Greed as an Incentive

NO SOCIETY CAN ADVANCE, inequality's defenders have always asserted, without incentives. If we want talented people to do great things, these defenders submit, we need to offer equally great rewards. Great rewards prompt great deeds. Societies that choose to limit rewards, say by taking steps that make accumulating wealth more difficult, reduce the incentive to achieve. These societies, the argument goes, will stagnate. The most talented within them will simply not offer all they have to give.

Any society that heaps rewards on the talented, the argument continues, will certainly end up with some people who hold far more wealth than others. But these differences in wealth can become powerful and positive incentives in their own right. They send the message that those without wealth need to shape up and work harder. The wider the disparities in wealth, the more powerful the message.[1] Imbalances of wealth and income, in short, grease America's economic gears. Eliminate these imbalances, apologists for inequality warn, and you eliminate the incentives that keep us going and growing.

These pages will certainly not challenge the notion that incentives can keep us on our toes. As individuals, we do need incentives. We use them every day. We offer our kids the opportunity to stay up an extra half-hour if they'll eat all their broccoli. That half-hour amounts to an incentive. We give our dogs treats when they obey our entreaties to sit and fetch. We scan newspapers for sales, the incentives that merchants offer us to part with our dollars. Incentives work. They change behavior. We couldn't get by without them.

But some incentives, we know from experience, work better than others. We might offer a lollipop to get a three-year-old to sit and listen. That lollipop would likely make no impact whatsoever on a refrigerator repairman. Some incentives, we also understand, might be inappropriate because they make too much of an impact. We do not, for instance, reward our canines with foot-long franks. Our pooches, if so rewarded, might learn how to sit and fetch quite nicely. But they would also become dangerously obese. So we fill our fanny packs with bite-sized biscuits. These make appropriate training incentives. Foot-long franks do not. In a different context, of course, hot dogs could serve as a perfectly appropriate incentive: To encourage ten-year-olds to attend a practice, a Little League coach might reasonably promise a hot dog cookout after the workout.

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With incentives, in other words, context is everything.

In America's executive suites, over recent years, incentives have been everything. Corporate America has been engaged, in fact, in human history's most costly incentive experiment ever. This experiment has, since the early 1980s, awarded America's top corporate executives over half a trillion dollars.[2] Has this enormous transfer of treasure — perhaps the single biggest reason why wealth in the United States has concentrated so intensely — served as a reasonable incentive? Are the lavish rewards that corporate boards continue to bestow upon executives legitimate? That depends.

We need to look at the context.

MOVERS AND SHAKERS IN CORPORATE AMERICA, and those who write about them, have always spent a great deal of time thinking about incentives. Large, modern enterprises, by their very nature, raise questions about incentives that small enterprises simply do not face.

Consider, for example, America's classic small enterprise, the mom-and-pop shop. In a corner candy store, the incentives never blur. Mom and pop work for themselves. If they work hard, and if their enterprise prospers, they know they'll prosper, too. But most of us don't work for ourselves. We work in large enterprises. Our paychecks come every two weeks, even when we're sick or on vacation. If a mom-and-pop has a bad day, mom and pop might not see any income at all. If our enterprise has a bad day, our paychecks still come. We are employees, not owners.

CEOs, in this broad sense, sit in the same boat as the newest corporate mailroom hire. CEOs don't own the companies where they work. They draw paychecks, just like any other employee. This employment relationship has always troubled scholars who study how businesses operate. If executives are mere employees and if executives can pocket paychecks whether their enterprises are doing superbly or just getting by, why would any sane person in an executive slot put out the extra effort needed to create a superb enterprise? Clearly, scholars have concluded, we have a problem here. Moms and pops will naturally work hard because what they get depends on how hard and how smart they work. Executives have no such natural incentive. How then can enterprises go about getting executives to exert themselves and truly do their best?

The answer, a generation ago, seemed obvious. How can enterprises keep their executives performing at the highest levels? Keep them happy! Enterprises succeed, argued analysts who advocated a "human resources" approach, when they find and hang onto talented executives. Wise enterprises, consequently, should do whatever they can to keep their talented executives content. Above all, they should pay well.

This human resources perspective suited executives, predictably enough, just fine. They appreciated any approach that stressed the need to keep executives smiling.[3] But other business analysts challenged this keep-them-happy perspective. Forget about keeping executives happy, these skeptics advised.

Keep an eye on them instead. Executives, after all, do not own the corporations they manage. They function merely as "agents" for the shareholders who do. As agents, executives do not necessarily share the same interests as shareholders. They have their own agendas, and that reality creates an ever-present tension between executives and shareholders.[4] How can this tension, this "agency problem," be overcome? Companies must introduce incentives, analysts known as "agency theorists" advised, that tie an executive's self-interest directly to the interests of the executive's firm. Sure, they argued, executives should be paid well — but only if the enterprises they manage are doing well.

After World War II, and into the early 1970s, with American goods dominating world markets and corporate profits holding up quite nicely, the hard-boiled cynicism of the agency theorists seemed woefully shrill. Executives were delivering. So why not just pay them well and keep them happy? Why rock the boat? Few corporate boards of directors did. America's top business executives would enter the 1970s the most generously paid in the world. The critics could only mumble from the sidelines. But the mumblers, in the 1970s, would find an audience. Throughout the decade, in industry after industry, American corporations were losing market share to foreign competitors. Profits were dipping, share prices stagnating. By 1980, many investors had come to agree, "a great many American companies were in a sorry state and in need of serious restructuring."[5]

America's executives, for their part, didn't seem to be up to that "serious restructuring" task. They had adapted themselves, Wall Street suspected, "to the special habits of working inside large, stable bureaucratic structures." They refused to "take big risks or initiate major changes." They acted like stodgy bureaucrats.[6] And corporate executives were acting like stodgy bureaucrats, critics hastened to add, because they were paid like bureaucrats. Executives were cashing healthy paychecks whether their companies were soaring or sinking. Corporate America had given top executives no real incentive to perform.[7] The agency theorists, big-time investors came to believe, had been right all along. Executives would not work to maximize corporate earnings until their pay — and their future — depended on the performance of their company.

BY THE EARLY 1980S, America's biggest investors had become absolutely convinced that America's corporations were being atrociously mismanaged, so convinced that a new breed of entrepreneurs would be able to begin making billions off that certainty.

These new entrepreneurs — "bright, insolent, cocksure individuals responsible only to their financial backers" — would soon become celebrated as "corporate raiders."[8] America's top executives, these dashing raiders pronounced, were not doing nearly enough to "maximize shareholder value." Corporate America needed to be completely restructured, under new management totally committed to making money for shareholders. The raiders, naturally, proudly presented themselves as just the ace restructurers America needed. They began their ambitious corporate crusade, in the early 1980s, by buying modest interests in targeted companies, then threatening full takeovers. The targeted companies would either panic and buy out the raider's modest stake — at a price much higher than the raider originally paid — or be swallowed up by the raider. This "greenmail" would evolve into a full-fledged takeover industry, almost all of it financed by bankers and bond traders anxious for a piece of the lucrative restructuring action. Corporate raiders soon found themselves controlling, as owners, a significant chunk of America's corporate assets.

Once in control, these raiders delivered on their promises. They shook up business as usual, mostly by breaking their newly purchased companies up into pieces. Some pieces they sold. Some they kept. In the pieces they kept, they ordered all operations managed to maximize cash flow, by any means necessary, a logical step since the raiders needed cash to pay back their debts to banks and bondholders. After a few years, raiders would typically place their "restructured" pieces back on the market and sell them off, usually at top dollar, making huge personal fortunes in the process.

Mainstream corporate America, dazzled by this derring-do, would adopt the bold raider mantra — "maximize shareholder value" — in remarkably quick order. In America's boardrooms, everyone now seemed hot to trot down the restructuring road, to gobble up companies, break them apart, and swap the pieces. From 1982 through 1988, American business would see over ten thousand mergers and acquisitions, over $1 trillion worth of wheeling-and-dealing.

The corporate raiders would actually stimulate, directly, only a small portion of these restructuring transactions. Their real impact would be indirect. Corporate decision makers, in the face of the raider challenge, simply decided to do their own "restructuring." This self-restructuring, notes Wall Street veteran Roy Smith, who watched the action as an investment banker, almost always followed the same script. A corporation would begin by "selling off divisions and other assets that no longer fit into a highly focused, back-to-basics strategy." The new "lean and mean" enterprise that remained would then emphasize operations that generated quick cash. Finally, to guarantee that everything went as intended, the restructured enterprise would "provide substantial incentives to management to work their butts off to make all this happen."

