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THE DISCLOSURE OF EXECUTIVE PAY AND LABOR RELATIONS: AN ORGANIZATIONAL JUSTICE PERSPECTIVE

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ABSTRACT

The disclosure of executive pay is examined from the organizational justice perspective. This perspective suggests that failure to anticipate union reaction to the disclosure of executive pay may adversely affect the relationship between the union and management. Unions may be less willing to ask their members to make sacrifices during times of economic hardship if no sacrifices are made by the top executives in terms of pay. This article provides some cases from the automobile industry to show how executive pay can influence relations with unions. Some suggestions are made to show how management might be able to coordinate executive pay policies with collective bargaining practices.

Unlike most compensation decisions, which tend to be secret, the pay of top corporate executives in the United States is information that is open to public scrutiny and criticism [1]. This is because federal regulations require public corporations to report the compensation of their top executives to the Securities and Exchange Commission (SEC) and disclose the amounts in their annual reports to the shareholders. While the reactions of shareholders to the disclosure of executive compensation have received considerable attention from scholars [2, 3], less is known about how this disclosure may affect the relationship between unions and management. The union, like the shareholders, is an important stakeholder, and its support may be vital to a firm's survival. By antagonizing or offending its unions, a firm may find itself in the bankruptcy courts, as Eastern Airlines and Greyhound did recently.

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This article examines executive compensation from the organizational justice perspective [4]. The organizational justice perspective provides insights into what constitutes a fair allocation of rewards. It suggests that the union expects both fair procedures (procedural justice) and fair pay allocations (distributive justice) when executive compensation is revealed. Failure to anticipate union reactions to executive pay disclosure may lead to a decreased willingness of the union to cooperate with management. These symptoms may include an unwillingness to support corporate cost-cutting efforts, increased demands for pay in labor negotiations, a greater propensity to strike, higher frequency of grievances, and intensified union political activity. However, sensitivity to the linkages between executive pay decisions and union management relations could be an important element of a firm's overall labor relations strategy.

EXECUTIVE PAY AND LABOR RELATIONS IN THE AUTOMOBILE INDUSTRY

The automobile industry provides several excellent examples of the effects that executive pay decisions can have on labor-management relations. As a result of the recession that gripped the U.S. economy during the early 1980s, General Motors (GM) expected concessions from the United Auto Workers (UAW) at the bargaining table during the 1984 round of negotiations. At the same time, the company granted substantial bonuses and salary increases to a number of its top executives. In response, UAW officials labeled the company's actions "obscene" and "outrageous" [5]. The 1984 round of negotiations proved to be quite difficult, in part because of the incongruence between GM's treatment of its executives and its expectations of the auto workers.

It appears that GM leadership did not learn the lesson from the early 1980s that executive compensation decisions can affect the tenor of labor-management relations. In 1990, GM changed the pension formula for its executives. As a result of this action, outgoing Chief Executive Officer Roger Smith received a substantial pension increase. At about the same time, the company wanted to press the union for cost sharing on the employees' health insurance program, and intended to resist the union's attempts to increase the pensions received by retired employees. The company's decision to enhance its executive pension program did no go unnoticed by UAW's leadership. In response to the company's action, union president Owen Bieber commented that "in light of GM's largesse to its executives, there will be no excuse for the corporation to be less than fully responsive to the needs of our older members and retirees" [6].

Executive pay decisions do not have to be an obstacle to labor-management relations and the collective bargaining process. When Lee Iacocca assumed the leadership of Chrysler Corporation, one of his early decisions was to decrease his salary to $1.00 per year. He understood the significance of the compensation decisions from a labor-management relations perspective. In his autobiography,

Iacocca wrote that he did not take the $1.00 a year to be a martyr. "I took it because I had to go into the pits. I took it so that when I went to Doug Fraser, the union president, I could look him in the eye and say: Here's what I want from you as your share; and he couldn't come back to me and ask: You SOB, what sacrifice have you made?" [7, p. 229].

Iacocca believed that the union's willingness to cooperate with him in the restructuring of Chrysler operations was strongly influenced by his decision to cut his pay. He labeled this phenomenon the "equality of sacrifice." On this point, Iacocca wrote, "There was plenty of screaming over some of the plant closings. But the union understood very well that we had to take drastic measures. They were able to accept these actions because they knew we were asking for equivalent concessions from our suppliers, our executives, and our banks" [7, p. 234].

