

Pay Limits Didn't Provoke Mass Exodus

New government data finds that executive-pay limits did not cause a mass exodus of senior executives at the five troubled companies under the pay regulator's watch, contradicting what had been the popular thinking on Wall Street. While some experts say those numbers don't really tell the whole story, there have been some lessons to learn from the situation.

By Michael O'Brien

Call it the exodus that never arrived.



While compensation analysts and others loudly complained last fall that imposing pay limits on the top executives at troubled companies that took federal bailout money would drive those executives to search out better-paying positions, new data has emerged to prove the naysayers wrong.

Of the 104 senior executives at AIG, GMAC Financial, General Motors, Chrysler and its auto financing unit whose pay was set, 88 of those executives are still with the same company, according to a recently released report by Kenneth Feinberg, the federal government's special master for executive compensation.

For the 119 executives whose pay Feinberg approved for 2010, cash compensation for 97 of them, or 82 percent, is expected to be \$500,000 or less, down by nearly half from 2008, according to the *New York Times*.

"That's the most important statistic I think -- namely that about 85 percent of the individuals who had their pay set are still at their desk working for these very five same companies," Feinberg said in a radio interview on American Public Media shortly after the data was announced.

"This is strong evidence that the pay determinations are not resulting in some sort of brain drain from these companies," he said.

When asked if he thought the original outcry was less than genuine, he responded: "I think probably key executives at these five companies really did fear the likelihood that the competitive marketplace would attract key officials away from these companies. I was always very dubious, skeptical about this. And it's been demonstrated."

But some compensation experts question the validity of his conclusions.

At New York-based Compensation Advisory Partners, senior partner Rose Marie Orens says she's not surprised by Feinberg's findings but remains skeptical nonetheless.

"In the nicest of ways, we all know numbers can be made to say anything," Orens says, adding: "A lot of people had been gone [from those five companies] before those particular [pay] decisions were made."

And for the executives who stayed at their companies, Orens wonders what other job options they had.

"Where is the market beyond GM and Chrysler for auto executives at the moment?"

Todd Gershkowitz, a New York-based senior vice president at Farient Advisors, a Los Angeles-based independent executive-compensation consultancy, says he's also not surprised by the Feinberg data, but for different reasons.

"The way the compensation was restructured," he says, "a lot of pay was forced into equity over time, so it's kind of a built-in retention mechanism. The fact that you have to receive it over three or four years will keep folks around."

"Secondly, it will be interesting to see how the next two or three years pan out because of the bargain-basement equity that was offered. If you [are to receive] a lot of your compensation in the last two years of a contract, then you will be sitting on a huge upside if the company rebounds," Gershkowitz says.

He also agrees, however, that many of the affected executives had a lack of alternatives.

"Where everyone is going to go, every large financial institution has adopted a lot of the same practices and you'd be subject to the same consequences," he says. "So a lot of the executives aren't interested in jumping from the frying pan into the fire."

One of the affected companies, AIG, has opted to embark on a new pay practice: a forced-ranking system to distribute an upcoming round of bonuses and incentive pay to its 10,000 employees, according to the *Wall Street Journal*.

The company will rank employee performance from one to five to "help decide who will get raises and larger incentive awards," according to the *WSJ*.

"I don't have a lot of inside knowledge," Orens says, "but my view is AIG may have really suffered from a lack of pay for performance in the past. It was a very patriarchal [organization] and there was not a lot of accountability there."

The new forced-ranking system, she says, may "really shock people into making these kinds of [pay] decisions. Applying a forced distribution makes some kind of sense. It's a change-management tool as well as [an] expectations-management tool.

"This is not a bad tool, when supported, for trying to get a picture of what the workforce looks like and helping people to start being competent at evaluating performers," she says. "You've got to start somewhere."

But Tom Sykes, senior product manager of Waltham, Mass.-based PeopleClick Authoria's compensation line, cautions that such a system can ultimately have a negative effect on a company's workforce.

"When companies have done [forced ranking], it sounds good, but people's hearts aren't in it," he says. "Over time, it becomes less a thought of how people work, and more a thought that 'we're going to have a hard line drawn here.' Over time, it becomes less flexible to the realities of the business."

GE was a model of forced ranking in the past, he says, adding that "employers like the idea of doing it, but there's a happy medium there that's difficult to find."

If AIG's forced-ranking system proves successful, Sykes says, other financial-services companies may also adopt it, "but I don't think it's going to be applicable across industries. What may work in financial services may not necessarily work in software development."

In his radio interview, Feinberg weighed in on whether he thought the new data would cause a rethinking of compensation among seasoned Wall Street analysts.

"I think historically there's always been a huge gap between Wall Street and Main Street," he said, "but it does make a difference in terms of my work because I'm required to take into account competitive pay as a way to keep people at their desks, and not leave these five companies. And now the statistics seem to demonstrate that they're not going anywhere."

Orens agrees the report's findings won't reverberate all the way to Main Street.

"For companies outside the TARP world, we don't think [the data] will directly impact the way pay is set," she says.

However, Melissa Burek, a partner at CAP, says there are HR lessons for non-TARP companies to learn from the whole episode.

"There are other parts of TARP regulations that are impacting what HR is doing, including severance, recoupment policies, perk policies and limiting provisions of severance. Lots of companies are now putting those in place," she says.

"At the end of the day, the name of the game is still paying for performance, and it's become more challenging in this economy as well."

Gershkowitz says the biggest challenge for HR "is that it's very tempting for a lot of companies to adopt an attitude of 'We got past this crisis, we suffered, but we survived and these things happen every five years. Let's make up for lost time.' My biggest concern [for] HR is how to make sure we learn and not make the same mistakes."

Top HR executives should be trying to make sure the company's leadership understands there needs to be a fundamental change in the way things get done as it relates to the setting of compensation, he says.

"A star system will distort the pay system," he says. "We have to remember that no one is indispensable . . . and we can't allow top talent to hold the company hostage."

"Every company will claim they emphasize and embody 'pay for performance,' but if that were true, we never would have seen any of this actually happen."

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