A Cozy Arrangement
The New York Times | Editorial

Thursday 13 April 2006

To fix something, first you have to understand what went wrong. That's especially true for a problem as complex yet pervasive as sky-high executive compensation.

Last Sunday The Times reported that in 2004, the average top executive at a big company earned 170 times the average worker's pay. These executives receive a dizzying combination of salaries, bonuses and stock grants. And their perks can go far beyond the use of a company car to even include infusions of cash to offset the taxes everyone else is expected to pay.

In many cases, the process that led to these out-of-kilter salaries has a chilling resemblance to corporate scandals in Wall Street stock research and accounting industry audits. In an era of bigger-is-better consolidation, the goal for many businesses was to find synergies, to provide so-called integrated solutions or one-stop shopping. But when one of the services being purchased requires impartial advice, conflicts arise. If a firm that promises to do objective financial statements is also attempting to woo the client it is auditing into other kinds of deals, the temptations are obvious.

It is just as true for human resources. To make the decisions on executive pay, many companies create compensation committees, drawn from the board of directors. That committee in turn is advised by outside consultants, experts in how much others in the field are getting paid. It looks quite logical at first glance. It is in the details that the value of closer scrutiny becomes clear.

Earlier this week Gretchen Morgenson explained in this newspaper how just one company, Verizon Communications, decides what to reward its chief executive, Ivan Seidenberg. It offers an illuminating look at a system gone completely haywire. The outside consultants who advise Verizon, Hewitt Associates, do loads of other business for the company. Among other things, Hewitt operates Verizon's employee benefits Web sites and performs actuarial work for three of the company's pension plans. The company has racked up more than half a billion dollars in revenue from Verizon and its predecessors since 1997.

Though the company says it has strict policies to maintain objectivity, Hewitt has a strong incentive not to rock the boat by offending Verizon executives. The end result is predictable. Mr. Seidenberg received a package worth $19.4 million last year, as his shareholders felt the pinch of a stock that fell 26 percent.

Runaway pay matters because top executives are snatching more than their fair share of corporate proceeds. More important, it also means that the board of directors is not performing its function as internal guardian of the company's health.