

United States House of Representatives
Committee on Financial Services

Testimony of Nell Minow
Editor, The Corporate Library
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Thank you very much for inviting me to appear today. I am very pleased that this committee is looking into this vital area of concern and considering a proposal I endorse with enthusiasm.

The economist John Kenneth Galbraith said, "The salary of the chief executive of the large corporation is not a market award for achievement. It is frequently in the nature of a warm personal gesture by the individual to himself."

He said that in the 1950's. The primary change since then is the number of zeroes at the end of the figures.

My firm, The Corporate Library, maintains an extensive database on corporate governance in public companies, and that includes a great deal of information and analysis of executive compensation. The data show that the disparity between pay and performance is enormous and growing.

The Corporate Library recently conducted a special study, for its latest CEO compensation survey, that was designed to test whether the highest compensation increases in the S&P 500 reflected significant long-term improvements in company performance. The results of the study showed that the largest percentage increases in total compensation had very little connection to long-term value creation. This table shows the examples of the greatest disparity between pay and performance:

Company Name	Ticker	Fortune Rank	Current CEO	Total CEO compensation in last two fiscal years	TCL Rating	5-Year TSR	Performance vs. Peers
AT&T Inc.	T	33	Edward E. Whitacre	\$34,435,596	D	-40.32	Underperformed
BellSouth Corporation	BLS	87	F. Duane Ackerman	\$22,747,700	D	-26.33	Underperformed
Hewlett-Packard Company	HPQ	11	Mark V. Hurd	\$27,056,129	D	-9.88	Underperformed
Home Depot, Inc. (The)	HD	13	Robert L. Nardelli	\$50,717,002	F	-19.05	Underperformed
Lucent Technologies Inc.	LU	247	Patricia F. Russo	\$17,317,113	F	-82.05	Underperformed
Merck & Co., Inc.	MRK	84	Richard T. Clark	\$40,754,311	D	-49.80	Underperformed
Pfizer Inc.	PFE	24	Henry A. McKinnell	\$26,365,439	D	-34.11	Underperformed
Safeway Inc.	SWY	46	Steven A. Burd	\$33,510,855	D	-54.99	Underperformed
Time Warner Inc.	TWX	32	Richard D. Parsons	\$26,058,130	D	-57.71	Underperformed
Verizon Communications Inc.	VZ	14	Ivan G. Seidenberg	\$26,580,200	D	-26.83	Underperformed
Wal-Mart Stores, Inc.	WMT	1	H. Lee Scott	\$27,961,065	D	-13.90	Underperformed

It's a very small group in the stratosphere of pay: rock stars, movie stars, athletes, investment bankers, and CEOs. Of that group, the first four are in the ultimate pay-for-performance category, with a tiny percentage at the very top making millions of dollars, and with deals that evaporate quickly if a movie, a CD, or a business deal tanks. Their pay is set through tough arms-length negotiations.

CEOs are the only ones who pick the people who set their pay, indeed they pay the people who set their pay. And no matter what "independence" standard we try to impose, the board room culture of congeniality and consensus is so powerful that it makes it very hard to object, especially when the compensation consultant helpfully provides an avalanche of numbers designed to justify pay increases. In the wonderful world of CEOs, like the children in Lake Wobegon, everyone is above average. Even Warren Buffett acknowledges his own failings as a director, particularly in approving excessive compensation: "Too often, collegiality trumped independence." If Warren Buffett, always a significant shareholder in any company on whose board he serves, does not feel able to oppose excessive pay, something is wrong.

In the 1990s, the cult of the CEO was based on the idea that vision and the ability to inspire were what made the CEOs worth the hundreds of millions of dollars they were paid. But a book by Harvard Business School professor Rakesh Khurana, *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs*, makes a compelling case that corporate boards err seriously when they pick chief executives based on "leadership" and "vision" or when they pay huge premium pay that is not sensitive to performance to attract a "superstar." Bringing in a CEO with a great record at another company may give the stock price a short-term boost. But high-profile transplants such as Al Dunlap at Sunbeam (which went into bankruptcy) and Gary Wendt at Consec (which went into bankruptcy), CEOs should have to make the same disclaimers that money managers do: "Past performance is no guarantee of future performance."

Disclosure is important. The SEC's proposed rules are a step in the right direction. But disclosure only matters if the people who absorb this information have the ability to act on it, and that is not currently the case. Executive compensation is a hydra-headed monster – every attempt to cut off one-head results in the growth of two more. Current abuses include these seven deadly sins of executive compensation:

1. Accelerated vesting of options
2. Manipulation of earnings to support bonuses
3. Imputed years of service
4. Setting the bar too low (guaranteed bonus)
5. Outrageous departure and retirement packages
6. Stock options that are not performance-based (including back-dating)
7. Perquisites and gross-ups

Until we remove the impediments to a market response from shareholders, we will never be able to address these problems.

I leave you with two key points. First, executive compensation must be looked at like any other allocation of corporate assets. Currently, the ROI for executive pay does not measure up to just about any other use of corporate capital.

Second, the pay-performance disparity is so outrageous, so atrocious that in my opinion it undermines the credibility of our system of capitalism. In a global environment, information and the ability to trade in any market at any time will provide our system with the toughest market test in the history of our country. As we compete for capital, we must be able to show those inside and outside our country that we deserve their trust and will provide them with a competitive return instead of shoveling more money into the pockets of the top executives.

Many thanks, and I will be glad to answer any questions.