

Three “Simple” Solutions

By Joseph R. Rich

For every complex problem, there is a simple solution that is patently wrong.



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Few would argue that executive compensation pay should be fair, equitable and performance-based. When a company is performing well under the stewardship of a

particular management team—and investors and shareholders are benefiting—its leaders should be compensated accordingly. Yet each year, executive compensation continues to escalate, even though not all companies are performing better. So, the question becomes, is this increased payday at the top based on fair, equitable and performance-based measures?

Executive compensation contracts are complicated documents. In fact, the intricacy of those agreements and the subsequent payouts are so complex that they have not been fully understood, even in some instances by the board members that approved them. As a result, in some cases there have been unexpectedly large payouts, and those payouts struck a public chord. The result has been an outcry for simplification.

Unfortunately, simple solutions, while ideal, don’t dispatch complex problems.

Three key solutions (and their presumed outcomes) have been proposed to simplify the difficult issue of executive compensation:

- Greater disclosure. If investors know what top executives are making that will ensure that compensation stays in check.
- Tally sheets. If the compensation committee tallies up all compensation elements and reaches “one number,” then knowing how large that number is will keep executive pay in check.
- A designated consultant for the compensation committees. If compensation committees have their own consultant who is uninfluenced by management, the board will have a straight answer and that will definitely ensure that pay stays in check

Should boards consider these things? Probably. But it is unlikely that these simple solutions will ensure that pay is fair, equitable and performance-based.

Greater Disclosure

The SEC, ISS and Congress all operate under the notion that disclosure of executive compensation levels provides investors with a window into corporate governance. And recent activities by all three suggest there will be a bigger push for more and more disclosure.

And while better disclosure is probably a good idea, disclosure in and of itself will not keep executive pay in check.

On the contrary: disclosure, and the availability of data in compensation surveys, instead often provides fuel for the ever-increasing levels of executive compensation. This disclosure provides firms and their advisors with the ability to compare programs; program comparison leads to gap identification and gaps get filled.

Companies will make choices about pay levels and structures with or without information. The availability of competitive information allows firms to identify best practices, and the prospect of disclosure likely keeps most potential bad-actors in check. However, the availability of information provides air-cover for all the generally good-actors to fill gaps to be competitive.

Let’s think about the distribution of pay: Bad-actors who are the egregious pay-recipients at the top may be checked by greater disclosure. But, the rest of the distribution—the good-actors—will

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now have additional information with which to assess their programs and ensure that they are providing their executives with competitive packages. So while the few may be restrained, more than likely, the masses will be enabled.

There is a social good in keeping executive compensation fair. And in order to keep pay in check, we need to address and remember that being competitive is not the eleventh commandment. The data and information aren't the problem; it's that we have substituted being competitive for the real goals: to be fair, equitable, and performance-based. Absent this change in mindset the cost of greater disclosure will inevitably be greater pay.

Tally Sheets

The high profile executive paydays we've seen over the past several years have often been associated with acquisitions and terminations. In some cases it has been argued that committee members may not have been fully cognizant of the high-dollar value of these payments prior to their occurrence. The resulting public out-cry has created the desire to have a complete aggregation of all elements of compensation distilled into one number summarized in the format of a tally sheet.

You and I both know that in reality, there isn't one simple number, because the number differs based on the scenario: whether or not there is a separation, and if so under what circumstances; whether or not there is an acquisition; how

the individual and the firm perform over time, and other factors.

The real value in completing tally sheets is that they push firms, compensation committees, and service providers to re-think and possibly re-approach how they reach those compensation decisions. It's doubtful that tally sheets alone can keep pay in check, but tally sheets can prevent firms and committees from overlooking how program elements interact (thereby avoiding unintended consequences), and it may keep some of the bad-actors in check.

In the end, a firm and its committee must know what they are trying to accomplish with their executive pay program, otherwise a tally sheet is merely a good measurement tool.

Committee Consultants

Should compensation committees have their own consultant? Under certain circumstances the answer is: probably.

The fact is much of compensation consulting is based on business judgment framed by analytical processes and tools. If a consultant is qualified and has ample time and exposure to the comp committee, it's likely that s/he could avert the actions of bad-actor management, or identify the mistakes of a poor consultant to management. And the mere presence of a committee consultant could temper managements' recommendations.

Certainly the analytical processes and tools can be vetted and

assessed, and definitive determinations about their appropriateness and accuracy can be made. But business judgment is more difficult to assess, and the results of differing choices might not be visible for many years.

The true value of a designated comp committee consultant is that there is an additional experienced person considering the problem, identifying and evaluating potential solutions, and making recommendations accordingly.

Better disclosure, tally sheets and a designated comp committee consultant are ways to help make executive pay fairer, more reasonable, and more performance-based. The key is to recognize that implementing relatively simple solutions is beneficial, but in the end, only good judgment can make pay programs effective and appropriate.

For more information on tally sheets, visit www.pearlmeyer.com/tallysheets.

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