Historically, the connections between executive compensation practices and labor-management relations have not been given much consideration. Little interest was expressed in executive pay due to lack of information about the subject. Additionally, unions and their members were participating in an expanding economy. As a result, a situation was created in which most participants were receiving acceptable rewards for their contributions to the organization. As long as workers had secure jobs and their wages increased over time, workers and their unions expressed little concern about executive pay practices. However, this stable situation changed. During the 1980s, factors such as a prolonged recession and intensified foreign competition challenged the job security and economic well-being of a substantial portion of the workforce. Rather than negotiating wage increases, unions had to work hard just to minimize their members' losses. Within this context, reports about lavish executive pay practices began to surface. In the 1980s, it was difficult to ignore the fact that decisions concerning executive pay practices were influencing union-management relations.

In the sections to follow, the organizational justice perspective will be used to develop an understanding of the relationship between executive pay practices and the quality of labor-management relations. Next, some management implications are developed. By viewing the union as a stakeholder, union reactions to disclosures of executive compensation can be planned and managed so that both the pay allocations as well as the practices that lead up to the decisions are deemed to be fair. Before the organizational justice perspective is introduced, the structure of executive pay packages will be examined.

THE EXECUTIVE PAY PACKAGE

The executive pay package consists of 1) salary; 2) benefits; 3) pay incentives; 4) perquisites (perks); and 5) provisions for severance pay. Each of these five components of the pay package may elicit different responses from the union when they are disclosed.

The executive salary is the most visible part of the pay package. The magnitude of the executive salary can easily be compared as a ratio to the salary of union members. If this ratio, or differential, becomes excessively large compared to historical pay relationships, union members may perceive that pay has been unfairly distributed. In the United States, the ratio of the top executive's pay to the lowest pay level in a company can exceed 100 to one in large corporations, whereas this ratio in Japan is closer to ten to one [8]. In most cases, top executives in the United States were paid higher salaries than their counterparts in Europe or Pacific rim countries.

The executive benefits consist of programs designed to provide financial and health security for the executive. While benefit programs are often provided as group membership rewards that are allocated in a nondiscriminatory way to all full-time employees, it is not unusual for executives to receive a "special" benefit package designed for them as a special interest group. For example, qualified retirement programs have a cap on the amount of income an employee and an employer may set aside in order to receive tax exemption on the deferred income. Since executives have larger amounts of discretionary income to invest and set aside than company-sponsored retirement programs allow, it is common practice to design special retirement programs for executives. Since these programs place few restrictions on the dollar amounts of cash set aside for the executive's retirement (which is the practice of programs designed for the rank and file employees), it is possible to allocate larger amounts of compensation (as a percentage of base salary) as an employer contribution to fund an executive's retirement. In other words, the size of the company's contribution to the executive's retirement plan may be perceived as inequitable compared to the size of the employer's contribution to the rank and file employee's retirement plan.

The "perks" that executives receive are special privileges they enjoy that reinforce their status as top leaders and elite employees. Perks can include unlimited expense accounts, country club memberships, fancy offices and furnishings, use of company jets, limousine service, executive dining facilities, special parking locations, and so on. Some of the perks are no doubt necessary for the executive to perform the job, but many of these perks (such as executive dining rooms, executive jets, and fancy offices) are simply designed to cater to the executive's ego, and can be dysfunctional to the labor relations climate. Many of the perks isolate the executives from other employees (making it possible to avoid eating with employees, parking near them, traveling on business trips with them, etc.), so that executives are perceived as an elite special interest group. While a few firms that value egalitarianism provide no special perks for executives, it is quite surprising how many firms provide a package of perks that is designed to pamper their every wish.

Executives receive pay incentives as another component of their compensation. The pay incentives are designed to reward the executive for meeting strategic business objectives such as profitability, growth, market share, or an increase in

value of company stock. In many cases, however, the executive pay incentives are totally decoupled from company performance [9]. Executives have been known to receive large bonuses during a year when the company lost money and employees either took pay cuts or had their salaries frozen. The executives may have been justified in accepting these bonuses, but the perception from the union standpoint is one of inequity and unfairness. In another automobile industry example, General Motors executives received large profit-sharing bonuses in the same year that the union employees' profit-sharing plan produced a negligible bonus for union members [10]. The reason for this was that the executives' and employees' profit-sharing plans had a different basis for rewards.

