To Rein in CEOs' Pay, Why Not Consider Outsourcing the Post?

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For several years now, chief executives of U.S. companies have been telling lots of employees that they have gotten too expensive. Since it is possible to find qualified but cheaper workers to write software and perform other labor in India, China, Turkey and dozens of other countries, it makes competitive sense, they say, to outsource jobs.

Perhaps it is time for American CEOs to include themselves in this strategy. Certainly the directors who determine their compensation should take a close, hard look at the colossal sums they are offering and do some global-labor cost analysis.

Many countries don't require publicly traded companies to disclose top executive pay, as the U.S. does, so precise comparative compensation figures can be hard to come by. Still, there is enough data available to show that American CEOs are by far the most costly.

The median salary plus cash bonus for U.S. CEOs in office for at least a year totaled $2.3 million in 2004, according to an analysis of 421 large companies by Boardex, of London. That compares with $1.2 million for the heads of the 304 United Kingdom companies surveyed, $857,000 at 104 French companies and $386,000 at 95 Swedish concerns.

The pay gap between U.S. and Asian business leaders is even larger. According to an analysis by Mercer Human Resource Consulting, the heads of the 248 Indian companies surveyed earned a median salary and bonus of $88,117 as of July 2004, compared with $317,864 for the heads of 187 Japanese companies, $302,078 at 174 Hong Kong companies and $263,301 at 394 Singapore concerns.

None of this means U.S. directors should disregard American management talent when filling CEO spots -- and pay fairly for it. What is galling is how rarely, even in a time of heightened governance sensitivity, compensation is linked to performance. Newly named CEOs are guaranteed a trough of money before they've done any work. When they fail and are dismissed, they are handed even more money.

That is the case at Morgan Stanley, where ex-CEO Phil Purcell received a severance and retirement package estimated at $106 million, including a new $44 million cash bonus for being shown the door. Former Co-President Steve Crawford is walking away with two years of severance estimated at $32 million after 3½ months on that job.

The investor furor that erupted last week when news about these packages surfaced forced newly named CEO John Mack to give up an agreement guaranteeing him $25 million for each of the next two years, however he performs.

Such excesses might be easier to accept if they were anomalies. But "Morgan Stanley isn't unique," says Arthur Levitt, a senior adviser for Carlyle Group, a private-equity firm and a former chairman at the Securities and Exchange Commission. "This is symptomatic of the fraternal culture at many boards that want to avoid any lingering bad feelings" when executives are dismissed and are willing to offer generous guarantees to their replacements before they lift a finger.

Carly Fiorina left Hewlett-Packard this year with severance of $14 million, plus a $7 million bonus and $23.5 million in restricted stock and pension payouts. Mark Hurd, her successor, will receive a base salary of $1.4 million a year and a $2 million signing bonus. Along with long-term performance-based incentives that include option grants and a $4.2 million to $12.6 million cash bonus, Mr. Hurd is eligible for an annual bonus of $2.8 million to $8.4 million, based on hitting performance-related targets, and received a $2 million signing bonus.

"But when you look at the fine print of his contract, you see that a chunk of that annual bonus is virtually guaranteed," says Lucian Bebchuk, a Harvard law professor and co-author of "Pay Without Performance." "The main justification for escalating CEO pay levels is the need to generate powerful incentives -- but in reality the links between pay and performance aren't strong," he adds. Indeed, a big portion of executive compensation, including rich guaranteed retirement payments and "stealth" benefits such as free lifetime use of corporate jets, are completely divorced from performance.

Meanwhile, the gap between CEO pay and just about everyone else except investment bankers and hedge-fund managers keeps growing. Last year, the median salary and bonus for CEOs rose 14.5%, while paychecks of nonunion salaried staffers rose 3.4%, according to Mercer. In 1960, CEOs earned an average of two times as much as the president of the U.S.; today they earn an average 62 times as much as the president, notes Rakesh Khurana, a Harvard Business School professor. "It's been three years since Sarbanes-Oxley, the broad governance reform law, took effect, so directors no longer have the excuse of saying 'well we negotiated this before we recognized the problems,' " he says.

So other than outsourcing CEO jobs, what's the solution? For starters, boards must stop rewarding incompetence. "When a CEO is dismissed, it usually means the company's performance has weakened, and you weaken it even more" if you then hand out exorbitant severance, Mr. Khurana says. In addition, directors must learn the art of "arm's length" negotiating and put a price tag on all forms of compensation so shareholders know what they are paying. It is shareholders' money, after all, that directors are giving away.