

On CEO Compensation – Ernest Nounou*

What began with the indictment of Jeff Skilling (Enron) and Bernie Ebbers (Worldcom), The trials of Dennis Kozlowski (Tyco) and the Rigas family (Adelphia), the possible suit of Dick Grasso (NYSE), the shareholder revolt against Michael Eisner's (Disney), the conviction of Martha Stewart and the announcement of CEO mega bonuses even as they were labeled Benedict Arnolds by John Kerry, the first week of March '04 was not a great week for US CEOs. One bright spot was the Yankee announcement of their intent to extend Joe Torre's contract. It is instructive.

Torre's on-field management of the Yankees is a CEO role. He is arguably the best in the business and appropriately the highest paid. His contract extension will be an arms-length negotiation with ownership (Boss); who now appreciates his value and would be devastated if he were to move on to the Red Sox. Yet Torre is not remotely the highest paid Yankee and, notwithstanding his leadership skills, no one would make the case that he should be.

Yet this was precisely the case CEOs and compliant boards made years ago, when they linked the need to dramatically increase CEO pay with the explosion in star athlete and entertainer compensation. The argument forwarded was that CEOs of major companies have significantly greater responsibilities, create value, and should be compensated proportionately. That was a canard. Some CEOs like Jack Welch provide tremendous value, but even he would admit he inherited a great organization and team, and that the value created at GE was done collectively. There are few performances like Welch's GE team, but there are a large number of CEOs with even greater compensation packages.

CEO compensation negotiations are a rigged game – just take the Grasso package. It was an outrageous rip-off by some of Wall Street's top leaders, who belatedly claimed they were "shocked, shocked" at the actual amount.

Skilling and Ebbers' responses to their indictments were that they knew nothing about their companies' finances, having delegated responsibility to others. In Ken Lay's case (Former Enron Chairman), rumor is he may not be indicted because his assertion that he was clueless as to Enron's financial improprieties is credible. So, if these and other CEOs largely delegate complex issues to their team and rely on outside expert opinions of lawyers and accountants, how do they justify being treated comparably to star athletes? Do Jeter or A-Rod receive any assistance when they bat? Have they ever delegated their at-bats when Pedro Martinez or Roger Clemens pitch?

Running a modern corporation is no small matter, and CEOs do so with their management teams and employees. Great CEO leadership enhances the entire company's performance and should be fairly compensated. But getting real for a moment, how much is enough, given that success is a team effort? And it's one thing to consistently increase profits via increased sales - that takes skill. But increasing profits only through cost control is not difficult and should not be similarly rewarded.

Retention bonuses should be serious considerations solely when CEOs want to pay for the privilege of retaining their positions. Salary, bonuses and perks, together with the commensurate status and power of the position, are such that the vast majority of CEOs, if pushed, would stay on at one-third to one-half of their total package. Few have Joe Torre's or Jack Welch's options to move elsewhere, and it is increasingly apparent who the really good ones are. A good bet is that Michael Eisner would gladly finish out his contract at Disney at a fraction of his compensation package, if only he were allowed to remain.

Finally, if CEOs insist they are worth star status compensation, they must include in their agreement a waiver of a future "clueless" plea, should they ever be indicted for corporate malfeasance. Otherwise, they should pick up a bat and try their luck facing Pedro or Roger.

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