

Sky-High Payouts To Top Executives Prove Hard to Curb

The Wall Street Journal

Carol Hymowitz

June 26, 2006

Investor complaints about executive pay are getting louder and angrier, but CEOs are likely to keep raking it in for some time to come. They think they deserve their steep payouts even when their performance has been far from stellar. And a majority of corporate directors don't think executive pay is hurting the economy or their companies' performance and aren't ready to say no.

Dana Mead, head of Pfizer's compensation committee, for example, defended CEO Hank McKinnell's hefty salary and pension package at the company's annual meeting in April. When one shareholder demanded to know why Mr. McKinnell received in two days what he as an orthopedic surgeon earned over the course of a year, Mr. Mead said that Mr. McKinnell's pay was based on market forces and reflected his responsibility overseeing 110,000 employees. Disgruntled shareholders even tried to unseat Mr. Mead and another director this past April but failed. They did, however, withhold a remarkable 20% of the vote.

Since Mr. McKinnell became CEO in 2001, Pfizer's shares have lost more than 40% of their value. Meanwhile, the CEO has received \$79 million in pay during that period and has a guaranteed pension of \$83 million when he retires.

At other companies, directors also have continued to fork over higher sums to CEOs despite heightened governance concerns. Last year, total direct compensation for chiefs -- which includes salary, bonus and the value of restricted stock when it was granted -- jumped nearly 16% to a median of \$6.05 million, according to an analysis of 350 major companies by Mercer for *The Wall Street Journal*. Most CEOs also received generous pensions, deferred compensation and other perks.

Directors think using pay incentives to lure top talent is good for the economy. A recent survey of directors by consultant Watson Wyatt found that 65% believe the executive pay system has "contributed to positive U.S. economic performance." Their reasoning is that the best chief executives create jobs and sell products that keep the economy humming.

But institutional investors, who were surveyed separately, think a lot differently. Just 22% think the pay system has helped the nation's economic performance. And some 90% said top executives are "dramatically overpaid," compared with 61% of directors.

These contrasting views illuminate the problem: Most directors -- many of them CEOs and retired CEOs themselves -- still are more aligned with chief executives than with the shareholders they purportedly represent.

Certainly, boards have become more independent in the past four years, thanks to

accounting scandals at Enron, WorldCom and other companies, and passage of Sarbanes-Oxley, the broad corporate-governance act, and other reforms. Independent directors meet separately from management and often have divided the jobs of CEO and chairman of the board.

Yet, because CEOs have influence over who gets on the board -- the only board slate offered to shareholders is the one proposed by management -- directors are careful not to offend them. "Displeasing the CEO hurts one's chances of being put on the company slate, so directors have an incentive to support or at least go along with pay arrangements that favor top executives," says Lucian Bebchuk, a Harvard University law school professor and co-author of "Pay Without Performance." "They don't have an incentive to change those arrangements."

Nothing will change until shareholders gain the ability to easily replace directors. Call it the fear factor: If directors knew they stood a good chance of losing their board seats -- and the prestige and valuable business connections these provide -- unless they aligned themselves with shareholders, they might stop forking over so much and narrow the gap between what CEOs and their managers and employees get.

To get there requires changing corporate laws and practices. As a first step, Mr. Bebchuk recommends that shareholders gain the power to place director candidates on corporate ballots and to initiate and adopt changes in corporate charters. Under current rules, shareholders can only pass nonbinding resolutions and must wage costly proxy fights to nominate a dissident director slate.

In the meantime, the pending SEC overhaul of pay disclosure, expected to take effect next year, will give shareholders more ammunition to confront board compensation committees. The new rules will force companies to provide a total compensation figure for CEOs that gives details about perks, projected retirement payments, severance and deferred compensation.

But even investor pressure might not be enough to get directors to stop paying big money to attract name CEOs, says Ira Kay, head of Watson Wyatt's compensation practice. "They aren't going to come down a lot on the direct pay side until there's less competition for executives with the qualifications to be CEOs," he says.

As it is, seasoned top executives are still in demand. "Board members are reluctant to take a chance on unproven talent," adds Mr. Kay.

URL for this article: <http://online.wsj.com/article/SB115127720534290299.html>