Cash Distributions to Shareholders (2004-2013) and Corporate Executive Pay (2006-2012)

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STOCK BUYBACKS AND EXECUTIVE PAY
RESEARCH UPDATE #1
August 2014

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The information contained in this document updates data relevant to the analysis in:

- **William Lazonick, "Profits Without Prosperity," *Harvard Business Review*, September 2014.**
  http://hbr.org/2014/09/profits-without-prosperity/ar/1

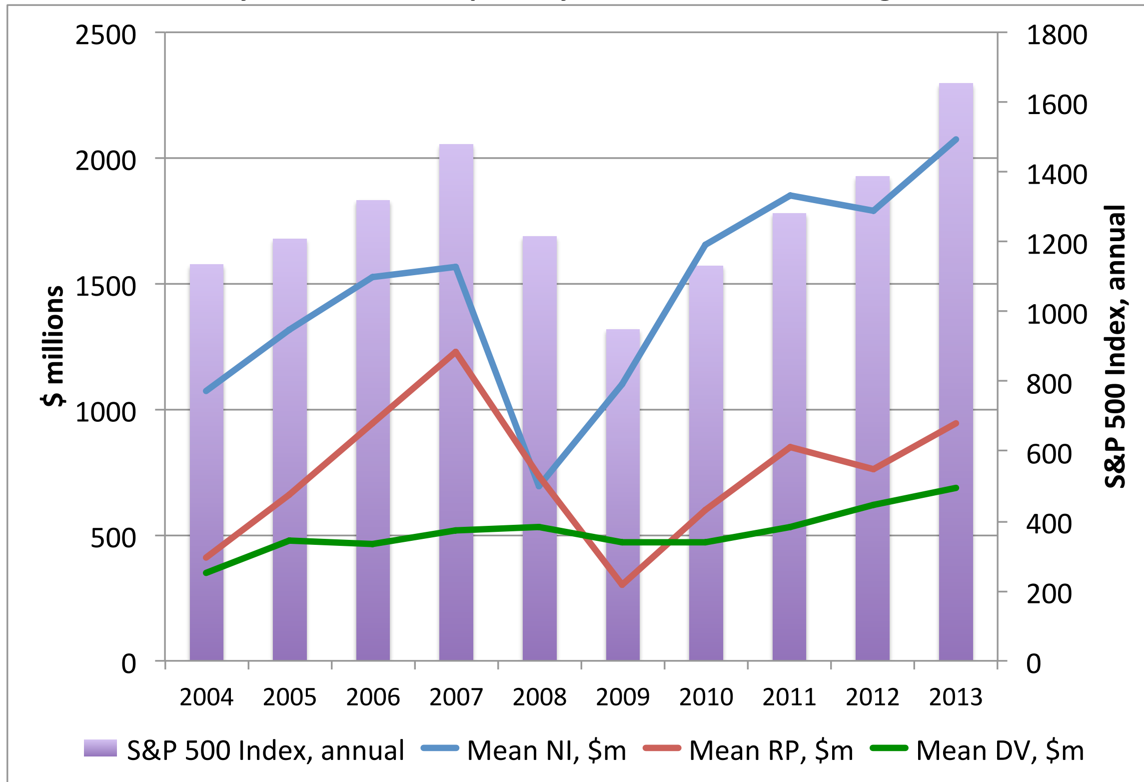
Further evidence and analysis can be found in:

- **William Lazonick, "Taking Stock: Why Executive Pay Results in an Unstable and Inequitable Economy," Roosevelt Institute White Paper, June 5, 2014.**
  http://www.theairnet.org/v3/backbone/uploads/2014/08/Lazonick_Executive_Pay_White_Paper_Roosevelt_Institute.pdf

- **William Lazonick, "Labor in the Twenty-First Century: The Top 0.1% and the Disappearing Middle Class," AIR Working Paper 2014-08/01.**
  http://www.theairnet.org/v3/backbone/uploads/2014/08/Lazonick_LaborInTheTwenty-FirstCentury_AIR-WP14.0801.pdf

Please visit http://www.theairnet.org/v3/
for more research and related information.

