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The former top CEO examines the scandalous and corrupt reasons behind obscene pay packages for corporate executives and explains how this hurts all of us--and how we can stop it.
Today, the pay gap between chief executive officers of major U.S. firms and their workers is higher than ever before depending on the method of calculation, CEOs get paid between 300 and 700 times more than the average worker. Such outsized pay is a relatively recent phenomenon, but despite all the outrage, few detractors truly understand the numerous factors that have contributed to the dizzying upward spiral in CEO compensation.
Steven Clifford, a former CEO who has also served on many corporate boards, has a name for these procedures and practices "The CEO Pay Machine." *The CEO Pay Machine* is Clifford's thorough and shocking explanation of the 'machine'--how it works, how its parts interact, and how every step pushes CEO pay to higher levels. As Clifford sees it, the payment structure for CEOs begins with shared delusions that reinforce one other: Once this groupthink is accepted as corporate dogma, it becomes infinitely harder to see any decision as potentially irrational or dysfunctional. Yet, as Clifford notes, the Pay Machine has caused immeasurable harm to companies, shareholders, economic growth, and democracy itself. He uses real-life examples of the top four CEOs named the highest paid in 2011 through 2014. Clifford examines how board directors and compensation committees have directly contributed to the rising salaries and bonuses of the country's richest executives; what's more, Clifford argues, each of those companies could have paid their CEOs 90 percent less and performed just as well.
Witty and infuriating, *The CEO Pay Machine* is a thorough and incisive critique of an economic issue that affects all American workers."

The CEO Pay Machine: How It Trashes America and How to Stop It Details

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From Reader Review The CEO Pay Machine: How It Trashes America and How to Stop It for online ebook

Mike Stolfi says

Not only did I like it, but the author (a former C.E.O. who's recanted) actually provided a simple solution to the problem!

Steve says

Would have enjoyed this book more if it had less pages. Overall, though, lots of good information on how U.S. company CEOs have gamed the system since the 1980's to increase their overall compensation compared to the average worker. He also makes a good argument that excessive CEO compensation is a main contributor to income equality.

Mike says

Guaranteed to stoke outrage. An ex-CEO himself, author calls out execs, corporate boards, and the comp consultants who enable them. CEO pay has been a huge contributor to income inequality.

Comp systems are not necessary to “motivate” senior employees. They are plenty motivated and have been their whole careers. Comp should align ceo interests w/ shareholders and not be needlessly complex. The ceo always knows more than the board and will game the system. Use salary and restricted stock and call it good.

Milton Friedman helped usher in the huge ceo paydays with his philosophy that companies exist to serve shareholders, not stakeholders. Seminal work was done in 1976 by Jensen and Meckling, “Theory of the Firm” which said profit maximization was the be-all end-all.

Best acronym: PUPNUP. Peer group Used for Pay, Never Used for Performance”. Define a high-earning group of peers but don’t compare actual business results.

Boards come under the most scrutiny, as they sign off on these pay packages. Most are delusional in five specific ways:
1. Importance delusion - gives ceo inordinate amount of credit for performance of company and seems them deserving of most of the rewards.
2. Market delusion - overestimates the competitive market for ceo’s. Is anyone really trying to hire away your ceo? Then why pay them so much?
3. Motivation delusion - that huge bonuses are best/only way to motivate ceos to do their job.
4. Performance delusion - that boards can effectively measure and reward performance.
5. Alignment delusion - stock options and bonus goals are the right way to align ceos and shareholders.

His solution. Pay cap, over which a dollar-for-dollar luxury tax would be levied. Restricted stock the primary comp.

Ryan Barker says

Overall this was a solid and informative read. There were some parts where Clifford repeated himself a lot, he's overly fond of the word "opined", and some of his sarcastic asides took me out of the narrative. Other than that it was a good book.

I'd recommend it to anyone trying to understand the rise in pay disparity and the problems with the current CEO pay structure.

