10 Things CEOs Won't Tell You

SmartMoney
By Sarah Morgan
July 5, 2011

1. "You're not the boss of me."

Technically, a CEO works for a company's shareholders, and his job is to run the company in such a way that produces profits and strong returns for those owners. In reality, a public company CEO answers to his board of directors, who monitor his performance on shareholders' behalf since they're too numerous and far-flung to truly weigh in. And at about 60% of big U.S. companies, the person running that board is the CEO himself. "That's a fundamental conflict of interest," says Amy Borrus, the deputy director of the Council of Institutional Investors, a nonprofit that advocates for shareholder rights.

Some companies are moving to make their boards more independent. Roughly 40% of public companies now have independent chairmen (not the CEO), nearly double the percentage from a decade ago, according to executive search firm Spencer Stuart. That's good news for shareholders, according to some research which has linked this and other corporate governance policies to better investor returns. For example, a hypothetical portfolio of stocks meeting certain governance standards, including having an independent board chairman, would have outperformed the Russell 1000 index by 2.75 percentage points a year from 2003 to 2010, according to a report by the Corporate Library, a research firm that recently merged with GovernanceMetrics International.

2. "The more money I make, the less you make."

It's shocking to discover the average CEO of an S&P 500 company made $11.4 million in total compensation in 2010. That's enough to pay the salaries of more than 250 firefighters, according to the AFL-CIO. But for investors, there's more to executive compensation than pure sticker shock. Over the years, a series of academic studies have tied higher CEO pay to lower returns for shareholders. For example, a 2009 study by researchers at Purdue University and the University of Utah found that the companies with the highest-paid CEOs (the top 10%, adjusted for size and type of company) fall more than 4% behind expected average stock-market returns every year. How much the CEO makes compared to the other executives in the C-suite also matters: Companies where the CEO grabs a bigger piece of the total compensation pie awarded to the top five executives tend to have a lower value and generate lower stock returns as the CEO's share of the pay pie increases, according to a 2009 study by Harvard Law School professor Lucian Bebchuk and colleagues at the Yale School of Management and INSEAD.

Researchers believe this link between CEO pay and firm performance also goes back to the board. A weaker board of directors, the thinking goes, will be more likely to overpay its CEO and less willing to fire him if he doesn't perform. "There are two centers of power in a corporation: there's the management team, and the shareholders," says Jesse Fried, a professor at Harvard Law School who studies executive compensation and corporate governance. "When the shareholders have less power, the board is not going to do as good a job in disciplining and

perhaps getting rid of the CEO. So the firm doesn't do as well, and the CEO ends up getting overpaid relative to his performance," Fried says.

3. "You may be paying me long after I'm gone."

For most people, getting fired is a nightmare. CEOs don't have it so rough. Thank the so-called "golden parachute," a common provision which provides that a CEO terminated under certain conditions receives a payment equal to a multiple of his salary. It can also include retirement benefits, cash or stock bonuses, and even reimbursements for taxes incurred by the payout. In some cases, companies may say the departing CEO is drawing his full salary for another year because he's "consulting" or helping the new CEO through the transition, but that's often just a smokescreen, says Michelle Leder, the founder of Footnoted.com, a website that digs through SEC filings for noteworthy disclosures. "I don't know of a lot of jobs where if you're not working out, you get paid to stick around," Leder says. New CEOs rarely, if ever, actually consult the old CEO for advice, Fried says. "It's a 'golden goodbye' payment that's dressed up as something else," he says. The Council of Institutional Investors considers excessive perks, golden parachutes and generous retirement packages for departing CEOs to be major red flags for shareholders: These practices may indicate that a board of directors is under a CEO's thumb.

The latest twist on the 'golden goodbye' isn't golden, but it is shiny. A few companies recently have given departing executives iPads, according to Footnoted. For example, Medtronic's outgoing CEO Bill Hawkins has a provision in his separation agreement allowing him to keep his company cell phone, laptop and iPad. Meanwhile, he'll continue to draw his full salary of $104,167 a month for a year after his departure in June. A spokesman for Medtronic declined to comment.