What sort of incentives? Incentives for maximizing shareholder value. Executives, the new conventional wisdom held, would only maximize that value if they saw themselves, first and foremost, as shareholders themselves, as part of ownership, not just the hired help.[9] Incentives in corporate America would now link executive rewards, directly, to share price. How shares fared in market trading would determine executive compensation. And how exactly would this compensation be tied to stock performance? Through stock options.

Stock options, on paper, merely give whoever receives them the right to buy shares of stock, at some specific time in the future, at some specific price. In practice, an option can be much more than a right. An option can be a chance to make a killing, by buying stock "at a cut-rate price" and selling at a premium profit.[10]

Imagine yourself an executive. Shares of your company's stock are currently trading at $50. You are granted the option to buy, four years from today, one hundred thousand of these shares at this same $50 per share. You do some quick calculations. If your company's share price rises to $100 over the next four years, you could "exercise" your option to buy those one hundred thousand shares at $50, then immediately sell them, on the open market, at their $100 value. You would make a profit of $50 per share, or $5 million. You smile. This option business could be a hugely good deal.

A good deal, investors agreed, for shareholders, too. Executives, with option sugarplums dancing before their eyes, would surely move heaven and earth to "maximize shareholder value." Who could doubt that? Who could doubt that corporate America had solved, once and for all, "the agency problem"?

STOCK OPTIONS, BY THE 1980S, had actually already become a familiar corporate fixture. Historians, in fact, have traced option incentives back to the 1920s.[11] But options remained little more than curiosities until 1950, when Congress "liberalized" how options could be treated for tax purposes.[12] Under the new law, and a subsequent ruling by the national board that then set accounting standards, companies could count options as deductions for tax purposes, yet not have to count options as expenses against earnings.[13] This accounting sleight-of-hand made a dollar's worth of options more attractive than a dollar's worth of straight salary, since any dollars shelled out for salaries had to be counted before profits could be figured. Options carried no such baggage and came somewhat "into vogue," after 1950, as an executive incentive.[14] Still, throughout the 1950s and 1960s, options remained a distinctly second-tier incentive. Corporate boards granted options "sparingly" and in modest numbers.[15]

This second-tier status would begin to fade in the 1970s, particularly in the emerging new electronics industry. Influentials in electronics had latched onto options early on. The founders of Intel, for instance, stocked their new company with talent by offering options, not higher salaries, to the executives and engineers they wanted to recruit from other firms. In 1971, to lure one top marketing executive, Intel offered options for twenty thousand shares, about 1 percent of the company. Intel gave that executive the right to buy the shares at $5 apiece. Later that same year, Intel's stock went public at $23.50.[16]

Options could be equally rewarding in more mainstream business circles. In 1978, Lee Iacocca, America's first modern celebrity CEO, humbly accepted from his new employer, the troubled Chrysler, the option to buy four hundred thousand company shares at just over $11 a share.[17] Iacocca would later turn his options into a $42 million personal payday.[18] But most top executives, unlike Iacocca, would show little interest in options in the 1970s, and for good reason. Options only pay off when share prices are rising. But share prices had stopped rising in the early 1970s, and the subsequent bear market lasted the entire decade. In a bear market, executives argued, stock options no longer make for effective incentives. In a bear market, the argument went, executives could break their backs, do fantastic work, and still not see any significant upward tick in their company's share price. Corporate boards obligingly agreed. They would, throughout the 1970s and into the 1980s, offer executives a variety of incentives not linked to share prices.[19]

These incentives often blossomed one on top of the other. Warner Communications, for instance, bestowed seven different long-term incentive plans on its CEO, Steve Ross, from 1973 through 1989. Among the incentives: an annual bonus that handed Ross a fixed percentage of the company's after-tax profits, as much as $4.2 million a year.[20] In all, the "prince of pay," as Ross was dubbed by one compensation analyst, took home about $275 million from 1973 through 1989, a $16 million annual average.[21]

IN THE 1980S, THE PRINCE OF PAY would have plenty of amply compensated company. CEO pay overall jumped 212 percent over the decade, at the same time corporate profits were rising only 78 percent.[22] To press and investing public alike, that seemed utterly ghastly. Something needed to be done. Executives had to be held more accountable, and that accountability could be achieved, critics asserted, only if stock option incentives finally became, once and for all, the dominant centerpiece of executive compensation.

This option drumbeat would intensify as the 1990s began, and no one would pound away any harder than America's "institutional investors," the pension funds, endowments, and other entities with huge conglomerations of cash that need to be invested.[23] These institutional investors had good reason to worry about executive pay and performance. They often owned such large stakes in individual companies that they couldn't afford to simply sell off their shares in an underperforming company, as a typical unhappy investor might. Any big sell-off on their part might send the sinking price of an underperformer's stock sinking even faster. Institutional investors, in effect, had no choice but to hold their huge stakes in poorly performing companies and try to get the poor performers to shape up. Stock options, these investors came to believe, might just be the incentive needed to light a fire under an underperforming management team.[24]

Options also held all sorts of attractions for corporate directors. For starters, option awards could be easily justified, from a public relations perspective. By granting options, corporate boards could reward executives without having to take flak for shelling out lavishly high salaries and bonuses.[25] This flak had hit hard against Reebok in 1988, a year company earnings fell, after the athletic shoemaker awarded CEO Paul Fireman an $11.1 million bonus. In 1989, Fireman's bonus soared even higher, to $14.2 million, prompting still more negative publicity. In 1990, Reebok's directors finally wised up. They renegotiated Fireman's incentives and limited his bonus to $1 million per year. Fireman wouldn't mind. Reebok stuffed his pockets with a 2.5 million-share stock option grant.[26]

For Reebok, and every other top company, options neatly shifted the responsibility for executive pay excess from corporate boards — and the individuals who sat on them — to the stock market. If executives do well by options, corporate boards could reasonably argue, their good fortune merely reflects the market's impartial judgment. The more highly the market values an executive's performance, the higher the executive's eventual option payoff will be, and vice versa, as Sprint would later take pains to emphasize after critics questioned its executives' high option earnings. "The less they make the stock price rise," Sprint explained, "the less they get paid."[27] What could be fairer?

Option grants still carried useful accounting magic, too. They amounted to "free money."[28] Companies could grant options to executives right and left, not record the options as expenses that count against profits, and end up paying less in taxes, because options, once cashed in by executives, became tax-deductible expenses for the companies that granted them. By the mid 1990s, such deductions were "chopping billions off corporate tax bills." In one year alone, this tax bonanza saved Microsoft $352 million in taxes, Cisco $198 million, and PepsiCo $145 million.[29] Stock options, one analysis concluded, "let companies have their cake, eat it too, and get a second helping."[30]

A few lonely business voices did dare to speak out against this voodoo accounting.

"If options aren't a form of compensation, what are they?" investor guru Warren Buffet protested. "If compensation isn't an expense, what is it? And if expenses shouldn't go into the calculation of earnings, where in the world should they go?"[31]

Corporate boards had little interest in Buffet's quibbles. But they did pay attention, in 1993, when the Financial Accounting Standards Board, the accounting industry's national rulemaking body, tried to demystify the option magic act. The board proposed that options "be charged against earnings as a compensation expense." Outraged corporate leaders immediately "protested en masse," claiming that the board's change would send corporate profits, stock prices, and the nation's economy into a cataclysmic tailspin.[32]

The standards board chairman, Dennis Beresford, did his best to defend his agency. In one particularly "heated" discussion aboard a corporate jet, Beresford "scoffed at the doomsday arguments" against the Board's option stance. The executives Beresford was debating, the *Wall Street Journal* reported, then "invited him to exit the craft — at 20,000 feet."[33] The standards board would eventually agree, under duress, "to exempt the cost of stock options from being reported as an expense."[34] Options would keep their magic.

By the early 1990s, top executives, no less than corporate boards themselves, had fully fallen under the option spell. Corporate executives, the "underperformers" that investors wanted option grants to "shape up," were now enthusiastically willing to swallow any option medicine investors wanted swallowed. The 1970s bear market that had soured executives on options had ended. Share prices, in the 1980s, were rising again.

But something else changed in the 1980s as well. Executives suddenly realized they were missing out on the real money to be made in America's booming economy. Top executives like Steve Ross might indeed be doing quite well. But Ross took seventeen years to cart home his $275 million from Warner Communications. Michael Milken, the junk bond king, cleared twice that, $550 million, in just one year.[35]

All the real money, top corporate executives saw clearly, was going to the wheelers and dealers, clever operators like former Treasury Secretary William Simon, who bought Gibson Greeting in 1982, with other people's money, and then cleared a quarter-billion personal profit on an "initial public offering" — an IPO — of the company's stock.[36]

Everybody on Wall Street, simply everybody, seemed to be making multimillions wheeling and dealing. On the biggest "leveraged buyouts," or LBOs as the insiders called them, just the transaction fees alone were enough to generate fortunes. In one classic mid-1980s buyout deal, involving Revlon cosmetics, lawyers and investment bankers walked off with $110 million in fees.[37]

These multimillions made an enormous impact on corporate CEOs. Their investment banker advisors were making fortunes that put their own executive bonus plans to shame.

