

Say on pay: 4 ways to defend executive pay under the new law

By Eleanor Bloxham, contributor

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(Fortune) -- At their annual meeting last week, WellPoint shareholders just voted in "say on pay," over the company's objections, after losing similar votes in the prior two years. At Sprint Nextel, both the company and shareholders favored say on pay this year. At Qwest, shareholders sided with management and voted it down.

But guess what? None of that matters now. The new finance reform bill is set to become law and say on pay, an advisory vote on compensation for shareholders, is a centerpiece of the reform. Few boards and companies, or investors, are ready for what that means.

Today, for many investors, 100 page long proxies are just so much mumbo jumbo. But with "say on pay", the stakes have been raised for boards to explain in clear, credible English why the pay packages they propose should be adopted. Clues about what boards might try to do can be found in some proxies that contained say on pay proposals this year.

It might help to think about these advisories like this: the tables have been turned. This year's dismissal of some activist

shareholder's offbeat ideas of reining in pay are next year's mainstream defense of soon to be mandatory votes on executive compensation.

Say on pay defense 1: Linking pay with performance

At WellPoint (WLP, Fortune 500), the company, in their proxy, disagreed with the "argument that an advisory vote by shareholders ... is necessary because executive compensation is 'insufficiently linked to performance.'"

Linkage to performance is a relatively new argument in the battle on pay, and a subtle one. Many boards themselves don't sufficiently understand this area -- nor do investors. For years, arguments have centered on the amount of pay, not the basis for it. Using earnings or stock price to justify pay has long been accepted as the norm, but no longer.

Investors and other stakeholders today increasingly want to see pay packages that adequately address the performance those

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CEOs must deliver, while discouraging bad decision-making. Investors are beginning to recognize that misaligned pay can have a greater negative impact on a company than nearly any other factor, encouraging executives to take excessive risk in order to inflate share prices.

Boards will need to become better educated on this issue, which is not an area of expertise for many of their current compensation advisors. They'll also need to be better communicators when defending their plans to investors.

Say on pay defense 2: Our pay package is not understandable by you

The size of CEO pay packages at U.S. companies has grown dramatically over the last 40 years, and has become a flashpoint for shareholders and other stakeholders. Arguing against say on pay, Qwest wrote in its proxy: "contrary to what the proponent implies, we believe that we have structured our compensation arrangements in a manner that is in the best interests of our stockholders.... In our view, the proponent demonstrates a lack of familiarity with the marketplace in which we compete when she claims that our compensation arrangements are unjustifiably costly."

Now, the onus will be on the board to ensure their statements do a good job of justifying their CEO's \$12 million dollar package, rather than dismantling the arguments that "proponents" have made for compensation review in years past.

Say on pay defense 3: Talking about pay is important, voting for it, less so

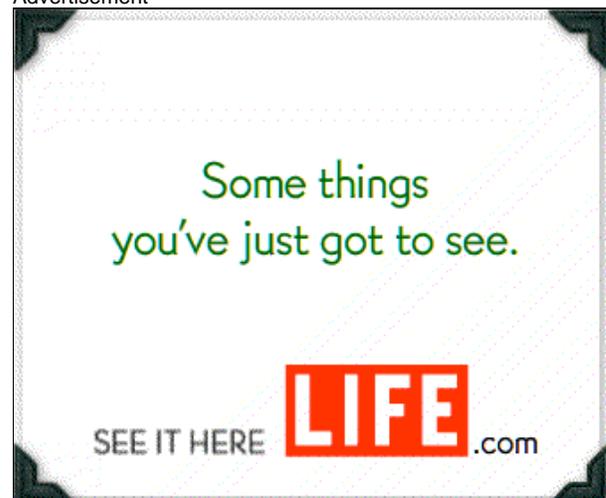
In arguing against say on pay at Johnson and Johnson (JNJ, [Fortune 500](#)), where it was narrowly defeated in April, the proxy stated: "In recent years, management has increasingly engaged in dialogue on executive compensation with key stakeholders and has found this dialogue to be constructive."

With say on pay, all boards will need to consider effective means of dialogue with shareholders on pay issues so they're not surprised by the advisory vote. Emphasizing the role of the board, not just management, will be key to effective communications with activist investors who want to know that the process is being decided in an objective and independent manner.

Say on pay defense 4: Pay can't be cookie-cutter (even though it already is)

Exxon Mobil (XOM, [Fortune 500](#)) holds its annual meeting this Wednesday, May 26. In their proxy, they too objected to say on pay, writing: "Widespread adoption of the advisory vote on compensation could have the negative effect of encouraging

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companies to take a 'one size fits all' approach to compensation under which programs would be designed with reference to standardized voting guidelines of proxy advisory firms, rather than to the particular facts and circumstances of the business."

This argument might be more credible if many pay plans for firms today didn't already look the same. In fact, boards tend to not make changes to plans for fear of falling outside of the pack. However, investors are growing more sophisticated.

With say on pay due to be signed into law in July, the board of Exxon Mobil will now be challenged to back up their jargon-laden defense and show that they haven't taken a one size fits all approach -- but have instead developed a pay program that, in shareholders' eyes, supports the company's long term goals.

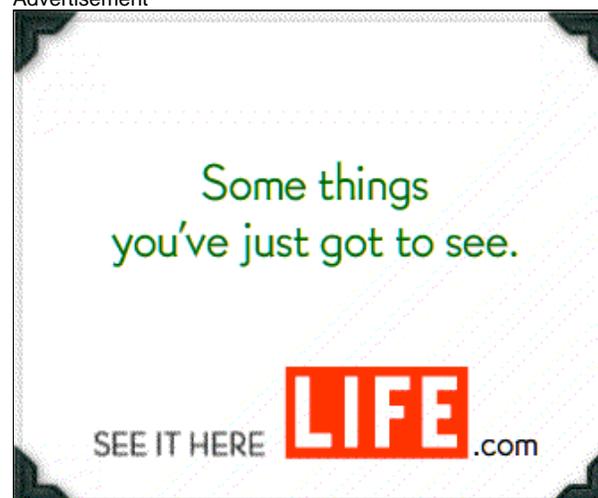
The only vote that counts

Companies, in other words, have offered "kitchen sink" defenses, as to why their pay plans are too different, too specialized, too standardized or too complicated for shareholders to properly understand and evaluate. But Congress has totally upended the board-shareholder power structure: companies are going to have defend their own words and statements to shareholders this year, at risk of eating them. So, let the votes begin.

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