

# CEO overpayment and underpayment: executives, governance and institutions

## Abstract

### Purpose

Based on the findings of Aguinis et al. (in press) that only a few executives are properly compensated, we examine potential causes and consequences of CEO overpayment and underpayment. Ineffective compensation of the CEO represents a governance failure by the board of directors. Better understanding the reasons for such failures may help boards to correct their processes and to enact more effective governance. Boards must look beyond the normally constrained focus of agency theory to examine executive characteristics and motivation. Thus, tailoring compensation plans and governance to the executive and organizational context requires attention to a broader set of theoretical notions.

### Design/methodology/approach

Using the Aguinis et al (in press) work, we conceptually identify and explain the causes and consequences of CEO overpayment and underpayment along with their implications for governance and future research

### Findings

We identify potential reasons for CEO overpayment and underpayment. For example, in addition to poor hiring decisions and inadequately designed compensation plans, CEO overpayment can occur because of executive hubris and greed. Alternatively, CEO underpayment may occur because of a poorly designed plan, inadequate information about the external labor market and the executive's interests in non-pecuniary benefits (e.g., socio-emotional wealth, altruism). Without proper monitoring and oversight by the board, firm performance commonly suffers.

### Originality/value

This work extends our understanding of why CEOs may be overpaid (e.g., hubris, greed) and why some executives may accept underpayment (e.g., desire for non-pecuniary benefits from SEW or altruism). We explain the consequences of ineffective corporate governance practices that allow inefficient CEO compensation. Finally, we explore several contingencies that can affect the governance practices and research needed to enhance our knowledge of this important area.

**Keywords:** CEO compensation, Governance, Institutions

Aguinis, Martin, Gomez-Mejia, O'Boyle and Joo (in press) found that very few of the highest paid CEOs were also among the group of the best performing CEOs. In fact, they found only a small number of