Executives Cash In, Regardless of Performance

By Ben White and Carrie Johnson
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High-profile meltdowns aside, it still pays to be the boss.

Hewlett-Packard Co.'s Carly Fiorina, recently muscled out of her job over lackluster performance, walked away with an exit package worth $42 million. Boeing Co.'s Harry C. Stonecipher, pushed out over an affair with a female employee, nonetheless is eligible for retirement benefits of about $600,000 per year. Franklin D. Raines bowed out under heavy pressure in December following accounting problems at Fannie Mae. But the firm says he is now owed $114,393 per month in pension benefits.

At many other corporations untouched by scandal, pay continues to climb whether performance is great, lousy or middling.

"Even though the escalation of pay has often been justified as necessary, when you look at the details, that is not the case, because much of the pay is not all that sensitive to performance," said Harvard Law School professor Lucian A. Bebchuk, author of the new book "Pay Without Performance."

"Our view is that pay is much less connected to performance than investors commonly recognize," he said.

Among the biggest pay winners in 2004 was Morgan Stanley chief executive Philip J. Purcell, who pulled down $22.5 million, including $13.8 million in restricted shares. Some Morgan Stanley shareholders have criticized Purcell's pay because, while the firm's earnings grew 18 percent in its fiscal 2004, the company's stock price dropped about 6 percent.

At Coca-Cola Co., chief executive E. Neville Isdell made about $11 million in cash, stock and bonus in 2004 and was awarded 450,000 stock options. Meanwhile, Coca-Cola shareholders watched the stock price fall from around $50 at the beginning of the year to just over $41 at year's end.

Overall, a study by Mercer Human Resource Consulting LLC found that bonuses at 100 big companies rose 46.4 percent in 2004, to a median of $1.14 million. The gains follow a decade of soaring executive compensation, a rise that has not been slowed by heavy criticism from some shareholder groups and institutional investors.

Between 1993 and 2002, total compensation paid by all public companies to their top five executives was $260 billion, according to a study by Bebchuk and Cornell University professor Yaniv Grinstein.

From 1993 to 1997, executive pay amounted to 6 percent of total corporate profit, the study said. That number increased to 10 percent of aggregate corporate profit from 1998 to 2002. At companies whose shares are part of the Standard and Poor's 500-stock index, average chief executive pay rose from $3.7 million in 1993 to $10.3 million in 2002, a hike of 178 percent, the study said.

"It's not something that can be explained by the economic fundamentals of a company," Bebchuk said. "The ratcheting effect that you have during this period . . . the boom in the stock market, the increased use of equity compensation, has made large pay more acceptable to outsiders.

"It's provided a good cover for increasing pay levels," he added.

One thing that has changed in the past year or so is a reduction in the use of big stock-option grants. That is largely because a change in accounting standards will soon require the options to count as an expense against earnings. Some shareholder groups have strongly criticized options, saying they encourage managing for short-term stock price gains rather than long-term growth.

Paul Hodgson, senior researcher at the Corporate Library, said that while option awards have gone down, plenty of executives capitalized on old option awards in 2004, netting big paydays.

At Merck & Co., for instance, chief executive Raymond V. Gilmartin realized a gain of $34.8 million in 2004 by exercising options. The gain came the same year Merck pulled its popular Vioxx pain medication off the market following a study linking its longtime use with an increased risk of heart attacks and strokes.

The company's stock plunged after the Vioxx recall, and the firm faces hundreds of lawsuits. On Feb. 22, five months after the recall, Merck awarded Gilmartin a 2004 bonus of $1.4 million.

At Riggs National Corp., parent company of troubled Riggs Bank, former chairman and chief executive Robert L. Allbritton received cash and bonus payments of $443,269 in 2002 and $541,360 in 2003, the last year for which figures are available. He also received sizable stock-option awards.

Allbritton exercised many of those options March 4, just before resigning as chairman and chief executive, realizing a value of $5.7 million that day by buying the shares at prices below Riggs's stock price.

Raines was forced out at Fannie Mae after regulators found the firm had misapplied accounting rules and would have to correct financial statements dating to 2001. Raines earned $5.4 million in cash compensation, plus more than $11 million in long-term incentive payments, as well as stock options in 2003.

Fannie Mae has since overhauled its executive compensation practices under heavy government pressure.

Some scandal-ridden companies have aggressively moved to collect pay and bonuses from their former executives. Tyco International Ltd. sued former chief executive L. Dennis Kozlowski and finance chief Mark H. Swartz, who are on trial on grand larceny and fraud charges in New York state court, seeking repayment of tens of millions of dollars in company loans.

Canadian technology giant Nortel Networks Corp. recently sued ousted chief executive Frank A. Dunn and other former officials under federal investigation, saying they carried out a widespread accounting fraud that helped the executives meet bonus targets. Dunn has not been charged with wrongdoing, and he is fighting the lawsuit, which seeks more than $10 million in bonuses from Dunn and others.

The 2002 Sarbanes-Oxley law gives companies the power, under certain circumstances, to "claw back" bonuses from top executives within 12 months of a restatement due to misconduct. But securities law experts say that relatively new provision has been used sparingly, if at all, so far.

Overall, federal regulators say there is little they can do directly to stem the steady rise in executive pay. Instead, they are searching for ways to make disclosure more complete and easy to understand.

Securities and Exchange Commission Chairman William H. Donaldson hits the pay issue regularly in his speeches, and agency staffers are trying to figure out how they can make pay charts contained in securities filings easier to read. Internal Revenue Commissioner Mark W. Everson last year launched an audit drive focusing on executive pay, including deferred compensation and use of corporate jets and other perks.

But any impact those efforts may have is still years away. In the meantime, veteran watchers of executive compensation predict only one thing when it comes to what the big boss gets paid.

"I expect it will only keep going up and up and up," Hodgson said.