Full Disclosure Leading to Full Executive Salaries

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Led by future Hall of Famers Bob Gibson, Lou Brock and Steve Carlton, the 1968 St. Louis Cardinals fell a single game short of defending the world championship the team won the previous year.

Those Cardinals were noteworthy for another reason – they were the first baseball team to break the $1 million payroll barrier.

My, how things have changed.

Less than 35 years later, a single player, Alex Rodriguez, signed baseball's largest contract ever at $252 million over 10 years. And word around town is that the New York Yankees are looking to extend A-Rod's contract, which still has a couple years to run. If they don't, the arch-rival Boston Red Sox are believed to be interested.

But what does this have to do with executive compensation?

Everything.

"Star player" pay also has taken off in the business world. Consider that Ford Motor Co.'s President and CEO Alan Mulally earned nearly $28 million in a year when the automaker lost more than $12 billion. That's a bit extreme, but there are plenty of executives at S&P 500 companies who are easily making eight figures.

So, what's behind all of this? Full disclosure.

Both professional athletes and CEOs are now aware of what their peers earn and how they perform. They use this information to negotiate their own contracts.

This transparency ultimately is a good thing. Sure, there will still be news articles about how some poorly performing CEO is running his company into the ground while collecting a king's ransom. But the transparency will help ensure that pay more closely mirrors performance.

Let's take a look at exactly what has changed:

• Option grants are now required to be expensed, which has caused companies to be stingy with options. Executives may be the only group receiving options or restricted stock within the company.

● Proxy disclosures are much more comprehensive. Those disclosures require more details about all elements of compensation, such as perquisites, change in control and severance payments, retirement and standard values for options, as well as what it takes to be paid at risk compensation. As a result of more disclosure, comparability of pay is enhanced.

Performance measures are now part of the disclosure unless they cause competitive harm. This would allow for comparability of performance requirements and actual results, again very similar to all the baseball statistics, such as batting average, home runs, runs batted in, etc.

● Governance by compensation committee is a best practice and these committees still must gain approval from the board of directors. Documented performance measures are good for management

and remove discretion. This should lead to the star performers receiving more pay and the poor performers receiving less pay.

Whether it leads to increased performance is another question, which depends on the environment surrounding the industry, the talent of the management team and the amount of risk inherent in company operations.

● Institutional shareholders have demanded – and received – higher standards for corporate governance of compensation. This increases the discipline and structure required to evaluate peer pay packages.

What is most important is for a board of directors to have in place a compensation philosophy and solid performance measures which add value to the shareholders. A philosophy and performance measures which equate high pay to high performance should reward everyone appropriately over time.

In the long run, executive compensation is likely to rise – perhaps sharply – but the executives receiving the big bucks are more likely to deserve it.

In that case, everyone wins. The executive receives well-deserved compensation, the properly managed company thrives and shareholders prosper when investors push stock shares to new heights.

Of course, there are numerous potential flies in the ointment, most of which center around companies which are doing poorly, yet reward the executive excessively.
Still, there are built-in mechanisms in the business world that will keep everything in line.

For one thing, companies doing poorly will see shareholders flee, dropping the stock price. Remember the example cited earlier about Ford CEO Alan Mulally? Shareholders certainly aren't rewarding Ford for its performance – shares haven't climbed above $10 apiece since the fall of 2005.

And should things get too far out of hand, the threat of Draconian remedies on par with Sarbanes-Oxley can certainly put a damper on the controversy.

Are things perfect? Far from it. Yet there's a pretty good framework in place, more information than ever before and regulators (and the public) still paying careful attention, even if the memories of Enron, Global Crossing and Tyco are starting to fade from consciousness a bit.

It's better to tweak what we've already got than to start anew, especially at a time when the market seemingly is setting new records every week. Nobody wants to point fingers during the good times.

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