"Once executives realized what their advisers were making," notes Charles Morris, an investment banker who watched the frenzy from a front-row seat, "they insisted on a share of the pie."[38]

But to get that share, executives first needed to get equity — an ownership stake — in their companies. Stock options could give them that equity stake.

"CEOs learned two things from LBOs," as New York corporate lawyer Dick Beattie would explain to the *Wall Street Journal*. "First, the way to build significant wealth was through equity ownership, not salary and bonuses, and second, you didn't need to do an LBO to build equity: You could give yourself options."[39]

Technically, of course, executives couldn't give themselves options. Only corporate boards of directors could bestow options upon executives — but these corporate boards now had absolutely no reason not to. Their critics, on the one hand, were demanding options as a "reform" that would keep executives accountable. Their executives, on the other hand, now saw options as a risk-free ride to windfall glory. For corporate boards, in short, options had become the ultimate no-lose proposition. Reformers demanded them. Executives welcomed them. Accountants winked at them. Uncle Sam blessed them with favorable tax treatment. Options seemed to please everybody.

By the mid 1990s, in nearly every important industry, most American top executive pay would be coming from stock options, not salaries and bonuses. In 1980, stock option grants represented less than 20 percent of total CEO pay.

By 1997, CEOs at the nation's top two hundred firms were taking home 55 percent of their pay from options.[40] Three years later, in 2000, that share of top executive pay from stock options had jumped to nearly 75 percent[41] — and sometimes much more. In 1999, America Online CEO Steve Case earned $575,000 in annual salary, a bonus worth $750,000, and $115.5 million by "exercising" — cashing out — his options.[42]

For corporate America's top executives, observed the *Wall Street Journal*, stock options had become "a virtual cash machine." In 1997, top executives at the 350 firms tracked by the *Journal* cashed in $1.02 billion in option gains — and carried in their pockets unexercised options worth $7.2 billion more.[43] A year later, Compaq Computer CEO Eckhard Pfeiffer found himself sitting on unexercised options valued at $410.4 million.[44] In 2000, the nation's biggest stash of unexercised options belonged to Oracle CEO Larry Ellison. He ended the year sitting on options valued at $3.4 billion. Eight other CEOs that same year could boast stashes worth at least half a billion dollars.[45]

Some of these billions in potential personal profit, to be sure, did evaporate early in the new millennium, when the stock market nosedived. But relatively few big-time CEOs would end up significantly stiffed. Most had cashed out option windfalls regularly throughout the 1990s. On average, top executives gained $2.9 million each exercising options in 1995, $8 million in 1999.[46] And some top execs, most notably Walt Disney CEO Michael Eisner, did spectacularly better. In 1993, option incentives pushed Eisner's total compensation to over $200 million, a staggering sum *Business Week* called the most any CEO "has made in a single year — or probably in an entire career in the history of American business." Eisner's $203 million take-home added up to $78,081 an hour or "more than a half-million dollars a day, every day, for an entire year."[47]

Four years later, Eisner would again make headlines. On December 3, 1997, he registered the single "biggest payday for an executive in history" by exercising options for 7.3 million shares of Disney stock. Eisner's incentive agreement gave him the right to buy those shares for $130 million. On that December day, the shares were actually worth $695 million. By exercising his options, Eisner cleared a $565 million personal profit.[48]

Executives from earlier eras could barely recognize this new business landscape.

"I have a difficult time relating to the compensation today," Donald E. Petersen, the former chairman of Ford Motor Co. told reporters in 1999, "and I've really only been out of the full-time part nine years."[49]

Not everyone, of course, was sharing in corporate America's compensation largesse. In 1999, the same year America Online's Steve Case cleared $116 million, three of the many individuals who had helped AOL become the nation's most popular Internet gateway filed suit against Case's cyberspace money-machine. The three had been AOL chat room "volunteers." In exchange for monitoring AOL's chats, the volunteers had received free Internet access, but no compensation, and that, their lawsuit charged, violated labor law, since

AOL treated the "volunteers" as employees. AOL both gave them assignments and required them to work a minimum number of hours every week.[50]

This lawsuit against AOL would draw little media attention — or sympathy. Yes, Steve Case and his fellow executives were raking in dollars by the tens of millions. Yes, not everyone connected with AOL was sharing in the dollar deluge. But didn't those ungrateful volunteers understand that the system was working just as intended. America Online, business journalists gushed, demonstrated just how marvelous an incentive options could be. Early on in their entrepreneurial journey, Steve Case and his right-hand man, company chairman James Kimsey, had each "negotiated tens of thousands of stock options" from the private lenders who bankrolled their new venture. The options gave them the right to purchase AOL shares "for prices ranging from 50 cents to $3.50 each," a nice right to have once the shares soared past $50 dollars a share. And credit that soaring, the *Washington Business Journal* declared, to options. Stock options gave Case and Kimsey "a powerful incentive to maximize share price."[51]

With stock options, corporate America had an incentive that truly seemed to work. Year after year, corporate America would keep working it.

"In the war for executive talent," enthused compensation consultant Ira Kay of Watson Wyatt, "the bullets are stock options, and there's plenty of ammo."[52]

With all that firepower on the loose, some less enthused observers did wonder whether corporations might be shooting themselves in the foot. Might nine-digit payoffs for executives be a tad excessive? Not to worry, advised option advocates. Talented executives, they insisted, "can often add so much value to a company that their outlandish pay, in the grand scheme of things, amounts to a small tip."[53] These small tips, business analysts declared, were solving corporate America's longstanding "agency" problem. Thanks to option incentives, executives were finally thinking like shareholders, not hired help.[54] "CEO pay is aligned with company performance more closely today than ever before," crowed *Chief Executive* magazine.[55] "A bigger percentage of CEO compensation is coming from stock and stock options," cheered Scott Page, a top executive headhunter. That's "good for Americans," he added, and "good for American business."[56]

THAT AMERICAN BUSINESS WAS DOING WELL certainly seemed indisputable in the 1990s. By century's end, shareholder value had been "maximized" to a degree that no bullish prognosticator would have ever dared predict back in the early 1980s. At the start of that decade, about five thousand companies had their stock publicly traded on Wall Street.[57] The shares of these companies were worth a combined $1.3 trillion. By the end of 1999, about nine thousand companies were trading on Wall Street. Their combined share value: an amazing $16.7 trillion.[58]

But some observers, as the 1990s moved along, found their attention grabbed by other, more troubling sets of statistics. Companies were certainly doing well. But executives continued to be doing even better. In 1996, *Business*

Week pointed out, corporate profits increased a healthy 11 percent and share prices an even healthier 23 percent. But CEO pay gains for the year — up 54 percent — "far outstripped" both profits and shareholder returns.[59] In 1998, the *New York Times* commissioned a survey that compared the gains registered by shareholders with the compensation of top executives. Between 1993 and 1997, the survey found, shareholders in large firms saw their average annual return jump 19 percent. The chief executives at those same firms saw their annual pay leap 38 percent, twice the shareholder gain.[60] The *Wall Street Journal* conducted a similar analysis on 1999 executive pay and found a similar story. Median shareholder return, down 3.9 percent. CEO compensation, up 23.5 percent.[61]

What was going on here? Option incentives were supposed to align the interests — and rewards — of executives and shareholders. In an "aligned" environment, if share prices were rising, executives and shareholders would prosper together, or so the theory went. But if options had indeed "aligned" the interests of executives and shareholders, how could rewards for executives be rising so much faster than rewards for shareholders?

Simple arithmetic could supply some answers. Executives, by the mid 1990s, were routinely receiving such large grants of options that only a small tick up in share price could trigger a mammoth windfall. Suppose, for instance, you were an executive fortunate enough to have been granted the option to buy 10 million shares at $80 each. If your company's share rose just $2 annually, a modest increase of 2.5 percent, you would stand to make $20 million for every year the share price rose this meager $2.[62]

Critical observers also pointed out another reason why executive pay was rising so steeply. Executive pay reformers had originally expected that their cherished stock options would essentially *replace* more traditional executive incentives. That didn't happen. The new waves of stock option grants were simply layered on *top* of the salary, bonuses, and other forms of compensation executives were already receiving. In effect, executives simply gained a new revenue stream. This new stream, coupled with the old streams, virtually guaranteed that executive pay would far outpace shareholder return.

