

Battle between two ugly human traits



There is nothing quite like a discussion about executive compensation to elicit strong opinions - of the informed and uninformed varieties. Throw in a crisis in the financial markets, an economy in recession, and a strange alchemy of public and private ownership of businesses, and you have a good old-fashioned brouhaha.

The most recent controversy surrounds the bonuses paid to American International Group Inc. executives after billions of dollars of taxpayer money had been invested in AIG to keep it solvent. Before that, the issue was the Merrill Lynch & Co. Inc. bonuses paid out "in haste" in December.

At a recent gathering, I raised the issue of the Merrill Lynch bonuses and got a wide variety of passionate opinions. The fact that a group of people would have different views on the subject isn't surprising - but every member of this particular group was a chief executive officer.

At its extremes, this is a battle between two equally unattractive human traits - greed and jealousy.

Consider greed. A friend of mine was at a Wall Street investment-banking firm years ago when someone suggested that the unusually large bonuses to be paid that year might create a public relations issue. I can't repeat the vulgarities the then-CEO used in reaction to the suggestion that his \$18 million bonus would be problematic.

Absent the expletives and insults, it went like this:

"It's my money, and I'm going to keep it no matter what anyone says."

His zeal for the issue startled even this room of insiders. The bonuses were calculated according to an approved formula, but his insensitivity to the public's potential reaction was, perhaps, a foreshadowing of the issues we are dealing with now.

Now about jealousy. Begrudging the good fortune of others can be an almost automatic reaction. Some are unhappy if peers get recognized or promoted. They are the first to "boo" a highly paid athlete, and they cannot imagine anyone in business could be worth - pick a number - \$250,000, \$1 million, \$10 million, \$50 million? No explanation will suffice.

The attitude is unfortunate. Like it or not, our free-market system, when working properly, provides equality of opportunity, not equality of outcomes. Productivity and talent are rewarded; jealous complaining is wasted energy.

What should guide compensation? People should be paid for what their services are worth on the open market. They are worth the unique value they bring to the enterprise and its owners.

The problem is that, in public companies, the "owner" is typically a large pool of relatively disconnected shareholders. They have limited or no say in compensation matters, other than through their vote for directors. Executive compensation is set by compensation committees of the board of directors, who rely on expert consultants to give them data on what other executives in other companies are being paid. They award stock options or other equity-participation mechanisms based on some standard practice.

So the test of comparability is met, but it doesn't always meet the test of "value added." If the stock price soars, the executive compensation soars - whether the executive was responsible or not. It's also true even if the executive took actions to artificially prop up the stock price at the expense of the long-term financial health of the company.

Did the profanity-spewing CEO really and individually add enough value to warrant an \$18 million bonus? Or could someone else have added the same amount of value for, say, \$9 million?

The question never gets asked. His pay was tied to the price of the stock - period. By the way, that same company's stock is now virtually worthless.

Change is needed, but not in the form of artificial caps or ill-conceived penalty taxes. Compensation structures should measure an executive's true value and contribution. Greater emphasis is needed on the amount of risk the company is assuming by virtue of the executive's actions and decisions. Too much emphasis has been placed on the market price of the company's stock and not enough on the fundamental success of the underlying business. To compensate executives significantly for the market price of the stock and to not consider the commensurate risk for a stockholder can be a recipe for disaster.

"Fair" pay is when value is paid for value received, adjusted for risk. Concentrate on the best way to achieve that, and keep greed and jealousy out of the equation.

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