One of the most controversial executive pay practices has been the use of golden parachutes, a form of severance pay for executives. The golden parachute goes into effect after a triggering event such as a hostile takeover takes place [11]. The golden parachute provides the executive with cash that represents three to five years of earnings in a lump sum that can equal millions of dollars. The logic behind this generous severance pay settlement is that executives will be less likely to fight an attractive takeover bid to protect their jobs if they are able to use their golden parachutes. However, the same firms that offer golden parachutes to executives are likely to make deep cuts in the workforce after the restructuring of the merged corporation. It is not unusual for the outplaced employees to receive only a few weeks' severance pay, which would be perceived as unfair compared to the generosity lavished on the top executives.

ORGANIZATIONAL JUSTICE AND EXECUTIVE PAY DECISIONS

The organizational justice literature provides some insights into the linkages between executive pay decisions and labor-management relations. The organizational justice literature suggests that executive compensation decisions can influence perceptions of both distributive and procedural justice. Distributive justice is concerned with the perceived fairness of the allocations or distributions that are made within an organization. When making distributive decisions, two major allocation rules can be used. When outcomes are distributed based on *equity* principles, rewards are determined by the individual's contributions (such as performance) to the organization. Allocation decisions based on *equality* considerations require that rewards be distributed equally among individuals. An example would be a seniority-based pay policy. While other distribution rules such as need could be used [12], it has been argued that equity and equality are utilized most often [13].

Procedural justice is concerned with the fairness of the process used to make resource allocation decisions. It is argued that when expectations concerning the fairness of procedures and the outcomes determined by these procedures are violated, moral outrage is a likely result. In the context of the present discussion,

when executive compensation decisions are considered unjust, the union and its members will probably experience moral outrage. Moral outrage is characterized by emotions such as anger and resentment.

Executive compensation decisions can lead to perceptions of injustice if the union and its members believe that the resulting distributions are unfair. Whether a particular distribution is deemed unfair is a function of the distributive allocation rule that is used. In the context of executive compensation decisions, the equity norm is likely to be adopted. The fact that executives receive high salaries and extensive benefit packages reflects the belief that they contribute more to the organization than others. As a result of basing decisions on one's contribution to the organization, rewards received by participants in the organization will vary. An equity-based approach assumes that individuals are unwilling to make the sacrifices associated with high contribution levels (long hours and grueling schedules) unless they believe that they will receive high levels of outcomes [12].

Equity based allocation rules are not anathema to labor organizations. Under the typical union contract, skilled workers earn more than unskilled workers, and senior employees have more rights than junior employees. This suggests that when unions react negatively to executive pay decisions and allow labor-management relations to be strained as a result, it is not the equity-based allocation rule per se.

It is reasonable to assume that unions and their members expect executives to earn more than other members of the organization. This is the case in every round of negotiations that takes place, and the labor-management relations are not adversely affected. As mentioned above, the magnitude of the difference between executive pay and worker pay has increased dramatically in recent years. *Business Week* provided support for the notion that executive compensation has become disproportional both to that received by others and relative to the performance of their firms. While executive compensation increased by 212 percent during the 1980s, factory worker compensation increased by only 53 percent, and average earnings per share of Standard & Poor's 500 company stock grew by only 78 percent [14]. Executives, because of their positions of power within the organization, are able to utilize the equity principle so that their self-interests are enhanced. They can become so powerful as a result of compensation practices such as stock options, that they can increase their returns even at times when their contributions to the organization are not as great as they had been in the past. Therefore, it might not be the unequal distribution of returns that rankles unions and their members. It could be the disproportionate distributions that occur when powerful executives utilize the equity principle to advance their positions relative to others in the organization.

It is also possible for the linkages between executive pay decisions and the nature of the labor-management relationship to be influenced by the incompatibility between the distributive allocation rules used when making executive pay decisions, and the rules deemed appropriate by unions and their members.

While it is quite likely that the equity principle guides executive pay decisions, it is possible that unions believe that the equality principle should guide at least some decisions. For example, when GM was losing market share and, as a result, was facing tough economic times, the equality rule would suggest that everyone experience cutbacks. When management negotiators went into bargaining demanding concessions by the union, use of an equality standard made it reasonable for the union to expect cutbacks on the part of management. When executives received bonuses or retirement enhancements instead of the economic burdens of the times, the equality principle was violated and feelings of injustice resulted.