Some companies, to be sure, were so committed to option magic that they did abandon more traditional executive revenue streams. In 1998, for instance, Steve Jobs, the once exiled founder of Apple Computer, came back to the company as interim CEO for a token $1 annual salary. In January 2000, Apple granted Jobs 20 million options to take the company's CEO reins on a permanent basis. The options would be worth $1.39 billion if Apple's shares increased 10 percent a year over the decade ahead. Unfortunately for Apple, this bold stock option incentive produced no surge in the company's share price — and no great displays of executive aptitude on Jobs' part either. Apple shares, worth over $43 when Jobs became CEO, sank below $20 over the next fifteen months.[63]

Industry observers blamed that decline, in part, on the "Cube," an eight-inch-square computer that Apple expected would fly off store shelves after its year 2000 release. But the Cube, a product that Steve Jobs had pushed relentlessly, didn't fly anywhere. Sales met just a third of expectations. Jobs, analysts quipped, had made just two mistakes: He had targeted a bad product to the wrong market. Apple discontinued the Cube halfway through 2001.[64] Option magic, apparently, had its limits.[65]

That magic, critics argued, rested on a deeply flawed premise. Those who touted options as a magical performance-enhancing incentive assumed that steeply rising share prices reflect outstanding executive performance. But share prices can rise in the real world, and rise significantly, without an executive doing anything outstanding or even merely astute. Share prices, in a complex modern economy, reflect all sorts of factors that may have nothing whatsoever to do with executive performance.[66]

Factors like supply and demand.

Prices rise, textbooks tell us, when demand exceeds supply. In the stock market, demand started rising significantly in the 1980s. Paycheck deductions for 401(k)s, an entirely new retirement savings vehicle, were pouring hundreds of millions into the market for shares of stock, rain or shine, every two weeks. Millions of Americans, made stock-savvy by their 401(k)s, were also investing on their own, many for the first time. All this cash cascading onto Wall Street generated enormous upward pressure on share prices. By 1997, the S&P 500 stock market index had gained, in just fifteen years, an incredible 1,026 percent.[67]

In this bull market, Wall Street's greatest ever, the stock options awarded to America's top executives quickly became sure tickets to fortune. The swelling bull market, observers noted, had created a rising tide that was lifting all executive boats. In this awesome market, explained New York University's David Yermack, even executives "with mediocre or below-average performance" couldn't help but "end up making a lot of money."[68] Executives, *Business Week* charged, were winning rich rewards "for stock market performance, not business performance." Corporate America had committed "the classic error of confusing a bull market for genius."[69]

Could corporate America undo that error — and figure out a way to make sure that options rewarded only the truly worthy? Many investors felt certain the bull market-raises-all-boats dilemma could be overcome. Standard grants of stock options do not automatically connect rewards to actual performance, these optimists conceded. But stock option incentives could reward performance — if options came with "strings."

These strings could come in various sizes and shapes. Executives, some investor advocates proposed, should be expected to outperform their peers at other companies before they can collect any compensation windfall.[70] Options ought to be worthless, suggested the Council of Institutional Investors, unless a company outperforms a market or industry index. Steps like these would help ensure that "a CEO doesn't get paid just because the stock market rises."[71]

Other critics pushed even tougher option reforms. Advocates of "premium-priced options," for instance, wanted executives to have to hike a company's shares to a specified target price before they could cash in on their options.[72]

Some corporate boards of directors did take this advice to heart. In New Jersey, the RCN Corporation, a telecommunications start-up, awarded top executives options that could only be cashed in if company shares hit a target price and rose faster than the S&P 500 index.[73] But such string-laden options came with complications that gave most corporate boards pause. Normal "no-strings" stock option grants, for one, did not have to be factored into corporate earnings statements. Corporate boards could reward all the standard options they wanted without cutting their profit rates. "Out-perform" options carried no such accounting benefits. Under a 1972 accounting rule, these options are charged against earnings — and lower a company's reported profits. Such charges cost RCN, the New Jersey telecom, $50 million in one year alone.[74] This discriminatory treatment against options that carry performance targets could easily have been remedied, by having accounting standards treat all options the same, as charges against earnings. But executives continued to lobby diligently, and successfully, against that change throughout the 1990s and beyond, ensuring, noted the *New York Times*, that "the stock market's tide — be it rising or falling — will continue to have as much of an effect on most option values as a company's performance does."[75]

In the end, few corporate boards would place any strings on their executive stock option plans. One 1999 survey found that only a quarter of CEO option grants "contained any sort of link to performance."[76] For America's top executives, no strings, no sweat.

THE SEARCH FOR THE PERFECT EXECUTIVE INCENTIVE would take one other turn in the 1990s. If the goal is to get executives to behave like owners, some corporate boards started wondering, why not just insist that they become owners? Why not require executives to buy — and hold — shares of the company they managed?

The idea would catch on.[77] In the early 1990s, hardly any large corporations insisted that their executives own shares. By decade's end, according to pay consultants at Pearl Meyer, over one hundred of America's two hundred biggest companies were requiring executives "to buy and hold sizable blocks of stock." Some demanded that top executives own stock valued at fifteen times their basic paycheck.[78]

These stiff ownership requirements initially caused a bit of a stir, but they would eventually make little impact.[79] Few corporate boards that set ownership standards actually bothered to enforce them. Companies with ownership requirements, the *Wall Street Journal* reported in 1999, would "simply extend deadlines or cut the requirements for executives who don't comply."[80] In other situations, corporate boards thoughtfully structured their ownership mandates to make sure executives wouldn't lose their shirts if the company's share price

— and the value of the executive's ownership stake — started sinking. Baxter International, an Illinois medical products company, started an ownership incentive program in 1994 that required the firm's top executives to buy company stock. But the company didn't expect these executives to risk their own money to make these required stock purchases. Instead, Baxter International "guaranteed" $122 million in personal bank loans, and the executives used this risk-free cash to buy company shares.[81]

Other corporations, to help their executives meet stock ownership requirements as painlessly as possible, actually went into the executive loan business themselves. In 1993, for instance, Eastman Kodak required its new CEO, George Fisher, to own Kodak stock worth four times his annual base pay within five years. Fisher met that requirement — without having to spend hardly any of his own dollars. Kodak loaned Fisher $8.2 million to buy the required company shares, then waived interest payments on the loan, then, incredibly, forgave principal payments for a five-year period.[82]

Still other companies simply forgave loans to their executives completely. Priceline, a dot.com darling in the late 1990s, loaned $3 million to the firm's chief financial officer, Heidi Miller. Less than a year into her CFO tenure, with the company's share price down 90 percent, Miller left Priceline. The company forgave her $3 million loan.[83]

At several corporations, loan programs would lurch even more out of control. One financial services giant, Conseco, handed its top officials $575 million in loans and loan guarantees to purchase company shares. The borrowers, naturally, figured these shares would appreciate. By selling off the appreciated shares, they would then be able to pay off their loans and profit handsomely. But Conseco's share price didn't rise. The price tumbled — the "incentive" of stock ownership apparently not working too well — and executives suddenly could not afford to repay their loans.[84] Conseco's executives and shareholders were now fully, and perversely, "aligned." They were all in hot water together. Conseco would eventually show CEO Stephen Hilbert, the nation's fourth most highly paid chief executive in 1999, the door.[85] In 2002, the company went bankrupt.[86]

In that same year, President George W. Bush would sign into law legislation that prohibits sweetheart loans to top executives. But the legislation "grandfathered" in all corporate loans to executives currently in place.[87] At the bill's signing, on July 30, 2002, over a third of America's fifteen hundred largest companies still had executive loans outstanding. The loans totaled $4.5 billion.[88]

OUT-PERFORM OPTIONS. Premium-priced options. Ownership requirements. All these attempts by corporate America to shower incentive rewards *only* on worthy, high-performing executives share, with plain vanilla stock options, the same basic assumption: that the price of a company's stock does indeed represent a reasonable measure of executive performance. If a company's stock market share price is rising, Wall Streeters believe, that company must surely be on the right track. The market, after all, is always right. But this faith in market wisdom, this absolute confidence in the ability of markets to render valuable judgments about company performance, rests on several shaky propositions that can't be "fixed" with any amount of incentive plan fine-tuning.

The first, and most basic, of these propositions: Investors know what they're doing.

