Moonves Making $69M Shows Boards Biased

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CBS Corp. (CBS) directors decided to give Chief Executive Officer Leslie Moonves a $69.9 million pay package last year after assessing the competitive market for senior executive talent.

The board defined that market as pay for CEOs at companies that are on average more than twice as large as CBS, and many in businesses far afield from media.

Such lopsided comparisons aren't unusual at U.S. corporations. To justify how much they offer CEOs, board compensation committees measure against the pay of CEOs at other companies, often picking larger firms from different industries that pay more and don't consider themselves rivals for management prospects.

"There is pretty straightforward evidence of cherry- picking, and it's pervasive," said Thomas DiPrete, a sociologist at Columbia University who has studied the use of self-selected peers to set CEO pay.

The size gap between CBS and its peers, for instance, is one of the widest in the Standard & Poor's 500 Index, according to data compiled by Bloomberg and more than 10,000 peer relationships supplied by Equilar, a company that sells compensation data. The data reveal companies with traits that researchers say are associated with bias: those that set pay against peers that are much larger, in different industries, or that rarely cite the subject company in return.

Peer Groups

In the 1980s and 1990s, when increasing executive compensation created controversy -- it is once again a contentious issue in this election year -- pay consultants sold many companies on the practice of benchmarking against peers. The idea was to compare compensation with similar-size companies in similar industries as a way of setting a fair compensation package.

The choice of peers can itself be arbitrary. Four teams of academic researchers have found evidence of bias in the peer groups that U.S. companies use to set pay. None identified specific companies. A fifth study concluded the process wasn't biased.

Intentionally picking better-paid peers "has been a big part of the ratcheting up of executive pay," said Bill George, a Harvard Business School governance professor who's a director at Exxon Mobil Corp. and Goldman Sachs Group Inc. and former CEO of Medtronic Inc.

The adjusted average compensation of CEOs in the S&P 500 (SPX) rose to $12.9 million in 2011, or 380 times the average worker's pay, up from $625,000, or 42 times the average worker's pay, in 1980, the AFL-CIO said in a report released this month.

Incentives

Many directors "have incentives to make compensation decisions that are more favorable to executives" than to shareholders, said Lucian Bebchuk, a Harvard Law School professor who has researched CEO pay. Directors may not want to risk upsetting their board position or their relationship with a CEO, he said.

"There's a significant body of research indicating that boards don't deal with executives completely at arm's length," he said.

Most companies vary pay based on performance yet still use competitive data to determine the size of target compensation, set at the beginning of a company's fiscal year. This includes salary, a bonus whose final amount varies based on annual performance, and an award of stock or options.

New York-based CBS said in a statement that benchmarking is "just one data point" it uses when setting CEO pay and it emphasizes pay that varies based on performance.

CBS Comparisons

Directors at CBS measure pay for Moonves against CEOs at five other media companies, all of them larger by market value and all but one larger by sales. Directors also look at bigger non-media companies, such as International Business Machines Corp. (IBM) and General Electric Co.

GE had 11 times CBS's sales, based on the latest figures available, while IBM had 14 times CBS's market value. Neither company sets its pay by reference to CBS. GE's CEO Jeffrey Immelt had total compensation of $21.6 million last year and IBM's Sam Palmisano, who stepped down as CEO at the end of 2011, had compensation of $31.8 million that year.

CBS stock has returned 68 percent including dividends since Moonves took charge in 2006. That compares with 16 percent for Time Warner Inc., 23 percent at News Corp. and Walt Disney Co.'s 93 percent gain over the same period.

Redstone's Compensation

CBS's corporate sibling Viacom Inc. (VIAB), separated in 2005, uses almost the same groups of outsize peers. The median company on Viacom's media-industry peer group is 56 percent bigger by market capitalization and more than twice as big by sales; the median company in its broader peer group also has more than twice Viacom's sales and value.

Viacom, which is based in New York, said in a statement that it doesn't set pay directly based on its chosen peers, and "uses this information to get a broader perspective of overall compensation practices."

Sumner Redstone, who is executive chairman of both companies and controls them through a special class of stock, made a combined $41 million in pay last year. Viacom CEO Philippe Dauman collected $43 million, and the company's stock has returned 33 percent since he took over in September 2006.

Cherry-picking larger peers often skews results because CEOs at big firms typically get higher pay. Companies with more than $10 billion in market value had average total CEO pay of $13.6 million compared with pay of $3.4 million at companies below that threshold, according to a Bloomberg analysis of data provided by Institutional Shareholder Services.

Different Peer Group

Some companies measure CEO pay against executives in different industries even as they gauge their financial performance by looking within their own sector.

Monsanto Co. (MON), the world's largest seed company and the maker of Roundup herbicide, looks at other chemical and seed- producing companies, including DuPont Co. and Dow Chemical Co., to measure revenue and profit, according to a regulatory filing. That's also how it used to help set executive compensation.

Since at least 2006, Monsanto CEO Hugh Grant's pay is stacked up against mostly health-care companies, such as Abbott Laboratories and Eli Lilly & Co. They're among the best-paid on Monsanto's list, including $24 million for Abbott's Miles White and $16.4 million for Lilly's John Lechleiter in 2011.

