Do CEOs Earn What They're Paid?

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As top corporate salaries and benefits continue to rise, critics see a growing gap between compensation and performance.

Is it back to business as usual on CEO pay? Maybe so.

Just look at the numbers coming out of the latest Pioneer Press survey of chief executives' pay at Minnesota's 100 largest publicly held companies.

- Bonuses climbed 18 percent in 2004 to $59.9 million, driving the basic cash package up 4 percent to $118.2 million.
- Long-term incentive pay rose 47 percent to $38.6 million.
- The value of stock options exercised went to $253.4 million, up 54 percent from $164.6 million in 2003.
- Options granted were valued at $198.3 million, up 22 percent from $162.4 million in 2003.

A similar story is playing out nationally. **Gary Locke**, the Twin Cities-based head of executive compensation for the **Towers Perrin** consulting firm, says 2004 saw the biggest increases in years for bonuses and long-term incentive pay. Bonuses were up 17 percent. Corporate directors aren't backing away from granting big paydays if they think executives' performance merits such rewards, Locke says.

But as the controversy about pay practices rolls on, the pressure continues to curb the excesses and to tie pay more directly to performance.

Two particular concerns have been boiling over this year.

One is the lack of "transparency," meaning the difficulty of fathoming companies' often cumbersome disclosures of executive pay arrangements. Only now are the lucrative pension packages, seen by shareholder advocates as "stealth compensation," becoming clear.

The Corporate Library, a research firm that monitors corporate pay practices, found that 113 CEOs at 500 large firms can anticipate retirement benefits valued at more than $1 million a year. **Henry McKinnell**, CEO at **Pfizer**, leads the pack at $6.5 million annually.

At **United Airlines** parent **UAL**, a pension benefit of $4.5 million is in trusts for **Glenn Tilton**, chairman and CEO. That has stirred outrage at the carrier, which is in bankruptcy. Employees have been dealt massive job, pay and benefit cuts, and shareholders have lost billions.

The second concern is the continuing practice of handing "golden goodbyes" to CEOs who are forced out. Two of the most egregious examples came at **Fannie Mae** and **Hewlett-Packard**.

At Fannie Mae, CEO Franklin Raines was allowed to retire instead of being fired. He will collect $8.7 million in deferred pay plus significant other benefits, despite the fact that Fannie Mae is restating billions of dollars in earnings after widespread questionable practices were uncovered on Raines' watch.

At Hewlett-Packard, **Carly Fiorina** got $21.1 million in severance pay and a pension of about $165,000 annually after the board ousted her.

Events in the workplace keep the pay controversy churning. Wages and benefits rose 3.5 percent last year, far below the gains for many top executives. Millions of workers continue to be thrown out of their jobs, medical insurance and pensions by mergers, bankruptcies and downsizings.

Some large investors, unsettled by the volatile stock market, are growing more skeptical. A survey of 88 institutional investors this spring by the **Pearl Meyer & Partners** consulting firm found that 75 percent think last year's average CEO pay of $10.5 million at large companies is too high. Sixty percent think earnings per share is among the least useful barometers to use in determining executive pay, even though many companies still see it as one of the most useful.

In its pay survey this year, the **Wall Street Journal** suggested the skeptics are having a significant impact. Greater scrutiny from watchdogs advising institutional investors, more shareholder resolutions on pay practices and increased pressure from regulators and litigators are having a cumulative effect.

Gary Locke agrees, adding that some of the strongest critics now sit on the corporate boards' compensation committees, which govern the pay of the chief executives. Rare is the comp committee that wraps up its meetings on time anymore, he says.

Defenders of the system say companies must pay well, and more all the time, to attract and retain top executive talent.

Law school professors **Lucian Bebchuk** and **Jesse Fried** see it differently. Last year, they skewered pay practices for top executives in their book, "Pay Without Performance."

They argue that the system is inherently flawed because existing pay arrangements generally don't link pay tightly with performance and even directors classified as independent are often co-opted by chief executives.

Most of all, they contend that current poor pay practices reflect inadequacies in the way companies are governed.

Bebchuk and Fried suggest shareholders could realize big savings by cutting top executives' paydays. They say that from 1998 to 2002, 10 percent of aggregate corporate earnings went to the top five executives.

Their solution: Move more power from the top executives to the shareholders.

Some improvements in pay practices have shown up in the corporate pay disclosures for 2004 since publication of the book. But Fried said in an e-mail last week that "little progress has been made in tying pay to performance."

Boards are replacing stock options with restricted shares, which are less sensitive to performance than options, Fried said.

"We see very few attempts to require managers to hold most of their equity for the long term," he added. And he said companies still haven't put in place provisions requiring CEOs to give back bonuses and other compensation based on earnings that turn out to be overstated.

Minnesota might be a special case. A prominent reason for the big run-ups in various measures of pay this year is the unusual success of the companies here.

UnitedHealth's high-pay culture for top executives reflects the gains the company's soaring stock has showered onto shareholders. CEO **William McGuire** was Minnesota's runaway leader in total pay this year. His exercises of options accounted for 92 percent of his whopping $124.8 million in overall pay.

Options exercises also accounted for that same share of **Stephen Helmsley**'s package of $61.1 million. Helmsley, No. 2 at the firm, isn't a CEO so he's not in our survey, but he's easily the second-highest paid executive at the companies on the list.

Our list is only a starting point for examining the complex topic of CEO pay. Yet a cursory look at the earnings, returns and pay packages suggests that at least some form of pay for performance might be working in Minnesota.

But there's no assurance that today's successes won't turn out to be tomorrow's failures.