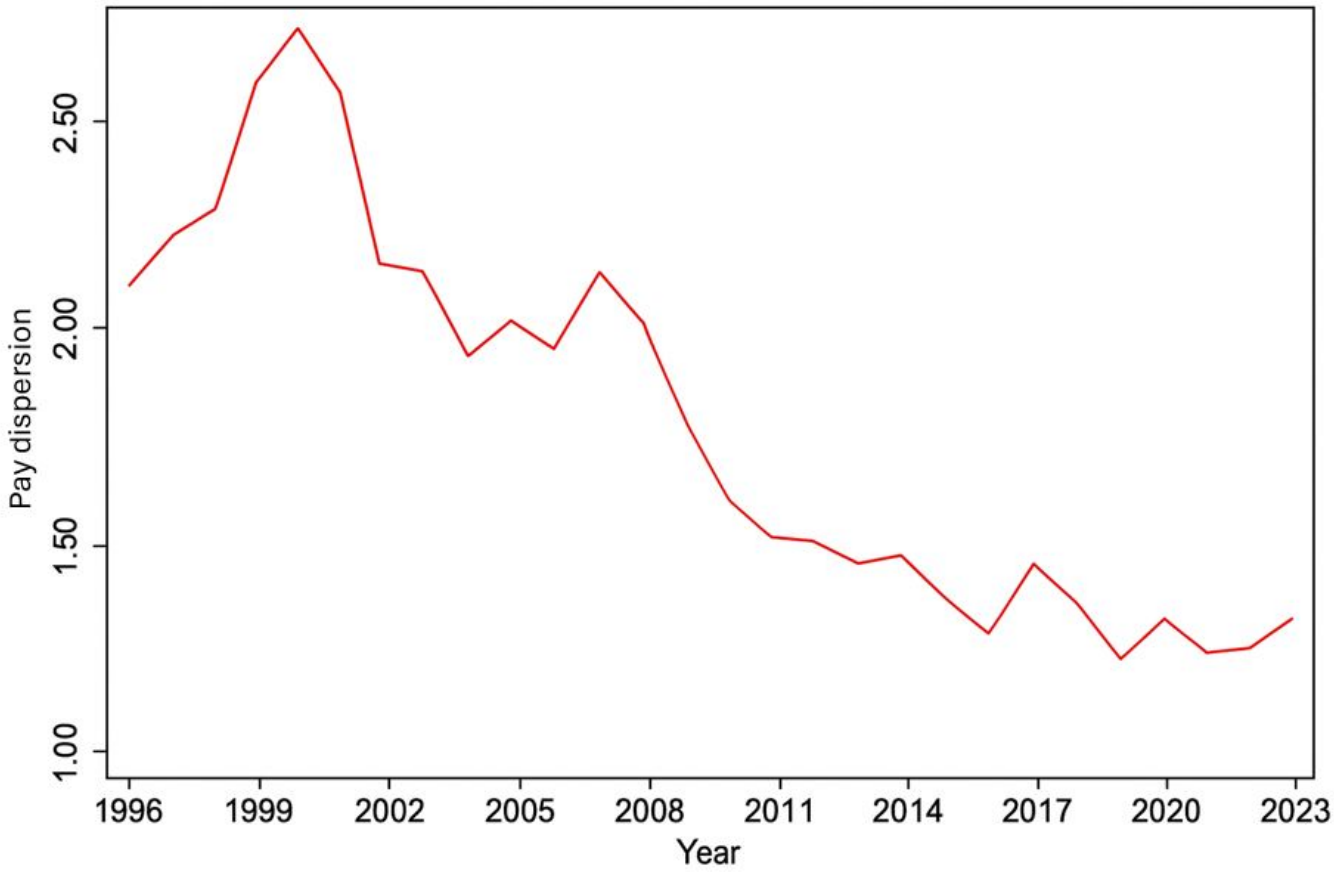
Drawing on a wide sample of U.S. firms, research shows that since 2006, 24% of the variation in CEO pay structures — spanning salaries, bonuses, stock awards and other components — has disappeared. A separate study that I coauthored finds a 40% decline in the dispersion of CEO pay levels over the past two decades. These patterns hold across industries, firm sizes and profitability levels, suggesting a widespread shift in how companies design executive pay packages.

The documented standardization of compensation practices extends beyond the amounts paid. Even the metrics used to evaluate CEO performance are becoming more homogenous, with firms increasingly relying on similar goals and benchmarks. Many companies now base their pay practices on the median compensation of their industry-size peers, creating clusters of firms that reference each other's policies.

CEO pay dispersion since 1996

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Why is CEO pay converging?

Importantly, this trend is observed in the U.S. but does not appear to extend to firms in other developed economies such as the U.K., continental Europe, Canada or Australia. The reason the trend toward uniformity in executive pay is only observable in the U.S. probably relates to several institutional developments in that country.

One significant factor is the Securities and Exchange Commission’s 2006 mandate requiring public disclosure of compensation peer groups. While this rule was intended to enhance transparency, it has also made it easier for firms to compare and emulate one another’s pay practices.

Proxy advisory firms have also played a major role, particularly after the rise of passive investing. Their influence on shareholder voting has encouraged firms to adopt standardized practices such as industry-size benchmarking. Companies that deviate from these norms often face negative voting recommendations, creating a strong incentive to conform.

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The introduction of say-on-pay votes in 2011 has further reinforced this trend. These votes have given shareholders a formal voice in approving executive compensation packages. Firms that receive weak support frequently adjust their pay structures to align with what proxy advisors and institutional investors consider acceptable. Over time, this feedback loop has entrenched standardization as the norm in U.S. executive compensation practices.

What's the impact of CEO pay uniformity?

But is this good or bad news? The answer is not trivial. On the one hand, standardization can simplify governance, enhance transparency and reduce opportunism in the design of compensation contracts. On the other hand, a one-size-fits-all approach might come with significant trade-offs. For example, the need to conform to uniform pay policies may limit firms' ability to design compensation packages tailored to their unique strategic goals and challenges. This lack of customization can weaken the alignment between CEO pay and firm performance, potentially undermining long-term shareholder value.

Although the phenomenon described above is currently centered in the United States, there are reasons to believe it could spill over into other parts of the world, particularly Europe. The globalization of business practices and the increasing interconnectedness of capital markets mean that trends in executive compensation can cross borders as firms compete for global talent and investors. Additionally, many jurisdictions are experiencing institutional changes similar to those taking place in the U.S., such as Say-on-Pay votes, enhanced disclosure requirements, increases in passive investment and growing reliance on proxy advisory firms.

Boards must navigate these dynamics carefully, balancing the pressures to adhere to standardized practices with the need for flexibility. By engaging proactively with shareholders and proxy advisors, boards can justify deviations from standard policies while preserving the discretion needed to craft compensation packages that reflect their firms' unique objectives.

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