Can CEO Pay Be Brought Down to Earth?

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Ellen Simon
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Will Robert Nardelli and Henry A. McKinnell do for executive pay what Enron Corp. did for corporate governance?

Just as Enron Corp.'s meltdown led to tougher corporate governance regulations, the eye-popping packages those executives received when they exited CEO jobs at Home Depot and Pfizer have caused everyone from President Bush to professional compensation consultants to suggest runaway pay needs to be reined in.

The topic is shaping up to be the No. 1 issue at this year's annual meetings of public companies.

Investor activists are buzzing about potential solutions, including shareholder advisory votes on executive pay packages and the end to provisions that give executives huge windfalls when companies are sold. And a handful of companies have shown a new willingness to talk to advocates about pay changes.

"There's a sort of silver lining to the whole Nardelli, Home Depot thing," said Chicago-based compensation consultant Donald Delves. "At least the shareholders finally spoke up."

Nardelli left Home Depot Inc. in January after months of shareholder complaints about his pay and the lagging performance of the company's stock versus home improvement competitor Lowe's Cos. And McKinnell's exit from Pfizer Inc. in July came 19 months earlier than expected in part due to growing shareholder anger about what had been disclosed about his lucrative retirement package.

But the true shock came when the details later emerged about just how large their severance deals were: Nardelli's was valued at about $210 million and McKinnell's came to almost $200 million, according to company filings with the Securities and Exchange Commission.

The packages were enough to warrant attention from Bush, who said in a speech on Wall Street last month that corporate board members must step up to their responsibilities. "You need to pay attention to the executive compensation packages that you approve," he said.

Rep. Barney Frank, D-Mass., chairman of the House Financial Services Committee, is expected to introduce legislation on the issue. Frank said in a January speech at the National Press Club that high CEO pay is "not just a matter of envy. It has reached a point where it has some macroeconomic significance."

Frank pointed to research done by Harvard professor Lucian Bebchuk showing that compensation of the top five officers at the country's public companies between 1993 and 2002 totaled about $250 billion - nearly 10 percent of aggregate profits. CEO pay grew by a median 11.29 percent in 2005, according to The Corporate Library, which tracks governance, compensation and performance.

Bebchuk, co-author of the book "Pay Without Performance: The Unfulfilled Promise of Executive Compensation," has become a frequently-cited source for information in proxy pay proposals. He's also started filing proposals himself on director pay at companies including Walt Disney Co. and Northrop Grumman Corp.

The American Federation of State, County and Municipal Employees has submitted "say on pay" proposals, asking for a nonbinding yes-or-no shareholder vote on pay packages at companies including Citigroup Inc., Wachovia Corp., Ingersoll-Rand Co., Merrill Lynch & Co. and Countrywide Financial Corp.

"I think it's a rare board that's going to ignore its owners," said Timothy Smith, director of socially responsive investment at Walden Asset Management, which manages about $1.5 billion.

About 10 companies, including Pfizer, Intel Corp., Bristol-Myers Squibb Co., Schering-Plough Corp., American International Group Inc., JPMorgan Chase & Co. and Colgate-Palmolive have formed a working group with AFSCME and Walden to discuss shareholder approval of pay packages. They met Friday at the offices of TIAA-CREF, which manages $406 billion.

Such a system, used in the United Kingdom, would not give shareholders a vote on pay. But it would allow them to bring nonbinding confidence or no-confidence vote on reported executive pay, letting shareholders either ratify or say no to the pay package an executive has already received.

"Only a handful" of pay packages in the UK have not been approved by shareholders, said Jeffrey N. Gordon, a law professor at Columbia University at a Thursday presentation to the New York Society of Security Analysts. One package that wasn't approved was from GlaxoSmithKline PLC, where shareholders were particularly upset about a "golden parachute" package for the CEO.

"In response to shareholder pressure, it was cut by two-thirds," Gordon said.

Other solutions are coming from companies themselves. While Ben & Jerry's is the best known example of a company where executive pay is a multiple of employee pay, DuPont Co. has used the same standard for the last decade, with the target cash compensation for the CEO set at about twice that of an executive vice president. The company also pays modest bonuses, considering its size.

The practice started under CEO Edgar S. Woolard, who retired in 1995. In a video message posted online, he pleaded with executives to ratchet down pay as a way to restore public trust in

corporate leaders. He argued against what he calls the "myths" used to justify high CEO pay, including the idea that CEO pay is driven by competition.

"To that, I say, 'Bull,'" he said. "CEO pay is driven by the outside consultant surveys and the fact that your CEO in your company has to be at least in the top half and maybe in the top quartile."

DuPont did not make Woolard available for interviews.

More than anything, this is an issue for corporate boards, said John C. Wilcox, senior vice president and head of corporate governance at TIAA-CREF. "We don't want to micromanage the internal decisions of the company's management."

One reason Home Depot's Nardelli got the rich pay package he did was because his hiring was a "hail Mary pass" by a company that was in "dire straits," said Ken Bertsch, executive director and head of corporate governance at Morgan Stanley Investment Management, at an event Monday hosted by Institutional Shareholder Services.

By contrast, companies that grow their own talent avoid the CEO star search - and the major league pay that comes with it. Michael L. Eskew, CEO of United Parcel Service Inc., has been with the company since he graduated from Purdue University's industrial engineering program in 1972. He earned about $2.5 million in 2005, outside options - and the 33,993 shares underlying his options aren't staggering.

As boards set goals for pay, they need to look harder at performance data.

"This is pretty simple stuff," said Delves. "If you want pay at the 75th percentile, you better have performance in the 75th percentile. It's not hard to figure out."