4. "Forget the salary check out my perks."

There's not much that a CEO can't charge to his company, it seems. According to company filings highlighted by Footnoted: Amazon spends what it calls an "especially reasonable" $1.6 million on unspecified personal security services for CEO Jeff Bezos; Chesapeake Energy spent $5.9 million on tickets last year to watch pro basketball team the Oklahoma City Thunder, which is part-owned by CEO Aubrey McClendon; Massey Energy's departing CEO, Don Blankenship, was given a free house and land on former company property. While it's hard to say precisely which perks should send up warnings for investors, in general, "there's clearly evidence that perks are excessive relative to what a board negotiating at arm's length would provide to its executives," Fried says.

And then there's the corporate jet. A recent Wall Street Journal investigation into company jets' flight records found many of them making 30% of their flights to or from popular vacation spots like Jackson Hole, the Hamptons, Martha's Vineyard, Aspen, Palm Beach and the Bahamas. That's not just tacky, it's potentially damaging for shareholders: A 2006 study by David Yermack at New York University's Stern School of Business found that companies that permit their CEOs to use the corporate jet for personal flights underperform a benchmark by 4 percentage points a year.

Chesapeake Energy's proxy statement explains that the company sponsors the Oklahoma City Thunder to support the local community and boost employee morale, and that the CEO's equity stake in the team "was not the determining factor" in the decision to sponsor it. The company also gets local advertising in return for its sponsorship, the statement says.

Amazon and Alpha Natural Resources, which recently acquired Massey Energy, did not respond to requests for comment.

5. "I'm donating the company's cash to politicians."

CEOs and other top corporate executives have the authority to make political contributions on behalf of the company -- often without much oversight from the board of directors, let alone shareholders, Borrus says. Companies aren't even required to disclose such contributions. And in the wake of the Citizens United Supreme Court decision in 2010 that lifted restrictions on corporate political giving, "there's concern that the flood gates will open," says Michael Garland, the executive director of corporate governance at the office of New York City Comptroller John Liu. "The risk is that corporate resources will be deployed in a way that's either counter to the company's interest, or supporting some other agenda," Garland says. Investor advocates point to Target, whose recent contributions to a group supporting anti-gay-rights politicians became an embarrassment to a company which had cultivated a hip, progressive brand image, and prompted boycott threats from some shoppers. A spokeswoman for Target says the company now has a committee overseeing political contributions, and contributions are made in support of the company's business interests or issues important to its workers, customers and shareholders.

The broader issue of corporate political donations matters to investors, says the Council of Institutional Investors, because companies that make large political contributions often see lower returns than their peers, according to a 2007 study by researchers at the University of Minnesota's Carlson School of Management that's been cited by the Council of Institutional Investors as part of its support for greater disclosure of political contributions. The study also found that companies with strong corporate governance policies tend to make smaller contributions.

6. "Be wary of my rosy outlook."

Investors spend a lot of time and energy poring over companies' quarterly earnings statements to help determine whether to buy, hold or sell. So if those statements are later shown to be inaccurate -- and need to be restated -- investors can be stuck with huge losses. David Larcker and colleagues at Stanford analyzed the transcripts of earnings calls where CEOs were discussing results that would later be substantially revised downward to change the company's statement of its net income. With the benefit of hindsight, "You know they're talking about the financial results, and you know whether they had to be restated, so you know whether they're lying," Larcker says. Deceptive CEOs, he found, used more extreme positive words like "fantastic" or "unbelievable," and they also referred less often to creating value for shareholders. "We expected going in that there would be more shareholder value references, like it would be part of the hyping," Larcker says. "We speculate that maybe they have some inkling that they'll eventually be caught, and they're concerned about putting themselves in a box that is just not supportable," he says.

