America's CEO Pay May Soon Face Squeeze

New Laws, a Change in Congress, and Investor Pressure Intensify the Scrutiny on Compensation.

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Mark Trumbull
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The pay packages of America's CEOs still include enormous stock options, rich pensions, and other perks of a Learjet lifestyle. But pressure from investors and regulators is exerting some new restraint on controversial compensation practices.

The changes so far can't be called a revolution. Yet after years in which top executives have faced mounting criticism for their lavish pay, new rules and scrutiny may be tempering the trend.

The signs include:

• Post-Enron laws have made corporate boards less likely to rubber-stamp recommendations of managers. On top of this, many boards are trying to tie pay more closely to company performance.

• Democrats, concerned about rising inequality of incomes in the US, may support more legislation to curb executive pay as they take control of Congress later this week. At the very least, committee hearings will become a platform for critics.

• Investors are stepping up to oppose compensation packages that can eat up 10 percent or more of company profits. Wednesday, Home Depot chief executive officer Robert Nardelli resigned after months of criticism for his high salary and the poor performance of the company's stock price.

• New federal mandates require large companies to disclose the total compensation of high-paid executives more straightforwardly in their annual reports.

"The good thing about this is it's going to force boards to sit down and carefully justify things that they are doing," says David Larcker, a compensation expert at Stanford University in California. "Executive compensation has always been controversial, and I think it's even more controversial now."

Indeed, critics say executive pay remains out of control. And even defenders of the current system say excesses need to be fixed.

A case in point may be the "golden parachute" offered to Mr. Nardelli. His exit fee: $210 million. That's what he will be paid to stop running the company.

Total executive compensation, meanwhile, remains at near record levels after growing at epic rates in the stock market boom of the late 1990s. In the early '90s, the pay of the top five executives at large US companies consumed, on average, 5 percent of the profits those

companies earned. During the years 2000-02, those executives took home 12.8 percent of company profits, a figure that has since edged down a bit, according to research by Lucian Bebchuk of Harvard University and Yaniv Grinstsein of Cornell University.

Critics fall into two camps, which overlap somewhat. Some say executive pay has simply gotten too large, period. It is a major factor behind the widening inequality that could at some point threaten the nation's social stability by fanning populist resentment of wealth, these critics say.

In another camp are investors who say the fundamental challenge is not the sheer size of a CEO paycheck, but the terms of the deal. More care is needed to make sure executives only reap big rewards when the company has succeeded.

"The CEO still has too much control over who sits on the board," says Nell Minow, of the The Corporate Library, a watchdog group based in Portland, Maine. "If you're picking the people who set your pay, ... then you shouldn't be too surprised when they overpay."

She says pay has not yet been effectively linked to incentives for enough executives. Recent rules set just before the Christmas holiday by the US Securities and Exchange Commission promise to help ordinary people understand what the top five executives at large companies are earning.

Some last minute SEC changes to the methodology stirred controversy, but the rules still represent a step toward greater transparency.

That's a useful step, experts say, because executive pay has become such a complex tangle of stock options, perks, and bonuses that it's hard for investors to judge one company against another.

Ms. Minow says another key step must follow: giving shareholders greater leverage to replace a company's board of directors if it mishandles its responsibility for setting executive pay.

US leads industrialized world in CEO pay

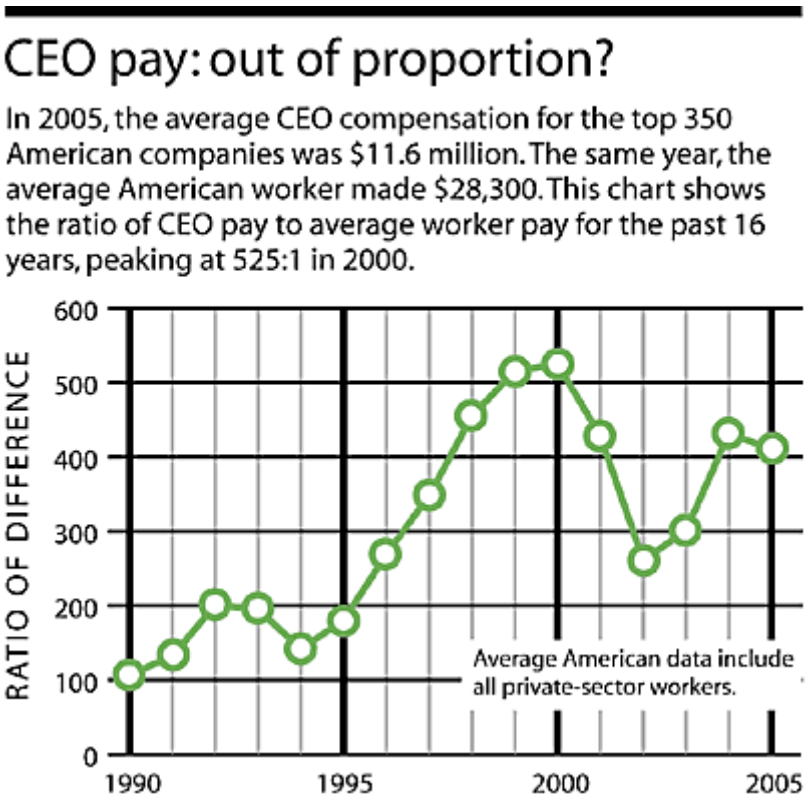
The ratio of executive compensation to employee pay in the US is 37 times larger than the same comparison in Japan. Here's a breakdown of the CEO pay disparity for several major economies.

	RATIO
United States	411
Mexico	61
Brazil	60
China	36
Britain	32
Canada	23
France	23
South Korea	23
Germany	20
Japan	11

To some extent, however, companies have already been moving to tie executive pay more closely to company performance. One sign of the times, according to Mercer Human Resource Consulting in Washington, D.C.: Companies are replacing traditional stock options - which executives can cash in after a few years - with rewards linked to hitting specific targets of earnings or stock price.

"I think these new disclosure rules ... will continue the trend," says Mark Borges, a Mercer principal who has also worked at the SEC.

But Wayne Guay, a compensation expert at the University of Pennsylvania's Wharton School, says the new disclosure rules haven't gone far enough. They emphasize transparency of pay, but not of the terms of the incentives.



"There are no tables that tell you, for a given change in earnings or stock price, how much the CEO would gain or lose" in pay, he says.

The puzzle, Dr. Guay says, is how to promote the growth of companies - and the economy - without giving CEOs perverse incentives to cook the books.

He warns against labeling the system as hopelessly broken. But "it's certainly feasible," he says, "that the incentives are ... too large for some of these individuals."

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