Ian Robertson says

A withering critique of the excessive compensation packages at American public corporations, written by a seasoned CEO and corporate board member in an accessible, insightful style, with just the right combination of personal anecdotes and academic references. When one thinks about the many $100,000,000 annual pay packages (let alone those just in the tens of millions), it’s hard not to believe there is something wrong with the system, but how did we get here, and what should be done? Steven Clifford delivers on both counts.

The book covers a lot of ground, beginning with examples of CEO pay, including how boards of directors use (very) distorted reference groups to establish base pay levels, set (very) easy performance targets, and even use their own creative accounting adjustments after year end to ensure CEOs retrospectively hit their targets. Clifford delves into the conflicted nature of compensation consultants and the way that many boards are captured by their CEOs (especially when the CEO has a long tenure or worse is both CEO and chair).

Clifford then provides some excellent and well referenced context. For example, he draws on the growing body of empirical evidence - Thomas Picketty’s Capital in the 21st Century; Joseph Stiglitz’s The Price of Inequality; work by the late Oxford economist Tony Atkinson; and inequality data from the World Bank - in linking CEO pay to both a lower performing economy and a less robust society.

Having established the issue and provided helpful context, Clifford uses the four highest paid CEOs as examples (note that he doesn’t cherry pick the most egregious pay setups (i.e. most obvious pay and performance mismatches)), and explores how each pay package works (or not!) in rewarding the respective CEOs, and aligning (or not!) the CEOs’ actions with the interests of shareholders.

Clifford then links the specific and the contextual issues, noting that he “can’t offer a comprehensive solution to income inequality, but reforming CEO pay is a good first step. This is the low hanging fruit.” He offers a bold and simple prescription to reform the system: cash for about 1/3 of a CEO’s pay, with the other 2/3 as long-term stock holdings that vest after about five years and which would be clawed back by at least 50% if the firm doesn’t meet a broad (not cherry picked) performance metric (beating the S&P500). The long-term stock ownership aspect is distinctly different than today’s stock option grants (which provide massive upside but no downside, and which can be maximized through various manipulative but legal practices). Further, long-term stock ownership aligns the interests of CEOs and shareholders, discouraging actions such as increased leverage, which can improve short-term performance but which also increase risk. It also eliminates or minimizes the need for particular board-mandated targets, which can quickly become stale-dated but nonetheless incent the CEO to pursue the target activities at the expense of other worthwhile emerging projects.

As a final measure, Clifford proposes that for every dollar above a certain threshold (e.g. $6 million), an equal penalty payment to government be required (e.g. a $7 million CEO pay package results in a $1 million penalty payment to government). A blunt but effective way to quickly ratchet down payments to a more reasonable level. “Plato recommended that a community’s highest wage should not exceed 5 times its lowest. In the late 1890s, J.P. Morgan set this ratio at 20 times the average.” Forty years ago, management guru Peter Drucker set it at 25 times, later revised down to 20 times. Today the average CEO pay is 300 - 700 times that of the average worker.”

The CEO Pay Machine should find a welcome place on the book shelves of investors (especially those who vote their proxies), regulators and those interested in how a simple agency issue - first described almost 250 years ago by Adam Smith, and explored almost 100 years ago by Adolf Berle and Gardiner Means - has morphed from a tug-of-war between management and owners over information sharing and small perks into such an egregious and self-perpetuating system that contributes to the widening gulf between ‘haves’ and ‘have-nots’.

Aaron says

The debate over excessive CEO pay is one for the ages. On one side is the free-market advocates who bless CEO pay as natural, earned, and fair. On the other side are liberals who dismiss CEO pay packages as greed run amock and an example of of our widening inequality.

The author of this book takes the side of the Liberals, but like my favorite authors he does not take his position on a moral standard. Rather, his is on a efficiency standard. The pay given out to top executives is wildy inflated and it is the result of a combination of factors (ideas from business, academia, and Government) coming together to unintentionally create the declared "CEO pay machine".