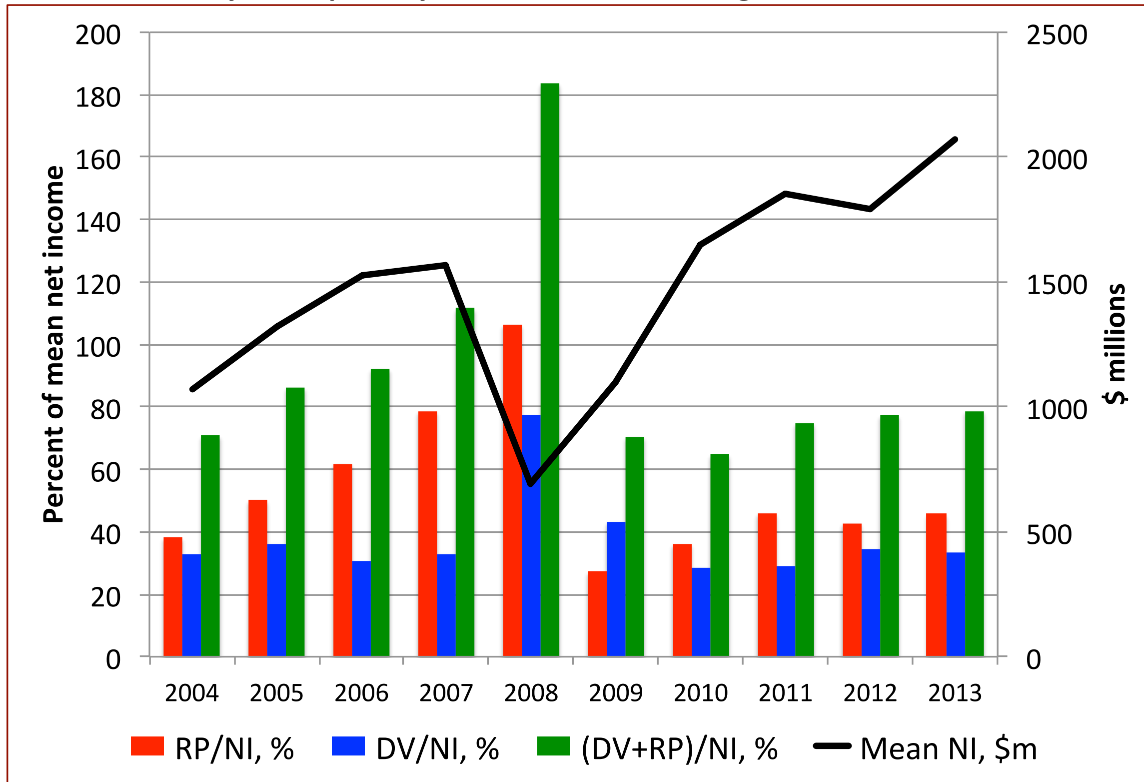
Figure 1. Mean net income (NI), mean stock repurchases (RP), and mean cash dividends (DV), 2004-2013, for 454 companies in the S&P 500 Index in January 2014 that were publicly listed from 2004 through 2013



Source: Standard and Poor's Compustat database, corrected from company 10-K filings by Mustafa Erdem Sakinç, The Academic-Industry Research Network.

- These 454 companies account for more than 70% of the market capitalization of all corporations in the United States. In 2012 these corporations had a combined $9.6 trillion in revenues and employed 24 million people worldwide.
- In 2004-2013, these 454 companies expended $3.4 trillion on buybacks (51% of net income) and another $2.3 trillion on dividends (35% of net income).
- From 2004 to 2007, with profits rising and the stock market booming, these companies tripled the value of their buybacks from, on average, $408 million to $1.231 billion. In the financial crisis of 2008-09 buybacks plunged, although in 2009 they were still $299 million per company. Since then, with corporate profits soaring to record levels, buybacks have been generally on the rise (there was a small dip in 2012, mirroring a dip in profits), and in 2013 averaged $945 million per company.
- Meanwhile, through boom and bust, dividends were stable, and on the rise from 2010. In 2004 mean dividends were $349 million; in 2013 double that amount at $685 million.
- In aggregate, these companies' buybacks were generally much larger than dividends, the traditional mode of giving shareholders a yield on their stock-market investments. Companies have tended to do buybacks when stock prices are high, contradicting the oft-heard claim from corporate executives that their companies do buybacks when the stock market undervalues their shares.

Figure 2. Mean stock repurchases (RP) and mean cash dividends (DV) as percent of net income (NI), 2004-2013, for 454 companies in the S&P 500 Index in January 2014, publicly listed from 2004 through 2013



Source: Standard and Poor's Compustat database, corrected from company 10-K filings by Mustafa Erdem Sakinç, The Academic-Industry Research Network.

- Figure 2 translates the absolute dollar data in Figure 1 into ratios of buybacks and divdends to net income – or what are generally called payout ratios.
- For the decade 2004-2013, the buyback payout ratio ranged from 27% in 2009 to 108% in 2008, while the dividend payout ratio ranged from 29% in 2010 and 2011 to 77% in 2008.
- When profits plunge, payout ratios may soar, as was the case in 2008, unless distributions to shareholders are cut substantially.
- Soaring profits in recent years dampened the increase in payout ratios, even though, as seen in Figure 1, both buybacks and dividends rose markedly.
- Much of the corporate profits retained (14% of net income over the decade) were not available for investment in productive capabilities in the United States because, through a corporate tax loophole that dates back to 1960, the U.S. government encourages U.S. corporations to make profits abroad and keep them there. In 2013, holdings of cumulated earnings abroad by S&P 500 conpanies were $1.9 trillion, with about one-third of that amount in cash. As a result, cash-rich companies often borrow to do buybacks and pay dividends in the United States.

