Morgan Stanley’s Missteps with Executive Pay Packages

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Morgan Stanley's board finally realized that the firm wasn't making enough money for its shareholders, so it decided to throw money at the problem -- shareholder money. The recipients? The people who weren't making enough money for the shareholders in the first place.

The furor over the golden parachutes for ex-CEO and autocrat Phil Purcell and his hand-picked co-president Steve Crawford, as well as over new chief executive John Mack's ill-conceived and short-lived pay package, should give shareholders pause. The decision to hire Mr. Mack, Morgan Stanley's former president, was a brief moment of sunshine. The clouds have returned to the firm's boardroom.

This is only the latest in the Morgan Stanley board's multiple missteps. The Corporate Library, a governance watchdog in Portland, Maine, gives the board an "effectiveness rating" of "D." Well, that's progress. It's up from the previous "F" rating.

"The Morgan Stanley board of directors continues to give capitalism a bad name," says Neil Barsky, a former Morgan Stanley analyst and now a hedge-fund manager. (His fund has no position in Morgan Stanley stock.)

To recap for those who aren't keeping score at home: In the years after the original merger between Dean Witter and Morgan Stanley, Mr. Purcell packed the board with long-standing loyalists from his Dean Witter days.

This crony board looked the other way as Mr. Purcell consolidated his power over the past several years, even as the stock and some financial measures lagged behind peers. The board declined to meet with the legendary Dick Fisher, former CEO of Morgan Stanley, when he wanted to plead his case for Mr. Mack before Mr. Mack left in 2001.

The board sat by over the years as Mr. Purcell moved his people into most of the major management roles at the company and sidelined Morgan Stanley folks.

Hedge-fund manager Scott Sipprelle, a former Morgan Stanley executive, wrote a letter to the board about his concerns last December. The "Gang of Eight" ex-Morgan Stanley top executives got involved in March. Yet the board continued to stand by Mr. Purcell, even as rainmakers from the Morgan Stanley side headed toward the exits.

But all of a sudden, Mr. Purcell stepped down and the board's staunch defense appeared foolishly steadfast.

Then the board said it was refusing to consider Mr. Mack or any of the dissident ex-Morgan Stanley executives to replace Mr. Purcell. But like a teenager doing donuts in the parking lot, it turned around on that, too. Mr. Mack was soon signing a contract.

Mr. Mack's first major decision was a whopper. He was offered a trough of money and grabbed with both fists. His contract not only guaranteed his pay but it was based not on how well Morgan Stanley did -- remember, that was the original problem -- but on how well his Wall Street peers were paid. The board of directors was outsourcing its compensation decisions. So much for pay-for-performance.

To Mr. Mack's credit, he quickly realized his mistake and his contract is being reworked to tie it to firm performance.

There was nothing Mr. Mack could do about the Purcell package. That was the board's handiwork. It is estimated at around $106 million, including a new $44 million cash bonus and retirement pay as well as some previously granted stock and options. But at least he worked for the money, albeit not very effectively.

Mr. Crawford was put into his job, by Mr. Purcell, 3 1/2 months ago after years in essentially administrative jobs. For this he deserves a golden parachute of $32 million in cash compensation? The board guaranteed him $16 million a year for two years -- but said he could just walk away with the whole shebang if he left by Aug. 3. Decisions, decisions.

Morgan Stanley says the pay packages were meant to insure management stability and aren't out of the norm on Wall Street.

According to a study completed this spring by Harvard Law School professors Lucian Bebchuk and Robert Jackson, the median pension plan for a departing CEO of a Standard & Poor's 500 company in 2003 and 2004 was $15 million. It's normal to offer merely one year of severance, pay experts say.

As the board was negotiating this contract in June with Mr. Crawford, the directors knew that Mr. Crawford was likely to walk under a new regime. It's a nice touch that Morgan Stanley wrote that its agreement with Mr. Crawford was meant to "mitigate the uncertainties that you may be experiencing regarding your future with the company." That's one word for it.

These recent board moves are disheartening. Perhaps Mr. Mack realizes now that even he isn't going get a free pass from employees and investors. He's trying to rebuild the franchise. The current board isn't helping.