Leadership

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# Outrageous Executive Compensation: Corporate Boards, Not the Market, Are to Blame

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*I am all about sustainable organizational effectiveness.*

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Corporations in the United States have been widely criticized for their approach to executive compensation. This approach has produced extremely high levels of compensation that are highly dysfunctional.

the top earners in the country and the rest of the population. Compensation has become so high that it significantly affects the profitability of even relatively large corporations. Perhaps less frequently noted are the pay plans that provide such a big performance incentive for individuals that they can lead people to take risky and even illegal actions in order to make their pay -for-performance compensation plans pay off.

The standard justification for the high pay of CEOs and other top executives is that the market demands it. It is argued that if you do not pay CEOs at or above the market, they will leave and go to a competitor. There are a number of problems with this argument. Perhaps the most important one is that numerous studies have shown that CEOs rarely move from one company to another, and when they do, they are usually less successful than internal candidates. In short, at least at the CEO level, there is little evidence that an efficient market for talent exists that is based on compensation levels.

Market data are a constantly escalating and flawed indicator of what executives should be paid. Few boards are willing to pay their executives below market. There are several reasons for this. Board members typically want to be looked upon positively by the CEO and other senior executives in order to get on and remain on corporate boards. A board member who argues for paying individuals below the market is not likely to be a respected or valued board member, at least in the eyes of the executive team of the company.

continues to go up, up, and up. They are the CEOs of other companies. You don't have to be a compensation expert to realize that if you vote for one of your peers to have a higher salary, you are in effect voting for your own salary to go up, because it is based on what will be a higher market.

If boards continue to rely on comparative compensation data to determine what CEOs should be paid, executive compensation will continue to spiral upward and out of control. What is the best way to stop the cycle of ever-increasing executive compensation?



One option that is gathering support in Europe is mandatory shareholder votes on executive compensation packages. This action does seem to be effective with respect to those extreme outliers who are easily identified by investors as greatly overpaid. It is not clear, however, that it has or will stop the continuing overall increases in executive compensation.

The group that is best positioned to change executive compensation is executive compensation.

For boards to change their stripes when it comes to executive compensation, major changes need to take place in who is on corporate boards and on their compensation committees. It would mean fewer CEOs on corporate boards. It would require more board members who understand talent management and are concerned about the societal impact of corporations. Another effective change would be to have a board membership that is dominated by strong, independent directors.

If boards do not reduce how much executives are compensated, there is a good possibility that further government regulations will be created and that large shareholders will become more active. Personally, I would rather see boards step up and reduce executive compensation. They are positioned to do a more informed job than regulators and investors.

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