Under collective delusion and under deep insulation at the top levels of corporate culture, the pay machine is a perpetual motion device that continuously reinforces and constantly feeds back onto itself in the goal of endlessly inflating CEO pay year after year.

If your a conservative, you should want this machine to be smashed: it brazenly Rob's shareholders, distorts and destabilizes the stock market, and creates twisted business incentives. If your a liberal your already on board with destroying the machine to alleviate income inequality

Both sides should be able to work together to end this problem. It's the low laying fruit of policy goals, and the author has a situation. Besides a few minor wonky policy tweaks, the solution is terribly simple: a luxury tax on top executive compensation over 6 million dollars. For every dollar of compensation over 6 million, the company will be taxed 1 dollar.

Want to pay the CEO 145 million dollars? Fine. But that will be 139 million please. If he's worth it (most CEOs are men), they shouldn't have a problem paying it.

It's so simple..... And wickedly effective. I have total faith that it would work if put into effect.

Such a big idea.... Could never be passed by our current Congress. Perhaps in 2018 or 2020 they will be able too, or perhaps the states can take this idea and run with it.

Either way, this book is compulsory reading for anyone who cares about the subject.

5/5

Greg Strandberg says

Good book that makes you realize we need some serious changes in this country.

Cat says

Timely book. Must read by anyone wondering what's going on with our economy and employment. Well researched.

Christopher Obert says

This book explains a lot about how CEO pay got so out of control and suggests things that we can do to try and get it back under control.

Charles says

I’ve been complaining about the topic of this book for at least fifteen years. Actually, my basic complaint has been broader—that almost all CEOs are, when not actually idiots, indistinguishable in their abilities and performance from any moderately competent manager. If this is true (and it is), one necessary consequence is that high pay for CEOs is stupid. For example, when I entered business school, in 2000, I was dragooned into going to a talk by Jack Welch, then CEO of GE and regarded as a colossus. I discovered, to my chagrin, that he was a total moron. A little further research after going home quickly confirmed this impression, as contrarian as it was. And in my earlier life as a corporate lawyer I knew personally many other such, if less famous, lionized nonentities. Steven Clifford agrees, and the question he asks, and answers, is essentially “Why do big corporations pay so damn much to morons?”

I think “The CEO Pay Machine” has probably a bit too much outraged repetition of interchangeable anecdotes, and a bit too little technical exposition, but I am not a layman (in addition to my law experience, I have served on a public company board and taught business law at a major business school), so maybe Clifford’s balance makes sense. It is not easy to explain modern corporate governance simply, and it has to be simplified to make it tolerable to the layman reader. His background, as a CEO and board member himself, certainly seems to fit him to write this book, and he generally succeeds.

Clifford starts with explaining that background, as well as how, in his capacity as a member of the compensation committee of a large (private) corporation, he persuaded the board to change the multi-stranded pay offered the CEO to instead consist only of salary and restricted stock that vested over time. The rest of the book is devoted to showing why multi-strand, so-called “incentive” or “performance,” pay is stupid and pernicious, and that the correct alternative is switching to only salary and restricted stock. The author frames his discussion by noting what is well known, that American CEO pay has increased in recent decades far faster than pay for any other level of job. Often this is measured as the ratio of CEO-to-average-worker pay, which is somewhere between 300 and 700 times in America today, depending on how it’s measured, up from 26 times in 1978. The corporate governance reasons for this increase in pay are what Clifford dubs the “CEO Pay Machine.”

