Golden Hellos, the Latest CEO Compensation Practice to Come Under Fire

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For years corporate boards have used so-called golden handcuffs (retention incentives) to keep treasured chief executive officers in the fold or provided golden parachutes (severance packages) to ease their departures. Lately, another gilded pay practice has taken hold: golden hellos, or multimillion-dollar signing bonuses used to get CEO candidates to join the team. The number of U.S. companies in the Russell 3000 Index and Canadian ones in the S&P/TSX 60 Index making upfront payments to executives has risen to more than 70 this year, from 41 in all of 2012, according to governance advisory firm GMI Ratings. Among this year's biggest: Zynga's (ZNGA) $45 million package to attract game industry veteran Don Mattrick.

Yet high-profile flameouts such as Ron Johnson show that such tactics can quickly lose their glitter—at least for shareholders. J. C. Penney (JCP) fired CEO Johnson in April, 17 months after giving him a signing bonus of $52.7 million in shares to recruit him from Apple (AAPL). "Investors should be skeptical of golden hellos, which represent pay decoupled from performance and provide no retention incentives," says Lucian Bebchuk, a Harvard Law School professor who has studied CEO pay.

Some welcome payments can yield disappointing returns: J. C. Penney shares slumped 50 percent during Johnson's reign, while Hewlett-Packard's (HPQ) dropped 46 percent under Léo Apotheker, ousted in 2011 just 10 months after getting $8.6 million in a signing bonus and relocation benefits. In total, he was entitled to $34.7 million in cash and stock for less than one year's work.

Some directors agree front-loading such largesse is bad governance. "The incentive should be they will come to the company and perform and be rewarded," says Jon Luther, chairman of Arby's Restaurant Group, a director at Six Flags Entertainment (SIX) and Brinker International (EAT), and former CEO of Dunkin' Brands (DNKN). Candidates for high-level positions who asked for signing bonuses where he's been a board member have been rejected in favor of those who didn't, he says, declining to identify the companies and candidates. Luther says he never asked for a bonus to take a job and was never offered one: "I said I'll get it done, and you can take care of me when I succeed."

Golden hellos are often a sign of other compensation dysfunctions, says Greg Ruel, a GMI senior research analyst. On average, companies dinged by GMI for giving out big upfront payments also have received grades of D for their overall pay practices. Chesapeake Energy (CHK) and Best Buy (BBY), two that have been flagged by GMI for offering golden hellos, also in recent years lost so-called say-on-pay votes, nonbinding stockholder polls on pay plans granted by their boards. Those ballots were evidence of shareholder dissatisfaction—and ultimately prompted changes in the companies' compensation practices.

In April, the same month as Johnson's ouster, golden hellos again were thrust into the spotlight, this time at Toronto-based Barrick Gold (ABX). Dissenting investors, including Canada's six largest pension funds, opposed an $11.9 million cash welcome package to Co-Chairman John Thornton, a former Goldman Sachs (GS) president. (Although the bonus wasn't rolled back, Barrick did adopt other governance changes.) "This is the kind of situation where you are not getting anything in advance, but yet you have to pay upfront for the hopes and the aspirations of what will be delivered down the road," says Robert Gill, a Toronto-based fund manager at Aston Hill Financial (AHF:CN), which manages $7.6 billion in assets, including Barrick shares. "We don't think that's commensurate with how the industry should remunerate people."

GMI decided to include golden hellos in its rating system in April because of evidence the bonuses were getting bigger, Ruel says. The payouts have risen even as CEO turnover last year fell to the lowest level since at least 2004.

Companies often justify golden hellos by saying they compensate for pay that new CEOs had to forgo for leaving their previous employers. Such payments partly explain why hiring an outside CEO costs about one-third more than promoting from within, says Chris McGoldrick, a senior research analyst at compensation tracker Equilar. Board compensation committees may have to consider that as they search to fill CEO vacancies at Microsoft (MSFT), Lululemon Athletica (LULU), and J. C. Penney, which is seeking a replacement for its interim CEO. Last year about 26 percent of new S&P 500 CEOs were hired from outside the company, according to executive recruiter Spencer Stuart.