Executive Pay: Over the Top?

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Debate Continues over Lavish Salaries

NEW YORK, MAY 7, 2005 (Zenit.org).- Salary levels for chief executives at many large companies continue to raise question marks over the correct way to determine compensation. In the United States, firms have been filing their data for 2004. At 179 large companies that did not change their chief executive last year, salaries for the chief executive officer rose an average of 12% on the previous year, the New York Times reported April 3.

The Times commented that the issue of remuneration for company leaders has become more sensitive in recent times given that shareholders are still trying to recover losses following the stock market drop after 2000.

In the face of criticism, companies are limiting some aspects of salaries, and there are increasing efforts to link salaries to company performance. For example, John Alm, who took over as chief executive at Coca-Cola in January 2004, will receive shares in the company, but it is conditional on targets set for an increase in the firm's stock prices.

Questions persist over matters such as payments for retiring CEOs. The New York Times gave the example of Lockheed Martin chief executive Vance Coffman, who retired last August with a lump-sum payment of $31.5 million. Other executives will receive lavish pensions for as long as they live. For example, Henry McKinnell Jr., chairman and chief executive of Pfizer, will be paid about $6.5 million a year after he retires, and Lee Raymond, Exxon Mobil's chief executive, will receive $5.9 million a year.

Other questions arise when executives stand to gain from decisions affecting a company's future. On Jan. 31 the Wall Street Journal reported on the case of Gillette's chief executive and chairman, James Kilts. Overseeing the fusion of Gillette with Procter & Gamble made good business sense, according to Kilts. But he also stood to gain $153 million in stock options and rights from the deal.

The article did note that Kilts had added billions to the share value of Gillette. But it asked, "Are top executives sometimes motivated to do mergers, at least in part, by personal gain?" Questions also arise, the Journal continued, when the top people walk away with millions, while thousands lose their job. Initial calculations estimate that around 6,000 jobs will be cut as a result of the merger.

In their book "Pay Without Performance: The Unfulfilled Promise of Executive Compensation,"

published late last year, Lucian Bebchuk and Jesse Fried noted that in 1991 the average large-company CEO received about 140 times the pay of an average worker. By 2003 the ration was about 500:1.

High performance?

They also noted that defenders of high levels of pay for company executives point to the need to pay well in order to attract talent. As well, a CEO should be well rewarded for good performance.

The book, however, outlines a series of problems regarding how compensation for CEOs is determined. In many cases, the authors note, the company board is too close, and too financially linked, to the CEO, leading to little critical oversight. Moreover, shareholders have little effective power to intervene on compensation levels for executives.

Bebchuk and Fried observe that the traditional view that considers an executive's salary as being set in a bargaining process between a board that is looking for the best deal for shareholders, and the executive who is seeking the best deal for himself, is mistaken. In fact, the data analyzed by the authors show that managerial power has played a key role in determining pay arrangements.

In addition, many benefits that executives received are hidden from public view. These camouflaged elements include deferred compensation, fringe benefits, and generous loans.

They also note that, apart from compensation based on stock options, there is a sizable part of executive pay that in practice is only tenuously linked to the company's performance. Moreover, many poorly performing executives receive lavish severance packages when they are ousted.

These problems continue, as some recent cases demonstrate. Last Oct. 21 the Associated Press reported that outgoing Kmart chief executive Julian Day would be receiving about $90 million in stock options for his 10 months of leadership at the discount chain. The company, noted the report, did improve under his leadership, but is still struggling to remain profitable after emerging from federal bankruptcy protection.

On Feb. 14 Reuters reported on how Carly Fiorina was ousted as chairman and CEO of Hewlett-Packard following disappointment over the company's performance. Nevertheless, her pay over the last five years at the firm, combined with the severance package, amounts to about $45 million.

Devising criteria

The importance of ensuring that salaries for chief executives are related to how well they are doing their job was raised by Arthur Levitt Jr., ex-chairman of the U.S. Securities and Exchange

Commission. Writing in the Wall Street Journal last Nov. 22, Levitt commented that following the corporate scandals of recent years, "the single greatest impediment to the restoration of confidence in corporate America is continuing instances of extravagant non-performance-based compensation."

Levitt suggested a number of ways to improve the situation. He called for greater independence on the part of a company's board of directors, to avoid an overly cozy relationship with the chief executive. Greater transparency regarding executive compensation would also improve matters, he added. And shareholders should be given information that enables a ready comparison on the performance of their company and how much its top executives earn in comparison to its peers.

The social teaching of the Church has little to say, at least directly, on the question of maximum levels of compensation. Ethical principles laid out in the magisterium have concentrated on the matter of a just wage for employees, concerned above all in ensuring minimum levels.

Indirectly, however, the texts collected in the recently published Compendium of the Social Doctrine of the Church can shed some light on how to judge the question of executive compensation.

In Nos. 330-45, the Compendium points out the need to give a moral dimension to economic activity, inspiring it through the application of solidarity, justice and charity. There is no moral problem with increasing wealth, but should be done in a way that contributes to the development of society and should not be limited to a quantitative accumulation of goods.

We have a right to receive the fruits of our labor and to employ our creativity in business activity. But economic freedom, the Compendium observes, is a part of human freedom in general, the core of which is ethical and religious. Therefore, the use of freedom in the area of business is linked to questions of individual virtue and also social virtues. As well, businesses should bear in mind their responsibility to contribute to the overall development of persons and society.

Further on the Compendium observes: "The free market cannot be judged apart from the ends that it seeks to accomplish and from the values that it transmits on a societal level" (No. 348). The practical consequences of these principles for determining salary levels are open to debate, and can also vary according to particular circumstances. What is clear, however, is the need to focus attention on the moral principles underlying what constitutes a just wage in today's economy.