Before he explains the mechanics of the Pay Machine, though, he detours to make a series of claims about the negative societal effects of excessive CEO pay. The book’s subtitle is “How It Trashes America and How To Stop It”; it’s a stretch to say that CEO pay “trashes” America as a whole, and trying to show that it does sometimes makes Clifford’s reach exceed his grasp. For example, I doubt if excessive CEO pay hurts employee morale and productivity as much as he says, or reduces product quality because workers are resentful. Most workers can’t or don’t think past their next paycheck, and as Joan Williams says in “White Working Class,” usually the lowest-paid workers are much less resentful of the rich, who are perceived to have earned their money, than of the parasitical “professional managerial elite,” of which CEOs are not members. Clifford then spends a whole chapter solely on inequality, focusing on the “Mega Rich,” those whose income is in the top 0.1% (a level I am personally desperately striving to reach). Some of what he says is undoubtedly true—inequality has increased, social mobility is low, and the outsized gains accruing to those in unproductive fields such as finance harms society as a whole, both by misallocating talent and by reducing trust. But some of what he says is less true—it is not at all clear that inequality increases crime, or undermines democracy, or that supply-side economics is responsible for income stagnation. He also claims that “capitalism [by which he means the free market] is difficult to defend on the basis of morality or equity,” which the billions of people lifted in recent decades out of poverty by the free market would probably disagree with.

Clifford’s core point, though, is that most of the Mega Rich are business executives. Of course, if he focused on assets rather than income, which is much more important for inequality given that there is massive turnover from year-to-year in the top income getters and much less turnover among the top asset holders, business executives would be a vastly smaller percentage of the Mega Rich. But he’s not wrong that business executives take home a lot of the income pie. Which would be fine, for most of us, if they baked the income pie. But they don’t. It’s more like they steal it, still warm, from the window sill—and that’s the point of the rest of the book.

After this extended introduction, Clifford describes the Pay Machine. In brief, because of a combination of events, primarily the rise of third-party compensation consultants offering supposedly objective analysis and tax changes under the Clinton administration, boards began paying CEOs based on (roughly) the 75th percentile of pay to CEOs of “peer companies,” and expanding pay to multiple strands of cash, stock, stock options, bonuses, and so forth. (Another cause was clever theory from clever business school professors, who in my experience exemplify the aphorism, “Those who do, do; those who can’t, teach.”) When combined with additional disclosure mandated by the SEC, the risk-averse, consensus-driven culture of most boards (and their frequent domination by the CEO), along with that that the shareholders’ money is being used by the directors, this created an escalator effect that skyrocketed CEO pay. This effect was then further enhanced by favorable accounting and governance treatment given to stock options—and nobody had any incentive to stop it.

If this were all, the obvious conclusion is that such a grossly defective and expensive system in a free market should self-correct. Of course, American public companies, covered by an extensive web of regulation often desired by them, and often designed by them, hardly exist in a free market. But even without that web, the

Pay Machine doesn't correct itself, because of the thicket of myths, or "collective delusions," that grew up around it, each of which was totally false but served to justify this bizarre system, found only in America. Clifford identifies these as the importance delusion (the CEO actually has a significant impact on company performance); the market delusion (there is a competitive market for CEOs that justifies paying them so they won't leave); the motivation delusion (CEOs need extra pay to motivate them); the performance delusion (it's possible to measure performance accurately); and the alignment delusion (incentives other than actual stock can align stockholders' interests with CEO interests).

When I started my business career after business school, working briefly for a successful entrepreneur who owned several companies, he instructed me that the one key, critical characteristic of a successful businessman was "the ability to get things done." That sounds too simple, but he was right, as I have found out for myself. Strange as it seems, most people just can't get everything done that needs to be done. Thus, CEOs are not important—anybody who can get things done can be a great CEO, if he has a little luck, and any decent company has multiple people who meet that description. Sure, there are a few unique CEOs, Steve Jobs being the preeminent example—he "transmitted inspiring visions and authentic values to [his] employees." (Now, of course, Tim Cook has turned social justice warrior, so we can confidently predict the gradual demise of Apple, and Jobs's wife is blowing all the money he made for her on gun control and other left-wing policies that Jobs refused to fund, so Jobs is doubtless grinding his teeth in his grave.) But such CEOs are very rare, and always confined to founder CEOs whose wealth is usually consists of significant stock holdings in their own companies, not cash payments or stock options. Run-of-the-mill CEOs are nothing at all like Steve Jobs; they are much closer to the janitor in their importance.