It is not only inequities with regard to money issues that can strain labor-management relations. Growth in the use of golden parachutes, perks and other elements of the typical executive compensation package can lead to feelings of injustice. It is assumed that tough economic times undermine job security and necessitate cutbacks in operations. The equality principle dictates that the burden of economic hardships be shared by all in the organization. Feelings of injustice are a likely response when employees are terminated with little or no regard, while executives have their "fall" cushioned by golden parachutes.

Similarly, injustice is likely to result when employees are expected to cut back in what they already have and, as a result, endure some hardships, while perks of executives (such as first class air travel) remain unaffected by the market conditions in which the organization finds itself. While executive perks may be justified by use of an equity-based allocation rule (executives are still working hard for their money), it is difficult to justify the perks during times of economic hardship if an equality-based allocation rule is employed. It should be noted that if the executives are viewed as being responsible for the adverse conditions facing the union's membership, referent cognitions theory suggests that resentment in the form of hard feelings towards the responsible party can be the result [15]. This resentment could interfere with effective labor-management relations.

Deutsch suggested that when fostering or maintaining good relationships is important, equality will be the dominant allocation rule [12]. The Chrysler example presented earlier, in which Lee Iacocca took a cut in pay, comports with the use of the equality principle when making executive compensation decisions. It appears that Iacocca knew that he needed the cooperation of the union and its members if he was going to be able to reestablish the firm's competitive position. He used an "equality of sacrifice" approach to help secure the union's cooperation.

Cropanzano and Folger argued that the response to distributive injustice, whether constructive or destructive, will be a function of the perceived fairness of the procedures that led to the injustice [16]. If the procedures are considered fair, constructive reactions to the injustice can be anticipated. However, if the procedures are considered unfair, destructive responses are likely to occur. In the context of labor-management relations, if executive pay practices are considered

unfair, the destructive reactions such as anger, resentment, and distrust are likely to interfere with effective labor-management relations [16].

Leventhal suggested that, to be fair, procedures should be consistent across different groups and should take everyone's interests into consideration [17]. Procedures also need to be free from bias, and must be based on accurate information. Also, to be deemed just, procedures must allow for mistakes to be rectified. When compensation decisions reflect vastly different treatment for union members and corporate executives, it is unlikely that the procedures leading to the outcomes will be considered fair. Part of the problem is that the processes used to make executive pay decisions are not well understood. It is possible that if the distributions are considered unfair, in the absence of other information it will be assumed that they must be the product of unjust procedures. Additionally, executive compensation decisions that allow executive pay decisions to be disrespectful of market conditions can be considered arbitrary, especially when compared with the results of a collective bargaining process that commonly reflects market considerations.

Even when both executive pay and worker pay are linked to firm performance, evidence indicates that executive pay plans are less volatile than those in which rank-and-file workers participate. For example, in a year in which corporate profits fell by 13 percent, GM chief executive officer Roger Smith experienced a decrease in his annual bonus of seven percent, to $1.4 million dollars. In that same year, profit sharing paid to hourly and salaried employees decreased by 81 percent. It is interesting to note that since that time, the UAW has negotiated an improved profit sharing plan with General Motors [18].

It is possible that, in a period of shrinking resources, executive pay decisions that enhance the position of a few while economic pressures threaten the well-being and security of the many will be considered unjust, regardless of how they are made. The objective reality of the situation is probably not a major consideration. Executives could argue that it is more demanding to run a company in tough economic times than when the economy is strong. As a result, the equity principle demands that rich rewards are needed to compensate them for their hardships. Or, they could contend that golden parachutes are needed to discourage hostile takeovers that could jeopardize everyone's security. Even if these claims are true, there is likely to be some skepticism if the resulting distributions are seen as being excessively disproportionate with the experiences of others within the organization. In response to the distributive injustice (unfair distributions as a result of unfair procedures), collective action is likely to be observed [16].

IMPLICATIONS

Notions of fair treatment can be established through comparisons with the experiences of others. When the economy is strong and unions and their members do well at the bargaining table, comparisons with executive pay packages are less

likely to lead to feelings of injustice. However, when workers are asked to sacrifice during tough economic times and executive compensation practices reveal no parallel sacrifices, feelings of injustice are likely to ensue. Given that the union does not have a role to play in executive pay decisions, it cannot directly work to reestablish equitable conditions. For example, the union cannot negotiate for fairer executive compensation policies and outcomes because it has no voice in the executive compensation process. However, the union can try to reestablish equities by negotiating improvements in wages, benefits, and security for its members. By doing so, a more just allocation of resources can be achieved.