If investors chose stocks by throwing darts at the financial pages, no one would argue that these dart-throwing investors were making reasoned judgments. Investors, of course, don't choose stocks by flinging darts. But no one who follows the stock market, not even the most ardent believers in market wisdom, would seriously argue that individual investors always make informed judgments when they purchase stocks. In real life, stock purchases sometimes reflect sober judgments — and sometimes hot tips from brothers-in-law. Some individual investors do pore over corporate reports, but most investors remain unsure about even the most fundamental of investing basics. In 1997, the National Association of Securities Dealers asked a cross-section of Americans if they could describe the difference between a load and no-load mutual fund. Only 12 percent could.[89]

Champions of market wisdom readily acknowledge that most individual investors are in no position to evaluate corporate performance and prospects. But these clueless individual investors, the market faithful argue, make only a marginal impact on the ultimate judgments the stock market makes about individual corporations. Most decisions to buy and sell shares of stock, these cheerleaders claim, are made by experts, either professional stockbrokers or the skilled investment managers of mutual funds and pension plans. Share prices reflect the market wisdom of these experts.

How much "stock" should we put in this claim? Not much. In the contemporary stock market, even with "experts" teeming all about, a company's share price can rise and fall for reasons that have nothing to do with the overall performance of the company or the individual performances of the company's top executives. Consider, for instance, the fascinating phenomenon sometimes known as the "Dow Jones effect."

Dow Jones and several other Wall Street firms currently compile what are called stock market "indexes." Each index tracks a different representative sample of stocks. One index might track utilities, another transportation companies. The Standard & Poor's 500, one of Wall Street's most influential indexes, tracks the five hundred companies that boast the largest market value within their industries.

Indexes, historically, have given investors a sense of which way the overall market, or a section of it, is headed. Today indexes do more than that. They actually drive investment decisions, through mutual funds that mirror specific stock market indexes. The experts who manage these "index funds" don't try to outsmart the market by picking individual stocks. Instead, they buy all the stocks in a particular index. An index fund tied to the S&P 500, for example, will own the shares of every company the S&P 500 tracks.

Here's where the investing plot thickens. Indexes regularly add new companies and delete old ones, as companies come and go, grow and shrink. These decisions to add or delete can carry enormous market implications. If a new company is added to Standard & Poor's list of America's top five hundred companies, for instance, all the index funds that track the S&P 500 must go out and buy shares in that company. Such index-driven purchases can give a company's share price a powerful jolt. One example: In 1995, Standard & Poor's added Comerica Inc., a banking company, to the S&P 500 list. Over the next two days, the number of Comerica shares sold soared fifteen-fold. Comerica shares rose a swift 6 percent.[90] By the late 1990s, just the anticipation of a company's addition into the S&P 500 could be enough to send its shares zooming. In 1999, the market price of Yahoo rose 24 percent in just one day, as investors "snapped up shares of the Internet service before it was added to the Standard & Poor's 500-stock index at the close of trading." The big winners: Yahoo founders David Filo and Jerry Yang. Filo's stake in Yahoo jumped $1.6 billion in value, Yang's $1.5 billion.[91]

Another common stock market phenomenon, the "Fidelity effect," can also distort market "wisdom." Some Wall Street stock traders have become so huge that, just like bulls in china shops, they can't turn around without wrecking something, even if they have no intention of causing trouble. By the mid 1990s, the Fidelity mutual fund family had become one of these china shop bulls. Fidelity managed over one-half trillion dollars worth of stock, more than a quarter of all the stock held in America's mutual funds.

All these shares gave Fidelity a huge stake in many individual corporations, stakes so large that a simple decision by Fidelity to sell shares in a company that had been doing well — a decision that might allow Fidelity to pocket some profits — could send the company's share price into a tailspin. In early fall 1995, for instance, Fidelity's Magellan Fund held 12.2 million shares of Motorola. Over the next two months, Magellan sold 8 million of these shares. Motorola's share price promptly dropped 18 percent, at a time, the *Washington Post* reported, "when the company announced no bad news and Wall Street analysts issued no sell recommendations."[92] Executives at Motorola, in other words, had done nothing wrong, at least in Wall Street eyes. But their share price took a hit anyway. Against Fidelity's size, market "wisdom" would be no match.

Big market players like Fidelity eventually realized that, given the immense volume of their stock trading, trying to pick individual corporate winners out of the stock market pool might not always be worth the effort. Instead, Fidelity and other big players started picking sectors. Was technology going to be hot? Fine, the big players reasoned, let's buy tech. Let's buy tech companies across the board. If some of these companies don't pan out, no problem, as long as the tech sector, as a whole, does well.

That reasoning made eminent sense for big market traders like Fidelity. But the impact of that reasoning gave poorly performing executives a free ride.

With Fidelity buying up every tech company in sight, high- and low-performing companies alike would see an increased demand for their shares. That would be good news for executive underachievers in technology and other "hot" sectors, bad news for executives, competent or not, in sectors that investors were writing off. And in the late 1990s, even at the height of the stock market boom, investors were writing off plenty of sectors.

"Never have so many industries been out of favor with investors during a stock market boom," *Chief Executive* magazine complained in 1999. "In one of the most bullish years ever, 10 of the 17 industries we studied suffered negative shareholder returns."[93]

These negative returns in autos and other out-of-favor industries meant that executives in these sectors were missing out on the juiciest option windfalls. Corporate boards of directors in these disfavored sectors reacted predictably. They panicked. To keep their executives from jumping ship and flocking to industries where the options were greener, corporate boards started dishing out incentives less dependent on market "wisdom." Ford Motor, for instance, handed CEO Jacques Nasser a multi-year cash bonus. Under the terms of Nasser's pay agreement, he would be able to collect that bonus even if Ford's share price sank.[94] Option magic, with a twist.

INDIVIDUAL INVESTORS WHO HAVEN'T the slightest clue about which executives are performing well and which aren't. Companies whose shares go up in price simply because they've been added to a market index. Shares that go down in price simply because a king-sized player like Fidelity has decided to pocket profits. Executives who win stock option jackpots because they're lucky enough to work for a company in a sector the market defines as "hot." Executives rewarded with extra compensation goodies because they work in a sector the market dismisses.

Something surely must be missing from our picture. Where are the experts paying attention to how well individual companies — and their executives — are performing? And if no one is paying attention, how can anyone possibly claim that share prices represent a fair measure of executive performance? We must have omitted some element of Wall Street market reality. And indeed we have. We have yet to consider that key financial world player known as the stock market research analyst, Wall Street's single most important source of wisdom about corporate and executive performance.

Stock market research analysts specialize in specific industries and companies. They parse company balance sheets line by line, ever vigilant for indicators that reveal just how well, or poorly, a company may be doing or about to do. Every so often, they share their wisdom. Buy these shares, they tell those of us who haven't the time to identify emerging corporate winners, sell those others. Every major securities firm on Wall Street maintains a stable of well-paid analysts. These analysts can be enormously influential. A good word from the right analyst can send a company's shares into the stock market stratosphere —

and turn executive option incentive awards into eight- and nine-digit fortunes.[95] This dynamic gives executives, in turn, an incentive to give stock analysts more than a good bit of their time and attention. Top executives seem to understand almost intuitively that a calculated burst of CEO charm and charisma, carefully targeted to just the right stock analyst, can work wonders for their bankrolls.

"I do know from my own experience watching how security analysts respond to CEOs that the personality of the CEO has a significant effect on the price of the stock," noted T. J. Dermot Dunphy, one former CEO, in a 2001 interview.[96]

CEOs also understand that analysts can be as easily intimidated as charmed. Among the most notable intimidators: Enron CEO Jeff Skilling. "If you didn't act like a light bulb came on pretty quick, Skilling would dismiss you," one big trader told *Fortune* after the energy giant went belly-up. Enron "had Wall Street beaten into submission."[97]

But charisma and browbeating only partly explain why stock analysts so seldom discomfort the companies they are supposed to be rigorously rating.[98] Much more significant have been the institutional pressures — the powerful conflicts of interest — that encourage analysts to swallow any discouraging words a truly independent analysis might lead them to utter.

These institutional pressures have built up significantly over recent years. A generation ago, Wall Street brokerage houses gained much of their revenue from stock-trading commissions, and out of those commissions came the funding for analyst research. In that commission-driven environment, Wall Street firms didn't particularly care whether their analysts recommended that investors "buy" or "sell" a particular stock. The firms made money as long as investors kept buying and selling, since every transaction generated hefty commissions. But these transactions, in the 1980s and 1990s, became less and less profitable as first discount brokers and then the Internet captured significant stock-trading market share. With commissions fading, the Wall Street houses that used to count on commissions would come to depend more on investment banking for their revenues.

