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Public and Private Firm Compensation Compared: Evidence from Japanese Tax Returns

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ABSTRACT

Most studies of executive compensation focus on publicly traded companies. The high levels of compensation ~~there~~ in public companies are often attributed to agency slack ~~due to~~arising from ownership by diffused shareholders. If so, pay at private companies, more closely held, should be ~~much~~ lower. Governments in the United States and elsewhere do not require ~~the pay of executives in~~ private companies to disclose the pay of their executives ~~to be publicly disclosed~~, but until 2004 the tax office of Japan published the name and tax liability of any individual paying over ~~about~~ some $100,000 in tax. We match this tax data with executive rosters of some 1,400 ~~presidents of~~ public and 4,100 ~~presidents of~~ private corporations. We find that public and private company presidents have similar incomes. ~~Both groups earn i~~Incomes ~~that~~ rise with ~~the~~ company size and profitability ~~of the firm~~in both, but ~~the presidents'~~ incomes are more sensitive to profitability at public firms ~~than at private ones~~. In Japan, at least, public firms pay their presidents no more than private firms do, and they tie that compensation more closely to observable performance benchmarks, not less.

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Using individual-level tax liability data from Japan, we compare compensation patterns at privately and publicly held firms. To date, most scholars of executive compensation have used regulatory filing data on American firms~~ available from regulatory filings~~, data ~~most conveniently obtained through ExecuComp,~~ that as Cadman, Klasa, and Matsunaga (2006) ~~describes~~describe is usually obtained through the ExecuComp database. Scholars have had access to this information because publicly traded U.S. corporations must disclose executive compensation data along with their financial accounting records. ~~Crucially~~Unfortunately for studying agency slack, however, privately held firms need not disclose what they pay their executives.

Compensation practices at privately held firms matter to what we think about governance at publicly held firms. Some observers suggest that public firms pay their executives ~~inappropriately large amounts~~too much. Often, they explain the phenomenon ~~through~~ as a collective action ~~problems~~ problem among ~~their~~ widely dispersed shareholders. Owners of private firms should face fewer such problems. If collective action problems drive compensation at public firms~~ (~~ and ~~if~~ prevent salaries from equalizing across the public-company and private-company markets for executives~~ in the two populations do not equilibrate)~~, then compensation ~~patterns~~ at private firms should differ significantly from public firms in level~~.~~. and contract design.

To explore this issue, we use ~~individual-level~~ Japanese income tax data on individual taxpayers. Japanese securities law does not require either public or private firms to disclose ~~what they pay their~~ ~~executives~~executive pay. Until recently, however, the tax office published the names, addresses, and tax liabilities of everyone owing more than 10 million yen in taxes (the high-income taxpayer list, or "HIT list" as we ~~will~~ shall call it). We found personal and company information for ~~locate~~ the approximately 1,600 company presidents ~~among them~~on the list, and on ~~add personal and company information on~~ 3,900 presidents not on ~~this~~ the list whose tax bills we know (since they do not appear) must be less than 10 million yen.[1]

~~Of course, t~~The fact that Japanese public firms pay their executives less than U.S. public firms (as measured in Nakazato, Ramseyer & Rasmusen, 2006) plausibly suggests that Japanese~~ public~~ firms do not suffer collective action problems as severe as those ~~that~~ critics attribute to U.S. firms. As a result, one might reasonably prefer a comparison of U.S. private and public firm compensation practice. Given its infeasibility, however, we offer the Japanese contrast as a potentially instructive ~~if less-than-ideal~~ substitute.

Our focus on taxable income rather than~~ firm~~ corporate compensation brings both benefits and costs. On the one hand, the information on total income allows us to study ~~the way~~how an executive's aggregate financial welfare varies with company performance. His salary alone would not disclose this information. On the other hand, with only income we cannot directly learn how highly the company values a president's labor services or how much he is extracting from the company.

Nevertheless, ~~although~~ though we do not have labor income broken out separately, we do know which executives are most likely to have substantial investment income. We place an executive in this category (a "Capitalist" ~~rather than~~as opposed to

[1] Some Japanese firms cross-list on American exchanges. Cross-listed foreign firms do have to disclose some financial numbers to the SEC, but ~~nothing about~~not executive pay.