EDITORIAL

“Executive Compensation”

With the current economic crisis and the government bailout of the financial sector, public outcry intensifies over excessive executive compensation. Public debate on the latter is ongoing. I, as guest editor for The Open Ethics Journal, invited authors to submit papers on executive compensation for review, which resulted in this special issue.

A SYNOPSIS OF ARTICLES IN THIS ISSUE

The first article, “Why is Industry Related to CEO Compensation? A Managerial Discretion Explanation,” by Sydney Finkelstein explains variations in CEO compensation across industries with an industry-level theory based on the managerial discretion concept, and the theory is tested by using a multi-level structural equation model. The results indicate that industry discretion has a significant and positive relationship with each of the following: CEO compensation level and the proportion of performance-contingent pay.

The second article, “The Effect of Missing Quarterly Earnings Benchmarks on Chief Financial Officer Turnover and Annual Bonus,” by Ella Mae Matsumura, Jae Yong Shin, and Steve Yu-Ching Wu indicates that Chief Financial Officers (CFOs) suffer penalties including forced turnover and bonus reduction due to missing quarterly earnings benchmarks. Further, the relationship between the CFO’s forced turnover and the failure to meet the consensus analyst forecast is more pronounced for better-governed firms. The authors suggest that CFOs may engage in earnings manipulation due to pressures created by penalties for missing earnings targets. They recommend that future research should examine whether the CFO is subject to pressure from the CEO to engage in earnings manipulation.

The third article, “Economic, Moral, and Motivational Criteria of Executive Compensation: Recent Developments,” by Lawrence A. Vitulano and Francis T. Hannafey, S. J. explores economic, moral, and motivational criteria based on which executive compensation decisions should be made. They recommend that an internal panel should be established to ensure the pay-performance linkage. They emphasize that compensation decisions should reflect “virtuous frugality” in bad economic times.

The fourth article titled “The Economic Crisis, Employees, and Executives: Who Wins? Who Loses?” by William J. Heisler explores the losses suffered by executives and employees from the recession, and his comparative analysis indicates that employees suffer much greater losses than executives. The author commented that executives experience to a greater extent “apparent” rather than “real” losses in a number of cases.

The fifth article, “Pay Now Lose Later: The Role of Bonuses and Non-Equity Incentives in the Financial Meltdown of 2007-2009,” by Dan Palmon, Michael A. Santoro, and Ron Strauss questions the use of cash incentives to reward executives. As these incentives are based on reported earnings and asset values that may not be realized in cash, shareholders are exposed to ongoing economic risks. The authors suggest that future empirical studies should be undertaken to examine the association between executive cash incentives and irregularities in financial statements.

The sixth article titled “How to Rein in Executive Compensation?” by Marjorie Chan examines the relationship between excessive executive compensation and various corporate governance, compensation design, and equity issues. The author discusses numerous reform efforts and regulations/legislative measures to rein in executive pay. The author suggests that similar-sized firms in each industry should come up with justifiable executive pay, and that pay components which are not linked to performance such as perquisites, nonqualified deferred compensation plans, and enhanced supplemental executive retirement plans (SERPs) should be greatly reduced or eliminated.

DIRECTIONS FOR FUTURE RESEARCH

The first article by Finkelstein indicates that CEO compensation is influenced by industry discretion, and other industry attributes may account for differences in CEO compensation across different industries. Acknowledging the inter-industry differences in executive pay, the sixth article by Chan suggests that in order to rein in executive pay, similar-sized firms in each industry should come up with a justifiable CEO to average worker pay ratio and a rational pay range for each of the major executive positions in the industry.

The second article by Matsumura, Shin, and Wu points to the need for research on the relationship between unethical activities and the pressure to meet earnings targets which are tied to compensation incentives. It would be interesting to examine the effectiveness of the Sarbanes-Oxley Act (SOX) in curbing unethical/illegal activities undertaken by top executives.

The third to the sixth articles discuss executive compensation issues in the current economic crisis. These articles, taken together, illustrate that excessive executive compensation inflicts injustice to employees, shareholders, and society. As pointed out by Vitulano and Hannafey in the third article, there must be ethical and moral justification for compensation decisions. The fourth article by Heisler illustrates the inequities between executive pay and employee pay. As suggested by Chan in the sixth article, similar-sized firms in each industry should exert effort to reduce the substantial pay disparity between the CEO and the...
average worker with a justifiable CEO to average worker pay ratio. Palmon, Santoro, and Strauss in the fifth article point to the injustice to shareholders with executive cash incentives.

The articles in this special issue suggest the furtherance of research in the following areas:

• Industry influences on executive compensation.
• The relationship between CFO compensation incentives/career concerns and the pressure experienced by the CFO to engage in unethical/illegal acts to meet or beat the earnings targets.
• The ethical and moral justification for executive compensation.
• How to reduce the substantial disparity between CEO pay and employee pay?
• The relationship between executive cash incentives and income misstatements/overstatements.
• Reform efforts on the part of each industry to rein in executive pay.
• Further regulations/legislative measures to curb executive pay.

As guest editor of this special issue of *The Open Ethics Journal*, I would like to thank all the invited authors for their valuable contributions. I firmly believe that executive compensation will remain an important subject that stimulates research, thinking, and discussion for many years to come.

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