In defence of the indefensible - Executive perks

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The case for executive perks

Is showering the boss with perks good for shareholders?

NOTHING has come to embody corporate greed like executive perks: the corporate jets, chauffeured limousines and country-club memberships that bosses consume in a seemingly deliberate attempt to outrage public opinion. Not for nothing has Warren Buffett, Omaha's celebrated investor, named his corporate jet "The Indefensible".

The usual explanation for the perk is that it is a (rather enjoyable) way for corporate insiders to misappropriate shareholders' money. Because perks are poorly disclosed, shareholders have no way of knowing when the boss is living it up at their expense. This has led to the theory that perk-laden executives are likeliest to be found in firms with lots of cash, but few investment prospects.

But in a recent paper*, Raghuram Rajan, the IMF's chief economist, and Julie Wulf, of the Wharton School, looked at how more than 300 big companies dished out perks to their executives in 1986-99. It turns out that neither cash-rich, low-growth firms nor firms with weak governance shower their executives with unusually generous perks. The authors did, however, find evidence to support two competing explanations.

First, firms in the sample with more hierarchical organisations lavished more perks on their executives than firms with flatter structures. Why? Perks are a cheap way to demonstrate status. Just as the armed forces ration medals, firms ration the distribution of conspicuous symbols of corporate status.

Second, perks are a cheap way to boost executive productivity. Firms based in places where it takes a long time to commute are more likely to give the boss a chauffeured limousine. Firms located far from large airports are likelier to lay on a corporate jet.

So there it is. The boss needs his luxury pad on Fifth Avenue and his chauffeured stretch-limo because he might otherwise do less work. Making it harder for the boss to consume conspicuously risks dangerous anarchy as, bereft of its symbols of corporate status, the firm's hierarchy collapses into a muddled heap. Perhaps, in light of these findings, Mr Buffett should call his next jet "The Indispensable".

*"Are perks purely managerial excess?," NBER working paper, 2004

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