**Compensation Administration Project**

-Each student was required to submit a special report for the CEO of a company on an issue of great topical concern.

-I chose the following scenario:

-A special task force has been set up at Anchorage Systems, Inc. to review the compensation packages for its executive teams.  Since there is a lot of debate on executive pay, the chairman of the task force has asked you to outline the main issues on the topic and to advise them on specific items that need special attention.

-I received an A+ on the assignment.

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| --- | --- |
| To: | Chairman of Task Force |
| From: | Bradley Hall |
| CC: | Task Force Members |
| Date: | 04/05/2009 |
| Re: | Compensation Packages |
| Attached: | Report |

The following report is from the information I have obtained from research in the field of executive compensation. There are many issues to consider when deciding the compensation package for the executives at Anchorage Systems. What types of packages should be offered to an executive? A package that is comprised of a large base salary and a small proportion that is devoted to add-ons such as incentives and benefits may suit the company’s goals or a package that has a smaller base salary and a larger proportion of incentives would work equally as well. I do feel that before the team proceeds on the types of packages to offer they need to consider this:

* Are executives being underpaid or overpaid for their contribution to the company?

It helps to answer this question and then begin to design the packages. If Anchorage Systems feels that an executive is being overpaid or the package is too extravagant, do not fear. In my research I kept seeing the phrase, “there is no correlation between executive compensation and company or firm performance.” That being said, I may say with confidence that you need not match the salary of other companies just to gain a great executive. Do not feel pressured to overpay an executive in hopes of attracting a great candidate.

I believe if Anchorage Systems wishes to attract high performing executives that will look after the long-term interest of the company it should:

* Hire an executive that will develop a code of conduct and enforce it.
* Keep the board members up-to-date on compensation practices.
* Hire internally as an internal hire is more likely to look after the long-term interests of the company.

If a code of conduct is in place and not enforced it is useless. If someone at the top, an executive, enforces the rules then his or her subordinates will be inclined to do so and this effect will trickle down the organization. If the board members communicate with professionals that may share their knowledge of compensation practices at other companies, the board members will make more educated decisions concerning compensation packages for executives. The last tip seems like common sense, but since empirical evidence exists in the research I felt I needed to acknowledge the fact.

Thanks again for the opportunity to work with Anchorage Systems. If you have any further questions please contact me.

Bradley Hall

MGS 4390

Option 2

4/1/09

**Executive Compensation Packages**

One issue that has arisen surrounding executive pay includes feelings of inequity by the average worker when comparing themselves to the executives in charge of a firm. A worker may compare themselves to those at the top of the ladder in an organization based on pay only, at times failing to recognize the duties and responsibilities of the executives. Are the executives being underpaid or overpaid for the value they contribute to an organization? Has the government intervened to help the problem of excessive compensation packages?

When the average worker thinks about how fairly they are paid they compare themselves to each other and to their superiors, the executives of a company. The pay of top executives in an organization is readily available in annual financial statements provided by publicly held companies. Mel Perel (2003) points out a few reasons why executives are overpaid: conflicts of interest with the board of directors and the influence of stock options. The board of directors in a company does not always possess the best knowledge in making decisions concerning executive compensation. “They themselves may not be accountants or experts in the financial field and will rely on company insiders or auditors to provide the information” (Perel, 2003) the board needs in making decisions concerning executive compensation packages. If those auditors or insiders do not actively sit on the board it is not likely that the board members will interact with them on a daily or even monthly basis. Without this important information available the board of directors may rely on their close relationship with the chief executive officer in deciding his or her compensation package. It is possible that the board members may be executives in their own companies. Wade, O’Reilly, and Pollock (2006) found that “CEOs that are board members use their own pay as a referent in setting the pay of CEOs on whose boards they serve.” A person sitting on the board will want to pass along their pay or what they consider fair to the active CEO. If they are getting overpaid then the board members will certainly pass along the monetary torch to the CEO they are serving. Many board members own their own companies and they may undoubtedly try and boost the executives’ compensation packages to be more in line with their own.