7. "Charisma isn't everything."

A Berkeley professor ranked 2,000 CEOs by their companies' long-term stock performance. Sure enough, Steve Jobs was No. 1. But many of the rest of the winners are folks you probably haven't heard of (John C. Martin of Gilead Sciences, anyone?). The study's author, Morten Hansen, has said this is a sign that the business world focuses too much on high-profile leaders who land on the covers of magazines, and not enough on CEOs who generate long-term value for shareholders.

In fact, charisma and social skills may not be all that important to a CEO's success, says Steven Kaplan, a professor at the University of Chicago's School of Business. Kaplan recently did a study on CEO success, looking at qualitative evaluations of CEOs or CEO candidates made on behalf of private equity investors. He compared those evaluations to the companies' later financial performance and the private equity firms' assessments of the CEO's effectiveness. General smarts and talent, interpersonal skills and a reputation for efficiency all helped CEOs get hired, but the soft skills like being a good listener or a team player didn't matter much when it came to actual performance, Kaplan found. The lesson, Kaplan says: "Don't hire someone who's really smooth and seems like a great person, but who has no track record of getting things done."

8. "Who knows how good I'll be at this job."

Academics and consulting firms have crunched a lot of numbers and come up with many ways to predict whether a CEO will underperform. For example, if a CEO has won an award from the business press, he's actually more likely to underperform afterwards. They've also determined that certain factors -- such as where an executive went to college -- don't predict much of anything. But there's little if any evidence pointing to specific factors or traits that predict success. Why? Nobody can agree on how exactly you measure CEO success, says Peter Capelli, the director of Wharton's Center for Human Resources. "We'd need to know how well the company would have done if you hadn't been there, and that is tricky to do even as a thought experiment," he says. Plus, a company's performance also influences who gets chosen as CEO; companies tend to do better with CEOs who are promoted from within. But many researchers believe that's because successful companies are more likely to groom talent within the organization to be the next CEO, while struggling firms often have to search for an outside rescuer, he says.

9. "I'm worried about my job, too."

The average CEO stint at a public company has fallen from 10 years in the 1970s to just six today, according to research by the University of Chicago's Kaplan. Other researchers have found evidence that underperforming CEOs are now more likely to get the boot -- and faster -- than in the old days, Kaplan says, pointing to recent work by Dirk Jenter at Stanford and Katarina Lewellen at Dartmouth. "There's a huge difference in turnover as a function of how well your company's stock has performed, particularly relative to the industry," Kaplan says. One reason for the increased turnover, he said, is the trend toward for better governance. Individual investors used to own the majority of all stocks, but now most shares are owned by institutions -- and institutional shareholders can more easily put pressure on boards to keep a closer eye on the

CEO and dump the poor performers. "Partly because of shareholder pressure, boards take their jobs a lot more seriously, and there's more pressure on CEOs as a result," Kaplan says.

10. "It's lonely at the top."

One CEO, asked by his board to become a director in order to help search for his replacement, didn't feel ready to move on. Overruled by the board, he had to start interviewing candidates for the job he didn't want to give up, but couldn't tell his team he might be leaving. "He found himself isolated, unable to speak frankly with anyone," says Leslie Mayer, the CEO of Mayer Leadership Group, an executive coaching firm. Mayer, a psychologist who works one-on-one with CEOs (and promises them confidentiality), often on emotional issues, says this feeling of isolation is common. They may work closely with a core team, but "they really aren't able by virtue of the boundary of their role to talk about any tensions they might have with the board, or their personal fears and doubts," Mayer says. "There are always issues they can't discuss." Perhaps making this emotional isolation worse is the fact that CEOs are rarely alone: A recent time-use study analyzing the days of Italian CEOs found they spent, on average, 85% of their time with other people. "Even when they get together with other CEOs, there is a little bit of talk, but it's more general business discussion and networking" than discussion of personal feelings, Mayer says.