I think the "market delusion" is also very important and rarely pointed out. It is simply not true that CEOs are often in demand by other companies, especially outside their own narrow industry. Unlike sports stars, paying CEOs with an eye to what is offered to their own CEOs by supposed "peers" who in reality have zero interest in hiring your CEO is dumb. Plus, as Clifford points out, most CEOs who are externally hired, in any industry, are either mediocre or total flops. Internal hiring is much more likely to be successful, as well as cheaper and easier. And the "alignment delusion" is also too often ignored—stock options, for example, are not at all the same thing as stock ownership, and create enormously distorted incentives.

All this is quite good. A problem, though, is that this comprises maybe half the book. The other half is taken up with endless, minute descriptions of the pay packages of the four highest paid CEOs in the years 2011-2014, including listing every single board member of the relevant boards. Yes, this is supposed to illustrate how the Pay Machine works, and it does, but really, it's excessive and boring. Also, sometimes Clifford oversimplifies. He repeatedly says that "hedge fund managers and private equity billionaires pay lower tax rates than everybody else." This is not true—they pay the same tax rates, but returns from their investments, so-called "carried interest," are taxed as capital gains. The argument is that since that is most of their actual income, it should be taxed as ordinary income. I agree with this, as it happens (as did Donald Trump, until he was captured by the vampire squid, Goldman Sachs), but in fact they don't pay lower rates, and this is not a "loophole."

But the biggest failure of the book is a failure to grasp the critical role played by lawyers in this system. It is incomprehensible to most people how bottom-feeding plaintiff's lawyers circle any public company like sharks, looking to jump on any event that can be cast as a problem, as an excuse to file a cookie-cutter lawsuit and extort money from the shareholders to benefit themselves, under the guise of benefiting the shareholders. This is the one of the main reasons compensation committees use outside consultants. They see perfectly clearly that the system is rigged to benefit CEOs, and they understand that "everybody does it" is a stupid response. But it is the only response that prevents the lawyers from seeing a possible weakness and zooming in for the kill. Paying a CEO less than other companies, if the company then does poorly, is guaranteed to get a lawsuit that may be very hard to get rid of. Any sticking out from the crowd attracts the sharks; better to stay within the herd. While Clifford mentions lawyers and lawsuits once or twice, and he must be aware of this problem, he almost totally ignores it—even though it is a big part of the explanation why excessive CEO pay problem only happens in America, with our uniquely lawyer-friendly system.

Clifford ends up where he began, recommending that all big company CEOs only be paid with a salary (1/3 of compensation) and restricted stock grants vesting over time (the other 2/3, with a clawback of the latter if corporate performance is lower than an objective benchmark, such as the S&P 500. No stock could be sold while a CEO worked for his company (up to 50% of the value could be used as collateral for loans, though Clifford does not address what happens if the value drops and a margin call is made, or discuss the need to restrict more sophisticated hedging structures that eliminate risk). Pay in general should be established mostly based on "internal equity"—that is, to be not excessive relative to the pay of others working for the company. Any pay, in any form (including perks) over $6 million would incur a dollar-for-dollar increase in corporate tax.

These are all great ideas. I wholly endorse them. Unfortunately, as with so many good ideas, the political will to implement them is lacking, and the ability of the malefactors of great wealth to manipulate the political system to their benefit appears nearly infinite, which is why the Trump administration is packed with Goldman Sachs functionaries, their allies, and their sycophants. Clifford seems to think someone like Bernie Sanders would be different, which is, um, unlikely. But when, and if, the political stars align, a book like this could be very valuable to policymakers creating a new dispensation.

Andrienne says

This is an eye-opener that everyone should read so they can start the conversation to make the change so that businesses can allot more money to research and development.

Joel says

You would not believe the idiocy of how we pay CEOs, how much we pay them, and why.
