No point griping about CEO pay

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The debate over rising CEO pay can be maddening. There's no doubt that American executives are the best paid in the world, sometimes obscenely so, and yet it's hard to prove that pay levels are excessive, fair or even matter much in the scheme of things.

What's not hard to argue is that the system that determines what top executives get paid is broken.

Some experts say that rising pay is the fair and square result of a free market where companies compete for a manager's services. But while executives get to fend for themselves at the bargaining table, irate investors can't get their point across to the people representing them, from the board of directors to mutual fund managers.

The latest case in point is a new study showing that big mutual fund companies largely ignore investor concerns when voting on pay-related proxy proposals at companies in which they hold shares.

An examination of the new voting disclosures required of mutual funds found that the nation's biggest fund companies consistently vote against shareholder proposals regarding pay and in favor of measures put forth by management. The study found that 18 top mutual fund companies collectively followed the board's recommendations on these proposals about three quarters of the time.

Several prominent names stood out as highly reliable rubber stamps for management on pay proposals, according to the analysis by The Corporate Library and the American Federation of State, County and Municipal Employees. At Morgan Stanley Inc., fund managers voted with the board 92 percent of the time. The AIM Investments subsidiary of Amvescap PLC, the Dreyfus unit of Mellon Financial Corp., and AllianceBernstein Holding L.P. all voted their shares with management at least 85 percent of the time. The fund companies maintain that they vote in the best interests of their customers.

It's not surprising, then, to learn that CEO compensation is still climbing. In a preliminary reading from the new crop of proxy disclosures, Equilar Inc. estimates that the median payday rose 1.6 percent to $8.2 million in fiscal 2005 among Standard & Poor's 500 companies where the CEO's have held the post at least three years. Average pay rose 5.3 percent to $11.3 million in cash, stock awards and option grants.

Again, while it's fairly easy to make splashy headlines of these numbers, there's no hard evidence that CEO's don't deserve their rewards or that this state of affairs is actually bad for shareholders.

An oft-cited study by Lucian Bebchuk of Harvard University and Yaniv Grinstein of Cornell University has established that top U.S. executives are clearly taking home a bigger share of the profits at their companies. Mr. Bebchuk and Mr. Grinstein found that the aggregate pay of the top five executives at U.S. companies amounted to 10 percent of the combined earnings at those companies between 2001 and 2003, double the rate of take-home pay eight years earlier.

Still, while more is more, there's no widely accepted benchmark for deciding how much is too much. Comparisons with what foreign CEO's earn ring hollow because no other nation has produced such strong economic growth and investment returns over the past century. While Whole Foods Market Inc. has drawn praise for capping the CEO's cash pay at 14 times the average salary of the full-time work force, such policies are unlikely to catch on and run counter to free-market principles.

That said, it's misleading to say today's pay levels are the pure result of free-market wrangling, an argument that often includes faulty analogies to high-paid athletes and entertainers. A fair negotiation requires two fully consenting parties.

The owners of a baseball team have direct control over their decision to sign a free agent for $20 million a year. And with sports, statistics provide a clearer sense of individual contributions to the result. You know how many home runs Barry Bonds has hit. While there's no guarantee he'll hit that many again, his past statistics are a clearer indicator of future performance than any executive can demonstrate. Once the season's over, it's easier to judge if Mr. Bonds was worth the money than if Google's CEO deserves credit for his stock quadrupling.

By contrast, shareholders who'd like to limit executive pay have no direct say in the matter. Instead, compensation is set by corporate directors who are sworn to represent the interests of shareholders. Since you can't negotiate a contract with millions of individual shareholders, this system offers practicality and the presumed business prowess of the directors.

That's in theory. Shareholders are so powerless in the current system that directors needn't mind them at all, even in the face of a sustained chorus like that over rising compensation. As shown by the mutual fund study, the same holds true for the relationship between money managers and their customers.

The free market is not governing executive pay if the owners can be so easily ignored.

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