Compensation through stock options has contributed to the increase use of stock options to attract high performing executives. “On average, 60-70% of a CEO’s compensation comprises stock options” (Perel, 2003). When a company goes public it is the responsibility of the chief executive to keep the company’s best interests in mind when making decisions. Shareholders, the actual owners of a company, get little say in an executive’s salary or stock options. Since an executive’s compensation package may include many shares of stock their package takes shares away that are available to the public. Even if an organization performs poorly the executives, in many cases, may still draw a salary including bonuses. Nichols and Subramaniam (2003) report “Stephen Case of American Online was paid $33.46 million over three years in options while the company’s return on equity was -413.” This is an extreme case, but a real world example of an executive being paid in stock options for poor performance. It does not make for good business practice to reward an individual with extremely large payments in hopes that the executive will perform better.

Enron may be pointed to as a great example of overpayment to its executives. The board of directors ignored the bad behavior being performed by executives at the company. The executives took advantage of the situation and misled the board of directors with false information about the company’s financial standing. “In 2002 cash bonuses exceeded $750 million while net income totaled only $975 million” (Perel, 2003). Grant it, the board of directors paid the executives based on company performance, but those numbers were manipulated to make the company appear it was performing better than in its past. Perel (2003) suggests “there is no correlation between executive compensation and company performance.” Even if Enron’s executives had performed exceedingly well, the firm should not have paid its executives as it did since research does not support its reasoning for awarding such high cash bonuses. A company cannot assume that because it pays for high performance, high performance will be seen in the company’s profit or bottom line.

An argument for underpayment with supporting claims is provided by Nichols and Subramaniam (2001) whom feel that “it is impossible to measure the absolute contribution of a CEO to an organization.” There are currently no systems in place to measure an executive’s contribution to the organization. The average worker may develop feelings of inequity and compare their rate of pay with that of an executive’s rate of pay. There is a fallacy in that worker’s thinking as they fail to recognize the value and contribution said CEO brings to an organization. An executive’s job is no doubt filled with more responsibilities and they must also share a greater burden if the company is hurt. This does not mean that an average employee’s work is less important than an executive’s work. It takes many a worker to run a large firm, from janitor to chief executive officer.

It is also possible that executives have been historically underpaid and are currently overpaid to cover this gap in history. “The executive’s compensation is a response to changes in work conditions and challenges that face the company and the talent and demand required by an executive is greater today because of globalization” (Nichols and Subramanaiam, 2003). Since the work required by the executive is more complicated than in the past, the executives are technically working harder than in the past and their pay should reflect this change in working conditions. If they have been underpaid in the past, then the executives are currently recouping their loss in pay and that is the explanation for such large compensation packages.

The government of the United States has enacted laws and amendments to make executive compensation less extravagant in recent decades. It has passed numerous laws to keep executive pay in check and subsequently it has helped squelch some of the public’s outcry for excessive compensation packages being granted to executives. Jarque (2008) mentions the passage of Sarbanes-Oxley Act, “the Act had several consequences for corporate governance practices, mainly mandatory executive certification of financial reports.” This law now makes the executives in charge responsible for the movement of capital in the company as they are required to sign the company’s financial statements. The executive’s signature meant he or she felt comfortable with the way the reports were written and presented to the Securities and Exchange Commission and IRS. If a problem should arise after looking through the reports, the government agents have an individual they may seek to hold accountable for the actions taken by the firm in a given year.

Perel (2003) felt that a company would function better if a code of conduct were put into place and if executives were hired from within the company. If a code of conduct is enacted then the executive has a guide to use as reference in making decisions for the firm. If he or she enforces the code then their subordinates will follow suit and the enforcement will trickle down the organization. The fact that reference is made to internal hires is quite interesting. So many companies try to attract executives with large compensation packages and overlook the money they may save by hiring an internal hire, not to mention the fact that an internal hire is more likely to look out for the long-term interests of the company.

It is hard to state with absolute resolution that executives are underpaid or overpaid. As presented before in the summary of research it is possible that executives are underpaid because of lack of payment for contribution to the company. However, the average worker may experience feelings of inequity and they look to their superiors’ salary with reference to their own. They may easily justify that the executive’s salary is too much more than their own and is unfair. Are the executives putting in more than their fair share by working long hours and making contributions to the company that the average worker may not see? It is interesting because great arguments are made for and against underpayment and overpayment. Ultimately the decision comes into play when a new executive is being hired or compensation packages are restructured to reflect the company’s values.

**Bibliography**

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