

The discussion revolves around the rise of Relative Performance Evaluation (RPE) in CEO compensation structures over the past decade and a half. RPE ties a CEO's pay to how their firm performs relative to similar companies rather than in absolute terms. This video approach allows firms to filter out random economic shocks, providing a clearer assessment of a CEO's effectiveness.

A notable consequence of RPE is that it incentivizes CEOs to focus on the performance of their peers. They may engage in strategies that involve leaking negative information about competitor firms to improve their own relative standing, potentially increasing their compensation, even if this means disclosing harmful information about peers rather than lying or disseminating misinformation. The evidence suggests that firms are carefully sharing genuine negative insights to manage stock prices effectively, enhancing overall market efficiency.

Moreover, companies in RPE peer groups tend to become more proactive in sharing their own negative information to control narratives and mitigate risk from potential leaks by others. The speaker also poses questions about potential retaliation strategies from firms targeted by RPE peers, suggesting that firms may need to manage the risks posed by their peers more effectively.

From a regulatory perspective, the findings indicate that while there may be some ethical concerns, there don't appear to be significant grounds for intervention since firms generally operate within existing regulations and disclosing negative information can enhance information efficiency in the markets.

Lastly, the speaker critiques the common practice of structuring RPE as rank order tournaments, which can cause severe incentive distortions, creating complacency among some performance levels or excessive risk-taking among others. Alternatives like simpler linear compensation models could provide more consistent incentives and better align CEO actions with shareholder interests without fostering the negative behaviors associated with tournament structures.