Compensation Peer Groups and the Relation with CEO Compensation

We examine whether firms are biased in their selection of compensation peer firms and test the influence of any bias on CEO pay. Using a sample of 608 firms from the S&P 1500 and 2,154 peer firms identified from their 2006 proxy statements, we do not find consistent evidence that firms choose peer groups in a biased manner. Rather, when defining potential peers as those with some relation to the sample firm, firms select peers that have more similar economic characteristics and compensation levels. In addition, firms often select peers that are from the same industry and with an interlocking relation (firms that have selected the sample firm as its peer). When examining the influence of peer group selection on compensation levels, we find some, but not consistent, evidence of a positive relation between compensation and peer groups with greater assets and growth opportunities, that have more interlocking relations with the sample firm, and that have greater unexplained pay. Overall, we do not find strong evidence that firms select peers with bias or that biased selection leads to increased CEO pay.