# Pay Without Performance: The Unfulfilled Promise of Executive Compensation

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Nina C. Ayoub
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In times both bullish and bearish, there is periodic outrage over huge compensation packages for executives at publicly traded companies. The recent wave of corporate scandals only inflamed concerns that companies' boards of directors, too cozy with CEO's, were betraying their duty to shareholders. Reacting, defenders of corporate America have often offered "rotten apple" theories and other explanations that deny any systemic problem.

Inadequate, say Lucian Beb-chuk, a professor of law, economics, and finance at Harvard University, and Jesse Fried, a professor of law at the University of California at Berkeley. In Pay Without Performance: The Unfulfilled Promise of Executive Compensation (Harvard University Press), the scholars uncover what they say are widespread, persistent, and indeed systemic flaws in compensation arrangements.

Under fire is the "official story" of "arm's-length bargaining" in boardrooms, or the notion that boards of directors, ever mindful of shareholders' interests, tend to negotiate at prudent distance with the executives they hire and compensate.

That official story is "neat, tractable, and reassuring," write Messrs. Bebchuk and Fried, but also more than an arm's length wrong. Using an alternative model of "managerial power," they identify structural, social, and psychological factors they say make directors act more beholden to CEO's than to shareholders. Directors, they say, persistently create compensation schemes that decouple managers' performance from their pay, from "golden hellos" that hugely reward CEO's who have yet to prove themselves, to "golden goodbyes" even for CEO's who have performed miserably. They are particularly detailed about "gratuitous" departure rewards, including conventionally unrecognizable pension and severance plans. They also detail measures used to camouflage the scope of compensation packages to minimize "outrage costs."

Some reformers, the authors note, have looked to "equity compensation," basically stock options, as a way of tying executives' interests more closely to those of shareholders. While approving, the authors criticize such plans' failure to filter out windfalls that have nothing to do with performance and tendency to allow executives to unload shares in ways that may encourage the promotion of short-term results over long-term value.

Finally, they close with ideas to make boards more independent of insiders and more dependent on shareholders. Among them: allowing shareholders to replace directors more easily, removing boards' veto of shareholders' proposals, and forcing CEO's brimming with stock to give ample warning before they sell.