As investment bankers, these Wall Street firms took the shares of stock their clients — individual corporations — had to sell and sold these shares to the investing public. Naturally, the Wall Street underwriters wanted the investing public to pay premium rates for these shares. Just as naturally, the Wall Street firms expected their analysts to help the process along, by issuing judgments about the shares that were suitably enthusiastic. But the conflict of interest didn't stop there. Wall Street companies were constantly on the prowl for new stock issues to take public. Analysts who regularly made negative judgments about companies were, in effect, alienating possible future clients. The fewer clients, the less investment banking profit, the smaller the firm revenue — and, eventually, analyst paychecks.[99]

All these pressures — the fear, the greed, the infatuation with charismatic executives — would combine, by century's end, to make stock analysis about as credible as pitches from carnival barkers. No matter the stock, no matter the circumstance, stock analysts had just one word for the often unsuspecting investing public: buy. One analyst, from Salomon Smith Barney, didn't stop recommending that investors buy Enron until shares had sunk to $15.40, a price down nearly $70 from the stock's high.[100] One survey, conducted in 2000, examined 27,000 different analyst recommendations. Fewer than 1 percent recommended "sell."[101]

America, by 2001, had seen enough. Midway through the year, even before Enron collapsed, stock analysis would emerge as a national op-ed issue, in both the business and general press. Congress would feel compelled, in June, to call the securities industry onto the carpet.[102] Why all the concern? Why had stock analyst conflicts of interest become such a major sore point? Stock analyst conflicts of interests, acute observers understood, threatened much more than the reliability of "buy' and "sell" recommendations. Problematic stock analysis subverted corporate America's entire incentive structure. This structure rested on the simple notion that share prices rise when executives perform well. But if share prices could be sent soaring by factors that have nothing to with executive performance — by, for instance, bogus "buy" recommendations from stock analysts with hidden agendas — then executives could be rewarded even if they performed poorly.

Conflicts of interest in stock analysis, commentators urged, needed to be swept away, and, midway through 2002, Congress would finally do some sweeping, enacting legislation to "protect the objectivity and independence of stock analysts."[103] The unspoken assumption behind this reform legislation: Share prices, once established in a transparent, conflict-of-interest-free market, would accurately indicate how well, or how poorly, a corporation is performing. But what if share prices, even if set by an entirely "honest" market, are not the only important measure of corporate performance? What if judgments about corporate "success" need to take other indicators besides "return to shareholders" into account? And if other indicators beyond shareholder return do indeed need to be taken into account — before any company, or chief executive, can be judged successful — then wouldn't any compensation system that bases incentives on share prices end up rewarding executives who might actually be poor or mediocre performers?

Good questions. Inside corporate America, at century's end, no one was asking them.

PEOPLE USUALLY ONLY ASK QUESTIONS when they need answers. Corporate America's movers and shakers aren't asking questions about corporate success because they don't feel they need answers. They already *know* what success is. In corporate America today, success equals maximizing shareholder value. End of discussion. CEOs are expected to labor toward one goal and one goal alone: to make sure shareholders get their due.[104] No other stakeholders matter. Any executive who increases shareholder value, American corporate leaders believe, is performing nobly and ought to be suitably rewarded.

Elsewhere in the corporate world, by contrast, other stakeholders do matter. In Japan, in continental Europe, shareholders are considered just one stakeholder among many.[105] Only in the United States and the United Kingdom, note finance scholars David Collison and George Frankfurter, "are shareholders' interests regarded as preeminent."[106]

What gives shareholders in the United States the right to such all-encompassing preeminence? Corporations, one argument holds, desperately need the dollars shareholders invest in them. Without these dollars, companies would never be able to grow and prosper. In fact, few of the dollars modern corporate enterprises use to do business come from shareholders. Most of the dollars that investors shell out to buy stocks go to other investors who happen to own the shares, not to the corporation whose shares have been traded. Shareholders only rarely buy shares directly from a corporation.

So where do corporations get the money they need to operate? Not from stocks. In 1993, corporations whose stock traded publicly needed $555 billion to do business. Proceeds from equity — money corporations raised by selling their stock directly to investors — accounted for a mere 4 percent of that $555 billion, according to Federal Reserve figures. The overwhelming bulk of the operating capital corporations needed, 82 percent, came from "retained earnings," company income from selling products and services. Another 14 percent came from borrowing.[107] Revenues from the sale of shares can sometimes, to be sure, play a significant role, particularly for young companies. But overall, notes *Business Ethics* editor Marjorie Kelly, equity capital's limited contribution to business success in no way justifies a limitless shareholder claim on corporate earnings.

"Equity capital is one relatively minor source of funding, vital at a certain point," she points out. "Yet it entices holders to suck out all wealth, forever."[108]

Outside America's corporate suites, some critics have begun challenging this logic of privileging shareholders at the expense of consumers, employees, communities, and other stakeholders. An overbearing fixation on shareholders, notes columnist Ellen Goodman, isn't even ultimately in the best interests of shareholders themselves. After all, shareholders are people, too, "stakeholders in society," not just owners of stock.[109]

Corporate leaders usually dismiss such sentiments as do-gooder raving. But sometimes even corporate leaders openly acknowledge that corporations amount to more than share prices. These moments, curiously, only seem to materialize when corporate leaders are asking society at large to bail out a failing enterprise. Those who seek bailouts, and those who try to justify them, never argue the government must save a troubled corporation to "maximize shareholder value." They argue, instead, that the greater community has an important stake in a failing enterprise's survival. These arguments resonate powerfully, because communities *do* have a stake in corporate success.

If communities do have a stake in corporate success, then, of course, shareholders are not the only stakeholders that matter. And if shareholders are not the only stakeholders that matter, then executives should not be rewarded for pleasing only shareholders. Executives should be expected to please all an enterprise's stakeholders — and be rewarded only if they are successful in that endeavor.

In the 1990s, some corporate boards did actually embrace this notion that executive incentives need to consider more than shareholder return.[110] At Ford, for instance, the board of directors added a product "quality" incentive into CEO Jacques Nasser's compensation package. But skeptics suspected that Ford was only going through the motions. They soon had ample evidence. In 1999, Ford failed to meet its vehicle warranty and customer satisfaction "quality" target. No big deal. Ford would hand CEO Nasser $10.2 million anyway, a 48 percent raise over his pay in 1998, when Nasser headed up Ford's auto operations. So much for quality as job one.

By century's end, in boardrooms the nation over, America's corporate elite would worship shareholder value and shareholder value alone — and nowhere more so than at Computer Associates, a New York software company. Directors at Computer Associates would dangle more than a billion dollars in incentives before the company's top three executives. To realize that billion, the executives needed only to give the company share price a healthy boost up. What happened next warrants a few moments of our time.

COMPUTER ASSOCIATES, BY THE MID 1990S, had become a classic corporate success story. The company, just a three-person start-up in 1976, had achieved world-class status.[111] In the entire software industry, only a handful of companies stood any taller. Could Computer Associates grow even bigger? The company's board believed it could, if only the firm's three top executives — CEO Charles Wang, President Sanjay Kumar, and Executive Vice-President Russell Artzt — were extended just the right incentives. No garden-variety incentive plan, the board felt, would do. The company's new incentives would have to be grand enough to inspire lofty new levels of executive performance.

The board's new incentive plan, approved in 1995, would promise CEO Wang and his top two colleagues more than 20 million shares of company stock if the Computer Associates share price, in just one twelve-month period over the next five years, closed above $53.33 for at least sixty days.[112] To reach that milestone, the company's share price would have to jump 20 percent a year, twice Wall Street's historic rate of return.

Beating that ambitious marker would turn out to be mere child's play for Wang, Kumar, and Artzt. On May 21, 1998, the three hit the "jackpot" — and ahead of schedule. The company's shares that day closed at just over $55, their sixtieth day over $53.33 in the previous year. That close triggered an incentive windfall worth more than $1.1 billion.[113] The lion's share, over 12 million shares worth $670 million, went to the fifty-four-year-old Wang. Kumar pocketed shares worth $334.9 million, Artzt $111.6 million.[114]

Computer Associates shareholders, for their part, weren't complaining. The incentive plan seemed to have worked admirably. Shareholder value had been maximized!

That maximization would be brief.

The Computer Associates up-escalator, after the May 21 jackpot day, would suddenly reverse direction. By late July, company shares had dropped 31 percent off their May high. The reason? To offset the grants of actual stock to Wang, Kumar, and Artzt, the company had been compelled to book a $675 million charge against earnings. Before the charge, the company had claimed a $194 million profit. After the charge, the company stood $481 million in the red.[115] That did not please Wall Street — or shareholders. The incentives intended to enhance shareholder value, they suddenly realized, had instead sent that value sinking. The angriest of the shareholders, in a series of lawsuits, would charge that Wang and friends had scored their $1.1 billion windfall by "artificially inflating the company's stock price."[116] A year later, a Delaware judge, citing a technicality, ordered the three executives to give about half the windfall back.[117]

Throughout this litigation, the Computer Associates board of directors would remain thoroughly unrepentant. Their incentive plan, directors insisted, had worked as intended.

