Are Perks Really Managerial Excess?

The business press frequently reports on lavish executive compensation, particularly the many non-salary perks that CEOs and other titans of industry enjoy. Often, such perks are portrayed as wasteful corporate spending that hurts shareholders and contributes little to the bottom line. But is this interpretation warranted? In Are Perks Purely Managerial Excess? (NBER Working Paper No. 10494), authors Raghuram Rajan and Julie Wulf explore the evidence and offer an alternative explanation: corporate perks may simply be a way to enhance managerial productivity.

Rajan and Wulf define executive perks as non-monetary compensation offered to select employees of a corporation; they include non-essential items such as use of corporate jets or club memberships. Traditionally, financial economists have regarded perks as “a way for managers to misappropriate some of the surplus the firm generates,” explain the authors, referring to this as the “private benefits” explanation of executive perks. Managers can get away with such behavior because perks are often unknown to outsiders and underreported to shareholders.

In this view, perks would be especially prevalent within mature firms with low growth prospects (and thus few investment opportunities) and with substantial free cash flow (and thus less need to seek external financing from discerning investors). Perks also would be more prevalent in firms with less rigorous outside monitoring and corporate governance.

Alternatively, the authors posit that firms may benefit from offering perks more than individual managers benefit from receiving them. For example, an executive who arrives fresh and well rested on a first-class trans-Atlantic flight may be better equipped to negotiate a major deal than an executive who dealt with the hassles and cramped accommodations of flying coach. Perks could enhance worker productivity in other ways, too. Executive dining rooms keep high-level managers in the office rather than having them waste time at outside lunches; they also may foster more chance encounters and synergies between executives of different divisions.

To assess the validity of these competing views, Rajan and Wulf examine data on more than 300 publicly traded U.S. firms between 1986 and 1999, spanning a number of industries. More than 75 percent of the firms were listed in the Fortune 500 for at least one year of the survey period. The data include compensation information for top executives and several positions down in the corporate hierarchy.

Rajan and Wulf find that CEOs have access to the corporate jet in 66 percent of the firm-years, receive chauffeur services in 38 percent of total firm-years, and enjoy country club memberships in 47 percent of the firm-years. For division managers, by contrast, the figures are 30, 6, and 28 percent, respectively. The authors find that higher paying firms overall are more likely to offer perks to CEOs. Firms in the petroleum refining industry tend to offer the most perks, while computers and machinery companies offer the fewest perks. Rajan and Wulf also find that older and more hierarchical firms tend to offer more perks, consistent with the notion that perks are often inertial, and that firms may use perks to affirm status differences among employees and enhance CEO authority.

However, the authors find mixed evidence for the “private benefits” explanation for executive perks. For example, as noted earlier, perks should be greatest in firms that both generate substantial free cash flow and face few profitable investment opportunities. But Rajan and Wulf find that high-growth firms generating low cash flow are actually 11.3 percent more likely to offer CEOs use of the company plane. Similarly, 

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The Changing Path to Corporate Leadership

The executive suite at the world’s most powerful corporations has changed substantially over the past twenty years with the leaders of today’s global behemoths younger, more likely to be women, and less likely to be Ivy League educated than they were in the 1980s. Furthermore, the rise to the top is faster for today’s executives and requires holding fewer jobs along the way.

In The Path to the Top: Changes in the Attributes and Careers of Corporate Executives, 1980 to 2001 (NBER Working Paper No. 10507), authors Peter Cappelli and Monika Hamori examine career histories and personal characteristics of people at “the top ranks of the largest and most stable business operations, the Fortune 100.” The authors believe that it’s important to study the path to power at these companies, given that most of them have more assets than do many countries and can take actions that “can alter the fate of entire nations.” Furthermore, analyzing the ascension of the modern executive illuminates a long-standing American interest in the dynamics of social mobility and the individual journey to success within the corporation.

Cappelli and Hamori remark that, to a certain extent, they simply wanted to know “whether individuals with different attributes are getting to the top now.” The answer turned out to be a definitive yes. For example, in 1980, the average age of executives — high-level figures who include company presidents, chief executive officers, chief financial officers, and senior vice presidents, among others — was 56 while in 2001 it was 52. In 1980, the Fortune 100 featured no women executives, while in 2001, 11 percent were women.

In addition, Cappelli and Hamori point out that it used to be a given that the “Ivy League educated played a central role as a gatekeeper for a Fortune 100 executive career.” They report that in 1980, “a full 14 percent of top executives in the Fortune 100 companies attended one of eight Ivy League institutions for their undergraduate education” and only 32 percent attended public or state-sponsored schools. But in 2001, only 10 percent had Ivy League pedigrees while almost half — 48 percent — had attended public institutions.

Cappelli and Hamori also report substantial change in the executive as the “Organization Man,” the type who builds a career by joining a company at a young age and, over decades, secures a position of power by methodically and slowly navigating the corporate hierarchy, climbing the classic “ladder to success” one rung at a time. These authors discovered that the executives of 2001 were much less likely to have “spent their entire career at the same company” than their counterparts from 1980.

Furthermore, over the 20-year period the average tenure of executives at their current firm dropped “by almost a full five years.” Cappelli and Hamori note that executives were able to rise to the top in less time because they held “fewer jobs on their climb up the corporate ladder.” Essentially, a single promotion in 2001 brought one closer to the executive suite than it did in 1980.

In addition, Fortune 100 firms were more inclined to hire executives from outside the company in 2001, rather than focusing so heavily on promoting from within. Cappelli and Hamori believe the changes they discovered are evidence that the post-1980 period was “an important breaking point” for the corporate career model, given the fact that CEOs who chauffeur, so they can be more productive during their commutes. Similarly, CEOs who work in counties with longer median commute times are more likely to have access to chauffeur services.

“Overall,” the authors conclude, “we have found mixed support for the private benefits explanation.” Instead, they have identified “more compelling and robust evidence” supporting other explanations, especially that perks are a means to enhance executive productivity. The “narrow implication of this finding,” they assert, “is that a blanket indictment of the use of perks is unwarranted.” More broadly, they believe that examining non-monetary compensation can unearth very interesting and research-worthy aspects of business and organizational design.

— Carlos Lozada