Putting a Value on a C.E.O.

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By Andrew Ross Sorkin
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Wall Street often portrays itself as a pay-for-performance meritocracy. The rules are supposed to be simple: Make money, and you get rich. Lose it, and you get fired.

What, then, should Citigroup pay Vikram S. Pandit, its embattled chief executive? On his watch, Citigroup, hobbled by bad investments, grabbed not one but two financial lifelines from the government. Its share price plummeted about 80 percent. (In fairness, he took the reins of the firm less than a year ago.)

Many Americans, including many people on Wall Street, would argue that an executive with a record like that should get paid little or nothing. Usually, the public wouldn't have much of a say. But now the Treasury Department has to approve Citigroup's compensation program. Under the latest rescue plan, Citigroup is supposed to devise a pay plan that "that rewards long-term performance and profitability, with appropriate limitations."

You, fellow taxpayer, are now an investor in Citigroup and other major banks. Whether you like it or not, you have a vested interest in Citigroup's success. If this giant falls, we all lose.

So how exactly can we link pay and "long-term performance" (the same long-term performance that we taxpayers will require since it's unlikely we'll be able to sell our stake anytime soon)?

In a speech on Friday, Citigroup's chairman, Winfried F. W. Bischoff, said the financial giant was considering its options. He said he was unconvinced, however, that simply limiting pay and including more stock and longer-term rewards was the right solution.

"By itself, more share and retention-based compensation is not the magic bullet, because it certainly didn't stop us from running up very large losses," Mr. Bischoff said.

True enough. But many people argue that Wall Street's approach to compensation helped get us in this mess to begin with. Bankers were rewarded for taking risks that they clearly failed to manage. So something has to change.

The trick, of course, is to dole out enough rewards to keep executives working, and working hard, but not to dole out too much. By most standards, Mr. Pandit is rich already: he made $800 million by selling his hedge fund to Citigroup (he later shuttered it).

Citigroup and other firms need to find ways to keep and attract talented people who can make smart decisions, without lavishing pay on them or rewarding them for shoddy performance.

"What has caused the most outrage is the difference between pay and actual performance," said Lucian Bebchuk, the director of the program on corporate governance at Harvard Law School.

Mr. Bebchuk says he doesn't prescribe limiting compensation; he's fine with outsize pay as long as it matches outsize performance.

But will taxpayers and the government really accept a $50 million, or even a $10 million, pay package for someone like Mr. Pandit if he were to right Citigroup's ship?

Sarah Anderson, a director at the Institute for Policy Studies, is an advocate of aggressive pay curbs and isn't likely to buy into an eight-figure income, no matter what the performance.

"I want taxpayers to feel confident that an unreasonable amount of money isn't ending up in their pockets," Ms. Anderson said of the executives. "This may be the time to inject some sanity into the pay system."

That may be so. But Mr. Pandit and others — to the extent you believe they are the right leaders of Citigroup — or whoever takes their roles are unlikely to hang around if they're not amply paid.

Top executives at Goldman Sachs have already announced that they will forgo bonuses this year — a move welcomed by Andrew M. Cuomo, the attorney general of New York.

Alan Johnson, managing director of Johnson Associates, a compensation consulting practice based in New York, said he thought it would be wise for Mr. Pandit to follow suit.

"If I'm in Kansas and losing my house, I think it's madness to pay them a big bonus," Mr. Johnson said. "Vikram has to take one for the team this year."

Mr. Johnson said no one should expect Mr. Pandit to take a big hit two years in a row, however.

The tougher questions will come next year when the economy is expected to be in even worse shape, it may be even less politically palatable for Wall Street executives to get bigger compensation packages when the rest of the world might seem worse off.

Still, Mr. Johnson said, "In early 2009, the board should set up a long-term incentive system." He added: "I wouldn't care if it's politically incorrect. And I'd give him a lot of stock."

But the risk, Mr. Johnson said, is that if we taxpayers don't offer the possibility of a payday, we won't get the performance. "If you were in senior management and you knew you'd never get paid, you're not going to work as hard or you'll leave," he said. "It's actually worse if they stay. If you have a bunch of demoralized people hanging around, it will kill you."

But that may not be the answer, either. One thing this whole financial crisis has demonstrated is that Wall Street's old pay systems failed. Giving executives a lot of stock did not prevent the disaster. Worse, many executives cashed out before things went bad.

So here's another idea that might prompt executives to keep a closer eye on the risks that their bankers and traders take: have executives invest in their own firms on the same terms as we

taxpayers. And for good measure, have them invest in the financial products that their companies sell. If executives had put their own money into the tricky mortgage investments that their banks were selling, they might have asked hard questions from the start.