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Executive Compensation: Let's Look at Fund Managers' Pay, Too

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The white hot [debate](#) about executive compensation has focused almost exclusively on the "short-termism" of CEOs, other business leaders, and boards at corporations. The causes of the financial meltdown--excessive leverage, imprudent risk-taking, shoddy judgments--stemmed, in important part, from executives' seeking to gain huge annual bonuses and drive up the immediate value of stock options, with supine board approval.

One set of "solutions" to these problems, advocated by many both inside and outside of the government, is to give shareholders more power via new federal regulation, for example:

- through non-binding "say on pay" votes over executive compensation (on philosophy or measurements or application of the measurements to executives); or
- through "shareholder access" proposals to make it easier to put an alternative nominee on the list of director candidate

But are shareholders part of the solution or part of the problem? Surprisingly little attention has been given to the role shareholders and fund managers played in this debacle. Indeed, the glib assumption about "shareholder" as "solution" ignores some obvious issues.

- There is no such animal as "the" shareholder. Instead there is an extraordinary menagerie: large and small individual investors; public and private pension funds; a wide array of mutual funds; endowment funds for educational, health and other non-profit institutions; and an equally wide array of hedge funds. Almost all are trying, in one way or another, to beat their "benchmarks" whether those are the Dow Jones or the NASDAQ or relevant S&P or MSCI indexes.
- How many of these investors are driven by the goal of short-term performance in their portfolios, engage in relatively short-term trading strategies and have little interest in corporate creation of long-term economic value?
- What kinds of salary and bonus plans do the the institutional investors provide to their fund managers---the people who drive the stock market and may be an important source of the short-term pressure on companies? And, how are powerful investors governed and to whom are they accountable?

These are important issues that need to be explored empirically and systematically. But, there is plenty of anecdotal evidence that many CEOs or CFOs are appalled by the pressure for very short-term results placed on companies by powerful institutional holders. Another indicator: good leaders leave public companies for operational roles in private equity firms (not necessarily for greater short-term pay) because they can make resource decisions for the long-term good of the enterprise and not feel forced to go against their better judgment just to make the quarter.

Yes, inside corporations we need to alter executive compensation dramatically to reduce the naked annual bonus and the naked stock option as outsized components of executive compensation. Yes, we need to devise compensation systems that pay over time for real economic performance and creation of economic

value, that pay for financial discipline and risk management, and that pay for creating a culture of integrity (law, ethics, values).

But will needed executive compensation reform inside companies founder because relentless short-term pressure from (some) powerful institutional investors undermines the need to reward executive achievement of performance, risk and integrity measures over a number of years. Of course, we don't want to go back to the bad old days of the 1980s when there may have been little stock market discipline on then-complacent managers. But there is certainly an argument that we have we now swung too far the other way.

That is why the question of looking at the investors' role in the crisis and at fund manager compensation-- whether by the Congressional commission to study the causes of the financial crisis, or by a Treasury' working group on executive compensation, or by a host of academic institutions and think tanks--is as important as reforming executive compensation inside companies. Such analysis would, in the first instance, not be for the purpose of regulation, but for illuminating and understanding a significant issue and, at a minimum, focusing and structuring the debate both on compensation best practices for fund managers and on the larger question of when and how shareholders can contribute to the long term creation of economic value--and when they don't.

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