Time to rein in grossly overpaid CEOs

Al Jazeera America
By Dean Baker
April 21, 2014

Last week The New York Times ran an article on the pay of top corporate executives in 2013. It reported that the CEOs of major U.S. corporations continue to do quite well. At the top of the charts we find Oracle chief executive Larry Ellison, who pulled down $78.4 million; Bob Iger at Disney, who made $34.3 million; and Rupert Murdoch at Fox, who received $26.1 million.

At this point, most people have become used to hearing about these bloated pay packages at the top. We're also used to hearing the rationale from these folks and their boosters about how they are paid what they are worth.

To the contrary, they are grossly overpaid. First, many CEOs were running large successful companies in the 1960s and 1970s for pay that in today's dollars averaged about one-tenth as much as the current crop of CEOs get. We can also look to Europe, Japan and China and find plenty of successful CEOs of large companies who work for a small fraction of the price of American executives. And there are plenty of CEOs who get these outlandish pay packages even when they drive their companies into the ground.

The relevant question is not how much a CEO contributes to the company. That is not how economics works. After all, how much does the firefighter contribute who rescues three kids from a burning house? We don't pay our hero firefighters multimillion dollar salaries. We pay firefighters on the basis of how much it costs to hire another firefighter who can also do the job.

The question is how much does the CEO contribute compared with the next person in line for the job? Given the experience of large corporations in other countries, there is every reason to believe that there are lots of next people who could do the job as well or better and for much less. (Anyone who believes that CEO pay actually reflects the CEO's value to the company should read Lucien Bebchuk's outstanding book, Pay Without Performance.)

The problem here is grounded in the corruption of the corporate governance structure. In principle, CEOs should be treated like any other employee. Companies should ask if they can get away with paying them less or getting a lower-cost CEO of the same caliber in Germany or China.

If directors had to forfeit their pay any time a CEO compensation package was rejected by shareholders, it would likely help focus the directors' thoughts.

Most companies, however, never ask this question. The reason is that the people who should be doing the asking, those on the corporate boards of directors, largely owe their jobs to the CEOs, not to the shareholders they are supposed to represent. Just as it's difficult to organize large numbers of voters to unseat incompetent or corrupt politicians, it is very difficult for the shareholders of a large company to keep CEO pay in check and to dump incompetent CEOs.

The diffusion of stock ownership effectively allows the CEOs a free hand to line their own pockets. This is one reason that we are seeing so much hostility in elite circles these days to public pension funds. Major pension funds, such as the ones for public employees in California or New York, are among the few entities with enough stock to actually put a check on CEO pay. If these pension funds could be taken out of the picture, the CEOs would have even less to worry about than they do today.

In order for CEO pay to be brought down to earth, it will be necessary to change the behavior of the directors who decide their pay. In most cases, sitting on a corporate board means attending four to eight meetings a year and walking away with an annual paycheck of several hundred thousand dollars. Directors are usually prominent public figures such as former politicians or academics. They get their jobs because of their reputations; this means that the directors do not want their valuable reputations tarnished.

Many directors sit on multiple boards. For example, Erskine Bowles, a co-chair of President Barack Obama's deficit commission, has collected millions of dollars sitting on corporate boards. He had the distinction of sitting on both General Motors' and Morgan Stanley's boards in the years they needed bailouts from the government. Bowles has also sat on the boards of Krispy Kreme, Norfolk Southern and now Facebook. It should be possible to shame people like Bowles to take their responsibilities as a director seriously and stop handing blank checks to CEOs regardless of their competence.

The "say on pay" provision of the Dodd-Frank financial reform bill requires companies to put their CEO pay packages to a nonbinding vote of shareholders. Since this provision has been in effect, fewer than 3 percent of pay packages have been voted down. This reflects the difficulty of organizing among shareholders.

However, a minor modification to the that provision could make these votes far more effective. If directors had to forfeit their own pay any time a CEO compensation package was rejected by shareholders, it would likely help focus the directors' thoughts on constructing pay packages that were not excessive. This could put a serious constraint on CEO pay.

Reining in CEO pay is an important issue that goes well beyond the outrageous pay packages for a small number of top executives. The exorbitant pay at the top of the corporate ladder helps set in place a pay structure that leads to bloated pay for those at the top in every sector, including universities and private charities while leaving most of the rest of the workforce behind.

This is why it is so important to rein in CEO pay. And that means publicly humiliating all those prominent directors who pass out the blank checks.