Table 1. Top 25 stock repurchasers, 2004-2013, with percentages of net income (NI) spent on repurchases (RP) and dividends (DV)

Buyback rank	Company Name	RP/NI %	DV/NI %	(DV+RP)/ NI %
1	EXXON MOBIL	60	23	84
2	IBM	92	21	113
3	MICROSOFT	71	48	119
4	CISCO SYSTEMS	103	8	110
5	PROCTER & GAMBLE	71	47	118
6	HEWLETT-PACKARD	148	20	168
7	WAL-MART STORES	45	28	73
8	PFIZER	67	70	137
9	INTEL	70	37	107
10	GENERAL ELECTRIC	35	54	89
11	GOLDMAN SACHS GROUP	65	16	81
12	SBC COMMUNICATION	45	78	123
13	HOME DEPOT	99	35	134
14	ORACLE CORP	62	10	72
15	CHEVRON CORP	21	28	49
16	AMGEN	100	8	108
17	CONOCOPHILLIPS	48	34	83
18	TIME WARNER	230	50	280
19	DISNEY (WALT)	83	17	100
20	JPMORGAN CHASE	26	34	60
21	BANK OF AMERICA	36	63	100
22	JOHNSON & JOHNSON	29	46	75
23	PEPSICO	56	45	101
24	UNITEDHEALTH GROUP	73	7	81
25	DIRECTV GROUP	192	0	192

Source: Standard and Poor's Compustat database, corrected from company 10-K filings by Mustafa Erdem Sakinç, The Academic-Industry Research Network.

- For 15 of the companies in Table 1, distributions to shareholders over the decade 2004-2013 were 100% or more of net income. The combined payout ratios for petroleum-refining and financial companies were (with the exception of Bank of America) under 100%, despite huge payouts, because their profits were so high.
- The top 25 repurchasers were in a wide range of industries, including eight in information-and-communication technology, three in pharmaceutical drugs, and three in petroluem refining.
- Lazonick's papers, cited above, contain analyses of the damage that buybacks do to the U.S. economy, with examples drawn from different industries and different companies.

Table 2. Mean total direct compensation of the 500 highest-paid executives named in U.S. corporate proxy statements, and the components of total direct compensation, 2006-2012

		Percentage shares of components of total direct compensation						
	Mean Total Direct Comp. $m.	Salary	Bonus	Non-Equity Incentive Plan	All Other Comp.	Deferred Earnings	Realized Stock Option Gains	Realized Stock Award Gains
2006	**27.4**	3.3	7.0	7.6	5.9	0.5	58.9	16.8
2007	**30.0**	3.0	4.1	6.9	7.6	0.1	58.8	19.6
2008	**22.9**	4.1	4.2	8.7	4.1	0.1	43.9	34.9
2009	**14.4**	7.0	4.8	14.9	7.4	0.1	39.9	25.9
2010	**18.5**	5.5	4.8	15.0	6.2	0.1	40.3	28.1
2011	**19.4**	5.5	3.8	12.3	4.3	0.2	40.9	33.0
2012	**30.3**	3.6	2.7	8.2	3.2	0.1	41.5	40.7

Source: Standard and Poor's ExecuComp database, with calculations by Matt Hopkins, The Academic-Industry Research Network

- In 2012, mean total direct compensation of the 500 highest paid executives named on company proxy statements was $30.3 million, more than 600 times the pay of a worker with annual earnings of $50,000.
- By far the largest components of executive pay were realized gains from stock-based pay in the forms of stock-option grants and stock awards. In 2012 the combined gains from exercising stock options and from the vesting of stock awards totaled 82.2% of the total compensation of the 500 highest-paid executives.
- In recent years, along with stock-option grants, stock awards, typically with quarterly earnings per share targets, have become popular as a form of executive pay.
- Executive compensation is set by the company's board of directors, whose dominant members, alongside the company's own CEO, are CEOs of other companies. On the board, there is a community of interest in raising top-executive pay levels.
- For recommended pay packages, companies employ compensation consultants to benchmark the pay of other companies' CEOs. Consultants typically rate "their" CEOs at around the 75th percentile in terms of performance, and therefore top executive pay ratchets up over time.
- Given the importance of stock-based pay in compensation packages, a booming stock market boosts exeutive pay. Companies can use open-market repurchases to give manipulative support to rising stock prices, or to try to prevent their fall.
- But even when a company's stock price falls, U.S. style stock based pay can enable executives to gain. In a stock-market downturn, the board stuffs even more stock options and stock awards into top-executive pay packages to make sure that senior executives will be amply incentivized to do whatever is necessary to boost the company's stock price back up. And to engineer this stock-price manipulation, they can turn to massive stock buybacks

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BUT, AS RESEARCH AT theAIRnet SHOWS,
THE LETHAL COMBO OF STOCK-BASED PAY AND STOCK BUYBACKS
IS A PRIME SOURCE OF INSTABILITY AND INEQUITY IN THE U.S. ECONOMY.