Grant's pay has risen from about $2.7 million in 2004, his first year as CEO, to $11.6 million in 2011. None of the 14 health-care companies Monsanto cites compares its pay to the seed company.

Monsanto's Take

St. Louis-based Monsanto said in a statement that it's at least as big or bigger than its median peer and the group is "diversified" and from "nine industries." It said most "are science-based and research-focused like Monsanto."

Pay increases for CEOs sometimes follow adjustments to peer groups.

Northern Trust Corp. (NTRS) CEO Frederick Waddell got a 42 percent raise in 2009 after the board added six companies to the list of businesses it deemed CEO-talent rivals. There weren't enough asset managers on the old list, the Chicago bank and wealth manager said in explaining the decision in a regulatory filing.

Left unstated was the effect that government-imposed pay restrictions had on banks that accepted bailout funds during the financial crisis: Median pay among Northern Trust's old peer group dropped to $6.8 million in 2008 from $9.2 million the year before.

Shareholders' Say

None of the six companies added to the peer list -- five asset managers and a brokerage firm -- was subject to pay restrictions. Among them: BlackRock Inc. (BLK), the largest money manager in the world, which had just had the second-most profitable year in its 21-year history.

Waddell's pay rose to $11.9 million in 2009 from $8 million the year before. The bank didn't say whether peer comparisons played a role in that increase.

At Northern Trust's April 2011 annual meeting, 31 percent of shareholders voted against Northern Trust's compensation program. The bank responded by increasing Waddell's salary to $956,250 from $900,000 and cutting his cash bonus to $1.6 million from $2 million and long-term awards to $7 million from $8 million. Directors dropped the six newcomers and returned to the old peer list, calling it a "more targeted" group.

Appropriate List

That's not necessarily bad news for Waddell. By 2011, most banks had repaid their bailout, and the most recent data available from Northern Trust's peer companies showed median CEO pay at the old list of banks had risen to $12.9 million, compared with median CEO pay of $8.6 million at the new additions.

Northern Trust said in a statement that the current list is appropriate. It declined to comment on the pay difference between the two lists.

Since Waddell became CEO in 2008, the bank's shares lost 33 percent after dividends through yesterday, compared with a 40 percent deficit for the KBW Bank Index. (BKX)

Scholars have only been able to research how companies choose peers since 2006, when a Securities & Exchange Commission rule forced U.S. public companies that use them to start disclosing their lists. They're disclosed in the same annual SEC filing companies use to show how much they paid their senior executives.

The five groups of academic researchers who have studied the matter don't all agree that boards cherry-pick better paid CEOs. Brian Cadman, a professor at the University of Utah David Eccles School of

Business, and Mary Ellen Carter at Boston College looked at 608 companies and found they sought to pick the most appropriate groups.

Only One A-Rod

“A scarce commodity is going to be rewarded with higher wages,” Cadman said. “It’s like sports. There’s only one A-Rod and everyone wants him.”

Four other research groups, including Columbia’s DiPrete whose study looked at 1,183 companies, found that the firms were selecting better-paid peers intentionally.

One group, led by John Bizjak at Texas Christian University that looked at 707 companies, found that the amount of cherry- picking tapered off since the firms had to disclose their choices in 2006.

Another group, including Michael Faulkender at the University of Maryland and Jun Yang of Indiana University, found the opposite: that cherry-picking had gotten more pronounced since the SEC demanded disclosure.

“Observing opportunistic peer benchmarking at other firms, those firms that did not engage in such practices may have begun to do so,” wrote the researchers, who looked at 763 firms.

Harman’s Assessment

Harman International Industries Inc. (HAR) is also a firm that measures CEO pay against much larger companies. The maker of high-end audio equipment uses two groups of peers: a broad group of 103 companies, most of which are bigger by sales, and a more focused list of 16 firms, which has only two companies with lower revenue.

This second list, which Harman began using in 2011, included metal components maker Precision Castparts Corp. (PCP), with 62 percent more sales and four times Harman’s market capitalization, and auto-parts maker BorgWarner Inc., with 68 percent higher sales and 84 percent more market value. Only one of Harman’s 119 named peers sets pay against it.

Total compensation for Harman Chairman, President and CEO Dinesh Paliwal rose to $16 million in 2011 from $7.58 million in 2009, regulatory filings show.

Stock Performance

Stamford, Connecticut-based Harman said in its 2011 proxy that it compares CEO pay with a variety of companies because “there is no well-defined group of comparable publicly traded companies” in the U.S. Harman spokesman Jean Lepine said the company had no additional comment beyond what it said in its proxy.

Harman’s shares have lost 59 percent after dividends since Paliwal became CEO in July 2007.

Peer benchmarking, while intended to help make CEO compensation fair, can become “a game” that causes unwarranted swings in pay, said Harvard’s George.

“Compensation committees today are taking their decisions much more seriously, but not all,” said George, who doesn’t comment about companies where he’s a director. “No board likes to admit they didn’t hire an above-average CEO.”