"It was a very good plan," explained the chairman of the board's compensation committee, Willem F. P. de Vogel. "I have never seen three people work harder."[118]

But what exactly did the Computer Associates top executives work hard at? Producing great products? Not quite. Among the company's primary customers, the managers of mainframe computing operations, Computer Associates was striking out badly. At technology conferences, where these managers gathered, "probably 95 percent of the hands" in the room would go up when attendees were asked if they wanted to drop Computer Associates products, the *New York Times* reported.[119] These product failings never seemed to interest CEO Wang or any other top Computer Associates executives. They were too busy scheming to keep the company's share price inflated.

The most creative of these schemes involved the fees that customers paid to use the various Computer Associates software products. Computer Associates, under Wang, would regularly claim as immediate current income the total value of long-term, multi-year software contracts. This hocus pocus worked wonderfully as long as Computer Associates could get customers to keep signing long-term contracts. But moving Computer Associates software, as the 1990s wore on, became a harder and harder sell. The big mainframes that

Computer Associates software served no longer dominated business computing. In response, Computer Associates executives could have carefully analyzed the computing marketplace, made some judgments about the software their customers would need down the road, and then worked to create these new products. But why bother? Computer Associates executives had a more lucrative solution. They would buy up, by the hundreds, their smaller rivals. What these smaller rivals had, and what Computer Associates coveted, were customers with long-term contracts. Each of these contracts could be extended, or "rerolled," into new revenue for Computer Associates. A $2 million, five-year contract with two years to go might become a new $4 million ten-year contract. Computer Associates would then book the additional millions as fresh cash. Computer Associates, in the 1990s, would turn this rerolling into a sleazy corporate art form. The company, one former executive revealed, made a practice of hiring "young, cute girls to basically resell maintenance contracts."[120]

But the "cute girls" wouldn't be enough. CEO Wang and his gang figured out early on that they would only meet their personal incentive plan targets if Computer Associates had really big long-term contracts to reroll. And they could only get these really big contracts, the executives understood, by buying out their largest rivals. Wang and his colleagues would pursue exactly this course. In 1995, in "the largest takeover in the history of the software business," Computer Associates would buy out Legent software for $1.8 billion, then spend $1.2 billion the next year to grab Cheyenne Software. The scheming would continue even after Wang and friends scored their $1.1 billion windfall in 1998, since Wang and his fellow executives apparently knew no other way to keep their money-machine rolling. In 1999, Computer Associates would buy out Platinum software for $3.5 billion, then top that the next year by snatching up Sterling software for $4 billion.[121] All these buy-ups, essentially a high-tech pyramid scheme, would goose the Computer Associates share price after its post-windfall tumble — and help CEO Wang to still more mammoth personal paydays. He would gross $445.7 million in 1999.[122]

The Computer Associates share price comeback would be short-lived. After peaking at decade's end, the company's share price again plummeted. Wang would step down as CEO in 2000. Over his last three years as chief executive, *Business Week* calculated, he had earned $698.2 million. In those same three years, the return to Computer Associates shareholders had dropped 63 percent.[123] No other executive in America, *Business Week* pointed out, had given shareholders, over those three years, less for their money.

THE ENORMOUS WINDFALLS at Computer Associates signaled, for many business observers, a corporate incentive system gone more than slightly haywire. The link between pay and performance, *Business Week* concluded in 1999, "has been all but severed in today's system."[124] Incentives that tied pay to share prices, some thoughtful business leaders had come to realize, inevitably produced executives who spent more time manipulating the market than managing enterprises for success. But most business observers saw nothing amiss. Incentives tied to share prices remained corporate America's wonder drug.

"We really made it worth people's while to drive stock prices up, and they found ways to do it," exulted Jude Rich, a "human capital" consultant with Sibson & Co.[125]

Some observers put the blame for this sort of mindless cheerleading on corporate boards of directors, the bodies responsible for determining executive incentives in the first place. In the post-mortems after the Computer Associates billion-dollar windfall, for instance, critics faulted the company's directors for accepting a sixty-day trigger in the incentive plan for their top executives. How could sixty days, critics wondered, ever be considered enough time to demonstrate real improvement in a company's fortunes?[126]

Why do members of corporate boards accept such flawed incentive plans? They have their own incentives. The Computer Associates board, for instance, included Shirley Strum Kenny, the president of the State University of New York at Stony Brook. In 1996, Kenny's university received a $25 million donation from Computer Associates CEO Charles Wang.[127]

Such flagrant boardroom back-slapping, organized labor would note in 1998, infests the entire executive incentive-setting system. Corporate boards, the AFL-CIO charged, "are rigged to overpay CEOs."[128] Researchers would back up labor's charges. One study of almost twelve hundred companies, conducted by the Investor Responsibility Research Center, found intricate business ties between directors and the executives they were supposed to be making independent judgments about.[129] At MBNA Corp., a national credit card company, the board of directors compensation committee was chaired by the college roommate of MBNA's top executive, Alfred Lerner. The roommate's law firm supplied MBNA legal services. Between 1993 and 1997, MBNA CEO Lerner's pay increased 147 percent a year, three times faster than the company's share price.[130]

Board compensation committees, a leading National Association of Corporate Directors official would acknowledge in 2001, simply aren't very adept at setting pay standards.

"They don't spend enough time on it," noted Roger Raber, "and a lot of this is done by the seat of your pants in a clubby atmosphere."[131]

In this clubby boardroom atmosphere, chief executives set the dominant tone.

"Sixty percent of the directors of companies are the CEOs of other companies," corporate pay watchdog Graef Crystal estimated in 1999, "and they don't come to the table with a predisposition against high pay."[132]

The top executives who sit on each other's boards of directors, *Los Angeles Times* commentator John Balzar would add two years later, "solemnly tell each other they need all this money or they couldn't possibly be motivated to get out of bed and come to the office." And then, adds Balzar, "they hire factotums to step forward with straight faces and tell the rest of us that this is so."[133]

The most significant of these factotums: the executive pay consultants who do the statistical legwork for board compensation committees. Graef Crystal, before becoming an executive pay whistle-blower, spent more than twenty years as one of these consultants.[134] Crystal, like most of his consultant colleagues, would actually be hired by the corporate executives whose incentive plans he would be recommending, not by the corporate board committees charged with setting executive pay.

"Therein lay the problem," notes Crystal. "If the CEO wanted more money, and I didn't want to recommend to the board that he should get more money, well, then, there was always a rival compensation consultant who could be hired."[135]

NOT ALL CHIEF EXECUTIVES have their incentives set by corporate boards they totally dominate. Board members do occasionally take the upper hand. At other moments neither side may hold clear control. Turnover also clouds the power picture. Over time, within individual corporations, casts of characters will change. A particularly dominant CEO might retire. New board members might flex some muscle. Corporate power, as a consequence, is almost always flowing, sometimes running into the boardrooms where corporate directors meet, sometimes ebbing out into executive suites.

Could reforms in how corporations are required to operate help channel more power into boardrooms? Could these reforms produce incentive plans less stacked in executives' favor? Some observers believe so. Boards of directors would display more independent judgment, they argue, if CEOs were prevented from chairing the boards of their own companies, or if the individuals who serve on a corporation's board were not allowed to have any business dealings with the corporation. But other observers doubt that such steps would put much of a brake on escalating CEO pay. The sorts of individuals who serve on corporate boards, these doubters point out, all share the same underlying perspective. They all assume that chief executives can — and will — make bottom-line miracles happen *if* they are offered enticing enough incentives.

Where boards differ, researchers have shown, is on how they *justify* the lush incentives they offer executives to keep these miracles coming. Boards that seldom exert much independent judgment typically describe their executive incentive plans "as a means of retaining scarce leadership talent."[136] Directors on these boards tend to talk about their CEOs as "uniquely talented leaders" or "valuable human resources" that the company can't possibly afford to lose. On the other hand, where boards function somewhat more independently, often the case at companies where the CEO and the chairman of the board are not one and the same person, board members seldom spend much time blessing the brilliance of their executives. Directors on these more independent boards stress, instead, the importance of keeping executive noses to the grindstone. Incentive plans, these boards contend, should only reward executives if they deliver the goods.

