A $74 Million Bargain

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CEO Compensation
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At $74 million a year, Goldman Sachs Chief Executive Lloyd Blankfein may be a Wall Street bargain.

The 53-year-old Blankfein caught a lot of flak when Goldman unveiled it had paid him about $314,894 each working day in fiscal 2007. Investors, quickly forgetting that Blankfein had successfully steered Goldman through the subprime storm, producing profits that were the envy of Wall Street, staged a rebellion of sorts. A proposal that would give shareholders a say in CEO pay captured a stunning 43% of the shareholder vote at the investment bank's recent annual meeting. The usually unflappable Blankfein was forced to go on the offensive. Endearing himself to investors, he said he didn't want anyone "less sophisticated" in the financial industry making decisions on his pay.

Perhaps he has a point. Goldman's savvy board members may be the best judges of Blankfein's compensation. And given their performance so far, they haven't done a bad job. Consider Blankfein's pay as a percentage of Goldman's profits and the commodity salesman-turned-chief executive looks like one of the most underpaid bosses on Wall Street. The $74 million Blankfein pocketed last year amounted to 0.64% of Goldman's fiscal 2007 profits of $11.6 billion.

Contrast that with Lehman Brothers Holdings Inc. where Chief Executive Richard Fuld was paid 1.7% of Lehman's fiscal 2007 profits of $4.2 billion. Or consider Bear Stearns Cos. where former Chief Executive James Cayne didn't take a bonus but still managed to be paid out 4.73% of last year's profits of $233 million.

The only major Wall Street investment bank that doled out less of its profits than Goldman to its chief executive last year was Morgan Stanley where top boss John Mack also decided to forgo a bonus because of the firm's puny profits. Even without a bonus, Mack's pay amounted to 0.55% of Morgan Stanley's profits.

The findings, some say, underscore the lack of correlation between pay and performance. "Pay and performance have the most random link, and when there is a link it is more coincidence than causation," says Nell Minow, editor of the Corporate Library, an independent research firm.

It's an issue that hasn't escaped the attention of lawmakers. At a hearing this spring on chief executive pay and the mortgage crisis, Henry Waxman, chairman of the House of Representatives Oversight and Government Reform Committee, delivered this stunning statistic: "Incredibly," he said, "10% of corporate profits are now flowing" to the nation's top executives. Even when companies collapse, Waxman said, "it seems like CEOs hit the lottery."

As far as the Wall Street-pay lottery goes, Goldman chief executives have stood out as low-rollers for years.

Blankfein and his predecessor Henry Paulson (now treasury secretary) were paid a total of $136 million between 2003 and 2007--a time when the firm racked up $34.3 billion in profits. Their pay amounted to 0.4% of Goldman profits over that period--the lowest payout as a percentage of profits among five Wall Street investment banks.

By contrast, Lehman paid out long-time Chief Executive Fuld $354 million over the same five-year period even though its profits of $15.5 billion equaled less than half the amount Goldman earned during that time. And Bear Stearns awarded Cayne, also a long-serving Wall Street chieftain, nearly $138 million, or 2.2% of its profits over the five-year period. (Forbes calculates pay by valuing options only when they are exercised and restricted stock when it vests.)

Even when pay is calculated by valuing options and restricted stock grants as reported in the companies' proxies, Lehman and Bear Stearns paid out more of firm profits over the five-year-period to their CEOs than Goldman did, though, the disparity was less stark. For the entire financial services industry, the median chief executive compensation over five years was 1.5% of corporate profits.

Lehman and Bear Stearns declined to comment.

But Lucian Bebchuk, director of the corporate governance program at Harvard Law School, says the recent troubles in the financial sector highlight the need to follow a basic principle when arranging executive compensation plans: "If it isn't earned, it should be returned."

In a piece published in the Oxford Review of Economic Policy in 2005, Bebchuk examined the growth of U.S. executive pay between 1993 and 2003. He found that during this period, pay had grown far beyond the increase that could be explained by changes in firm size, performance and industry mix. Indeed, if the relationship of pay to attributes such as firm size had stayed the same, Bebchuk found that mean compensation in 2003 would have been only half its actual size.

As bad as this year's numbers on Wall Street pay look, Bebchuk says the picture is going to look even darker next year. That's because "2008 is going to be ugly for the financial sector," he says.

But don't look to find the greatest pain among Wall Street's top bosses. Again it will be investors who bear the brunt.

"Because the reversal is going to be so painful and dramatic and long-term performance will be so much worse, the compensation policies will prove to be quite costly--excessively costly--to shareholders," says Bebchuk.