Jerry Davis on Economic Inequality and Business Organizations

***Jerry Davis* is the Wilbur K. Pierpont Collegiate Professor of Management at the Ross School of Business and Professor of Sociology, The University of Michigan. He spoke with BEIF about economic inequality and business.**

BEIF: *Prof. Davis, thank you for joining us. What, do you think, is the effect of economic inequality on business?*

Davis: Economic inequality is going to take place in society one way or another, and it is going to create tensions in society. Some authors have argued that the history of humanity is the history of inequality-based struggles and you also see this in organizations. Ambient inequality in society creates pressures within organizations for *relative* equality. That seems paradoxical because it is very easy to highlight inequality within organizations. But, the amount of allowable inequality within a particular organization is pretty compressed compared to the level of allowable inequality in society more broadly. Consider that almost everyone in the US knows what the CEO of their organization makes, and there are labour organizations that have a very convenient online calculator that allows you to calculate how many years you have to work to make what the CEO makes. You can see what the ratio is between the CEO's pay and a company's individual workers (e.g., http://www.payscale.com/data-packages/ceo-income). So, on the one hand that is inequality, but on the other hand it is creating a system of accountability and legitimacy because the pay numbers are available for everyone to see. This keeps things relatively compressed, at least compared to what it would be otherwise.

Recently there was an article in the New York Times publishing the compensation of the top hedge fund managers. And the top four hedge fund managers all made more than 1 billion dollars each. I went to look up one of them, David Tepper, who has the business school named after him at Carnegie Mellon. Last year he made 2.2 billion dollars. It's just inconceivable that any CEO of any American corporation could make that much money. I mean, that's more than what a hundred CEOs make, or two or three hundred CEOs make. The reason is that he runs a hedge fund with a small number of people. So, within that hedge fund, compensation levels might be relatively equal, it's just at a stratospheric level. In short, inequality in society creates pressures within organizations for having an explainable level of inequality, but organizations also have much less inequality compared to the society at large and they operate in a more accountable fashion.

BEIF: *How can organizations reduce economic inequality in the society? In the first place, should they try to reduce it? And second, how can they do that?*

Davis: I think it would be a desirable thing, because the various social pathologies of inequality are so well-documented. The causality is a little bit tricky to figure out, but name a social pathology -- rates of homicide, infant mortality, mental illness, drug use, incarceration -- and it is associated with inequality. So, it is desirable for organizations to take care of their internal levels of inequality. However, I don't think they can have a very big effect on inequality at the broader society level. Social inequality is about the configuration of institutions at the economy-wide level. If you want greater equality, as in Denmark, you can't just eat soft cheese and drink schnapps at lunch like the Danes do. It takes an entire configuration of institutions to produce the level of inequality that you get. In Denmark, an American level of inequality is almost inconceivable because of the combined force of institutions around education, social welfare, and the regulation of business activity. Conversely, it's really hard to think what would you do to get the US to become more like Denmark. So, I think it's more about the configuration of institutions at the societal level, more than what any individual organization can do.

BEIF: *As a management researcher, if a CEO were to say "I'm very interested in doing something about inequality", what would you advise them to do?*

Davis: Within their own organizations, they can certainly limit their own salary (and there are businesses that do that), and convey we're all in this together. Whole Foods has a constraint that executives can't make more than 19 times the average hourly wage in the organization. That is certainly something that you could do. As a business professor, having seen the way that our kind think, my natural response is to consider what would happen if you passed a law that said CEOs can't make more than 20 times the average worker. What you'll see immediately is companies setting up subsidiaries, or subcontracting all the low-wage work so that only highly paid people work within a company. You'll get perverse responses unfortunately. If what you really want is a quality workplace where people feel valued, then you might do it voluntarily and not try any shenanigans. But that's going to end up being something that the founders of the business and the people at the top would have to do. It might work for that organization, but I'm not sure it's going to have a big effect on the broader levels of societal inequality because you'll see the David Tepper's of the world go off and start their own three person company.

BEIF: *Thank you, Jerry, for taking the time to talk to us.*