Perceptions of inequity and the associated feelings of anger, frustration, and resentment are motivators of behavior. When outcomes or procedures are deemed unfair, individuals will react. Similarly, unions will react if they believe executive pay decisions are unjust relative to the experiences of their members. It is reasonable to expect that some union reactions will influence the labor-management relationship and the collective bargaining process. In response to injustice, unions are likely to bargain harder to restore equitable conditions. They might be more resistant to concessions needed to maintain corporate profitability. It may be more difficult for management negotiators to argue "inability to pay" in response to union pressures for improved wages and benefits when corporate executives have lavish compensation packages. It is also difficult for management negotiators to resist job security provisions such as guaranteed employment when top-level executives have golden parachutes.

For these reasons, it appears necessary to coordinate executive pay policies with collective bargaining practices. Despite the fact that distributive decisions based on equity allocation rules can justify lavish compensation packages for top-level executives, such policies can interfere with effective labor-management relations if they are viewed as being unjust. As was the case when Lee Iacocca shared in the hardships being experienced by the Chrysler workers by drastically reducing his pay, executive pay decisions are probably linked in the minds of workers with their own experiences, despite the tremendous differences in the circumstances faced by executives and the other members of the work force. The Iacocca pay cut example points out that coordinating executive compensation practices with the organization's collective bargaining strategy can yield favorable results. As reflected in the GM examples earlier, failure to do so can adversely affect the collective bargaining relationship.

The inability to see linkages between executive compensation decisions and the collective bargaining process is, to a degree, a function of how each set of pay determinations is made within the typical organization. Executive pay decisions are likely to be made by a compensation committee composed of members of the board of directors. Collective bargaining has traditionally been viewed as a middle management function [19]. Given the different loci of decision making, it is not surprising that executive pay decisions that are incompatible with harmonious labor-management relations can be made.

To increase the likelihood that executive pay decisions will reinforce compensation decisions made elsewhere in the organization, such as through the collective bargaining process, two basic approaches are available. One approach is to simply encourage members of the board of directors that their charge to maximize the economic value of their shareholder's investments can be facilitated by considering the effects of their executive pay decisions on other members of the organization [20]. Directors must be made to recognize that their decisions are not made in a vacuum, and that other aspects of the organization such as labor-management relations can suffer if they make decisions that contribute to perceptions of inequity.

It must be emphasized that executive pay decisions do not have ramifications only for unionized workers. Middle managers and non-union employees also notice when top-level executives do not share in the adversity being experienced elsewhere in the organization. It is important that the symbolic nature of executive compensation decisions be recognized for its symbolic value. It is unlikely that limitations on executive pay will save the truly foundering corporation. However, it is possible that such restraint will have positive effects throughout the organization. The *Wall Street Journal* quoted Ward Smith, chairman and chief executive officer of Naaco Industries, who said, "If a chief executive recognizes that his organization is in terrible trouble, he's got to share in the distress . . . I'd sure as hell rather do it and assume there'll be a trickle down benefit than not do it and have people say, 'he's getting paid as if nothing's wrong.' " [18, p. B1].

A second approach that can be taken to better integrate executive compensation with other organizational human resources management decision-making practices is to include, for example, the vice president of labor relations as a member of the executive compensation committee. Such a person could provide expertise to the committee and reflect upon the potential reactions of the union membership to the executive pay package. The vice president of labor relations, in the role of boundary spanner, may be able to provide input to the executive pay decision that links it more closely to the labor relations climate. Thus, the committee would be more likely to design an executive pay package that is perceived as fair by the union.

Approaches such as the two just outlined are likely to decrease the possibility that executive pay decisions will strain labor-management relations and interfere with the smooth functioning of the collective bargaining process. However, greater sensitivity to the problem by the executive pay committee does not totally alleviate the concerns that emerge when executive compensation practices are incompatible with those found elsewhere in the organization. The ultimate solution lies in the development of pay-for-performance plans that truly link executive compensation to firm performance in ways that are deemed equitable throughout the organization. When executives make good decisions and the performance of the firm improves, there is likely to be little resentment among the work force when top-level officials receive generous bonus checks. However, the

pay-for-performance plans must be structured so that poor corporate performance hits the executives in the pocketbooks at about the same time workers feel the pinch of economic tough times. Pay-for-performance practices that allow workers and executives to share the fruits of good performance as well as sharing the hardships of bad times will help ensure that the workers' needs for just distributions as well as just procedures will be met.

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