Harvard Study Faults CEO Pay

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By Diana McKeage
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Evidence pointing to excessive risk-taking by executives at investment banks Bear Stearns and Lehman Brothers continues to emerge more than a year after the two investment banks collapsed in 2008—this time from a paper released online this weekend by three Harvard Law School affiliates.

According to the study, the collapse of the two firms reflected not shortsightedness on the part of top executives, but rather compensation structures that shielded the executives from the consequences of the firms' economic meltdown. Compensation structures of cash bonuses and equity options liquid regardless of the firm's financial state led to sustained profits for these executives even after the financial collapse.

The study was authored by Harvard Law School Professor Lucian A. Bebchuk, Holger Spamann, a lecturer at the Law School, and Alma Cohen, a visiting law professor from Tel Aviv University. The authors attempt to dispel what they call the "standard narrative of the meltdown" that does not give payment schemes a leading role in the financial crisis of 2008.

"Our work seeks to contribute to this ongoing examination. We do by showing that the examples of Bear Stearns and Lehman should not be used as a basis for dismissing the potential role of compensation structures in past risk-taking and the potential value of fixing such structures," Bebchuk wrote in an e-mailed statement to The Crimson.

The study's conclusions come less than a week after the heads of two major banks wrote editorial pieces in The Washington Post and the Sunday Telegraph calling for greater regulation and accountability in light of the financial crisis.

JPMorgan Chase CEO and Harvard Business School graduate Jamie Dimon wrote in The Washington Post on Nov. 13 that regulators should be empowered to liquidate assets and fire management when they see fit, so that individuals engaging in risky behavior will "feel the pain." The next day, Barclays CEO John S. Varley wrote in The Sunday Telegraph that "incentives and compensation must be better aligned to delivery, must take account of risk, and must be paid out over time."

Dimon and Varley's editorials point to a broadening consensus that a reform of the financial services industry is necessary. But Lawrence White, a professor of economics at the Leonard Stern School of Business at New York University, questioned whether this most recent study has added new insights to the debate.

"It didn't feel to me like the study was telling us a lot other than reminding us that there weren't clawbacks and that these guys aren't paupers, but who really thought they were?" he said.

Still, he said that "better corporate governance, more shareholder control is an important thing. That doesn't necessarily mean less risk-taking, but smarter risk-taking."