Directors at companies that don't fit snugly into either of these two categories — firms where "board control over management is neither particularly high nor low," about a fifth of the companies examined by Northwestern University researchers Edward Zajac and James Westphal — go both ways. These boards of directors laud their executives as talents the company can't afford to lose *and* insist that, without performance incentives, executives would likely go off and feather their own nests at corporate expense.[137]

Do any of these differences actually make a difference? Are "independent" boards that insist that executives "perform" before they are rewarded less likely to shovel dollars into executive pockets than kowtowed boards that hand executives rewards just to keep them from leaving? In a word, no. "Independent" boards of directors that orate endlessly about the importance of only rewarding performance are posturing, the research suggests, nothing more. These "independent" boards, in practice, demonstrate no rock-solid commitment to holding executives accountable.[138] By demanding performance-based incentives, these boards are merely signaling, to the rest of the business world, that they call the shots, not the top executive. Lions roar to proclaim their dominance. Corporate boards insist that their executives "perform."

And if those executives don't perform? Their corporate boards will reward them anyway. The boards know it — and their executives know it, too. Poor performers in executive suites can almost always count on their boards to be ever so understanding. America's top executives, in effect, now find themselves sitting in "an absolutely no-lose situation." CEOs who underperform, notes long-time compensation consultant Donald Sullivan, can count on continued rewards "as a goad to improve their results." And if those rewards don't improve results, chief executives can then count on boards to say "we have to stay 'competitive,' so let's ignore performance."[139]

At Time Warner, for instance, shares sank over 15 percent from 1993 to 1996, at the same time the S&P 500 was rising nearly 60 percent. But that poor performance didn't stop Time Warner from handing CEO Gerald Levin a $4 million bonus in each of those three low-performing years. The reason? Time Warner, the company explained, had to consider the rewards offered by its "most direct competitors for executive talent."[140]

In the 1990s, this imperative to be competitive would sweep through America's corporate boardrooms. By the early twenty-first century, 96 percent of S&P 500 companies were "benchmarking" their executive pay against the compensation of rival executives.

"Company boards figure that if a CEO doesn't earn as much as his peers," *Business Week* explained, "he'll take a hike."[141]

But who should be considered a top executive's "peers"? That would become, in corporate boardrooms, a $64 million question. Should corporate boards strive to make sure their top executives are paid as well as their industry's average-paid CEOs or as well as their industry's best-paid CEOs?

Executives about to be "benchmarked," naturally, always want their rewards keyed to what their more highly paid "peers" are making. They usually get their way. In America today, everyone involved in the benchmarking process has a vested interest, an incentive, to set the benchmark high, not low.

Executive compensation consultants, the people who compile peer group pay statistics, have an incentive to keep their consulting contracts. These consultants almost always recommend that top executives be paid at a rate higher than their average-paid peers, smart thinking since consultants owe their contracts to those top executives.[142]

Members of corporate boards, meanwhile, have an incentive to keep their CEO happy. That CEO, after all, must be above-average. Why else would the board have hired him — or, ever so occasionally, her — in the first place? Boards almost always agree to benchmark their CEO at some above-average level, most typically somewhere between the fiftieth to seventy-fifth percentile of all comparable executives. If they didn't set this above-average benchmark, board members fear, their CEO might just pick up and leave, forcing the board to go through the "time-consuming job of finding a successor."[143]

"Read the directors' rationale for CEO pay, contained in the annual proxy statement, and you're likely to find that the goal is to keep pay in line with that provided by the top half of the industry," notes *Philadelphia Inquirer* business analyst Jeff Brown. "That doesn't sound extravagant, but if all companies seek to offer above-average pay, simple math says the average must constantly rise."[144]

Competitive benchmarking gives corporate America, in essence, a perpetual upward motion CEO compensation machine.

"We want to make our CEO happy," as one corporate director told *Business Week* in 2001, "and the best way to make him happy is to pay him commensurate with our competitors."[145]

CORPORATE BOARDS PLAINLY FIND penalizing poor performance — by executives — a distinctly distasteful chore. They much prefer devoting their creative energies to more positive pursuits, like coming up with incentive packages sweet enough to keep their executives from looking elsewhere.

These "retention" incentives have taken various shapes. Some boards simply give their favorite executives shares of stock outright. These "restricted" stock grants — so named because the executives who receive them cannot do anything with the shares for a specified period of time, typically four years — hold charms ordinary stock options cannot match. With stock options, executives gain merely the *right* to buy stocks at a certain fixed price. An option to buy a hundred thousand shares at $20 a share, for instance, will only be valuable if the stock's actual market price rises above $20. Grants of restricted stock eliminate all downside. An executive with restricted stock owns an actual asset, not merely the option to buy an asset. This asset will have value even if the company's share value sinks. If, for example, a hundred thousand restricted shares originally worth $20 each crash to $10, those shares are still worth $1 million, and all the executive with these shares needs to do to collect that $1 million is sell the shares at $10.

"With restricted stock," as compensation watchdog Graef Crystal puts it, "you just have to breathe 18 times a minute to make a profit."[146]

Plenty of executives in corporate America can do that, and their boards seem determined to reward them for it. By 1999, more than a third of America's corporate boards, 38 percent, were dispensing restricted stocks to executives.[147] These grants, proclaims Jan Koors, a prominent compensation consultant, give corporate America "a strong retention tool." Executives who jump ship *before* they can cash out their restricted stock, he explains, stand to lose millions.[148]

In theory perhaps. In actual corporate life, restricted stock grants have proved a pitifully poor "retention" incentive. Companies on the prowl for executive talent simply up their offers to make up for whatever retention incentive executives might have to forfeit by exiting their current companies. In 1999, for instance, Fort Worth's Sabre Holdings Corp. snatched executive hotshot William Hanningan out from SBC Communications with a pay package worth $20.9 million. That package, a Sabre official told the *Dallas Morning News*, was designed to be cushy enough to make up for any compensation Hanningan lost when he left SBC.[149]

Restricted stock grants, in other words, work wonderfully as a retention incentive — so long as a company that grants the restricted stock has an executive nobody else wants. If, on the other hand, a company has an executive other firms lust after — in short, an executive worth keeping — restricted stock and other retention incentives make no impact whatsoever, except, of course, to raise the overall level of executive pay another several notches.

Boards of directors absolutely convinced that they must retain their top executive at all costs do occasionally change their minds. Sometimes quickly. In 1996, computer hard-drive maker Seagate Technology wanted desperately to lock up the services of its top executive, the sixty-five-year-old Al Shugart. The California company pledged to hand Shugart 150,000 shares of stock if he stuck around as CEO another five years.[150] Two years later, Seagate's board had become desperate once again, this time to show Shugart the door. The company had slumped, and the board that had locked up Shugart's services for five years now wanted him out after just two. Shugart refused to go. To give him an incentive to change his mind, the Seagate board would eventually accelerate the vesting of Shugart's restricted shares, extend the amount of time he could sit on stock options previously awarded him, and agree to pay him $750,000 a year over the next three years for consulting. Shugart would eventually walk away with $10 million.[151]

Corporate America, by century's end, had perfected executive pay incentives for every occasion. Executives could earn king-size compensation if they "performed" in their jobs, if they stayed in their jobs, or if they, like Seagate's Al Shugart, exited their jobs.

Corporate America's exit incentives, otherwise known as "golden parachutes," first started unfurling in the 1980s when corporate raiders began buying up stock in their takeover targets at increasingly inflated prices.[152] Big shareholders at the targeted companies welcomed the raider interest. Top executives, understandably, didn't. Any takeover could cost these executives their suites, and this unnerving prospect gave CEOs an incentive to battle takeover bids, even those bids that would make their shareholders fortunes. Corporate boards figured they needed to give executives a counter incentive, some contract sweetener that would encourage executives to approach takeover bids more open-mindedly. Enter the golden parachute, an agreement to award a displaced executive what amounts to super severance. Executives outfitted with golden parachutes need not fear whatever a takeover could bring. The new owners might shove the old executives right out of their top-floor offices. But no one, at least no one who mattered, would be hurt. The executives shoved out, buoyed by their multimillion-dollar canopies, would float softly down to earth and land, safely and securely, on their feet.

By the 1990s, golden parachutes had become standard corporate operating procedure. Companies of all sizes and shapes, *Nation's Business* magazine noted in 1994, were routinely using golden parachutes "to attract new talent and to retain key people."[153] Nearly three out of five major companies, added *Executive Compensation Reports* two years later, were offering their top executives super severance.[154]

These golden parachutes were soon funneling hundreds of millions of dollars out of corporate coffers. Leonard Abramson, the founder and CEO of USHealthCare, floated down from his lofty corporate perch with $56 million when Aetna gobbled up his company in 1996. In 1998, Bank of America chief executive David Coulter had a most comfortable landing after his enterprise merged with Nationsbank. Coulter walked off with $4.97 million a year for life, *plus* another $48 million in assorted extra severance.[155]

David Coulter and his fellow executives had come to reside, by century's end, in a truly wondrous world. In this special place, executives with incentives to perform didn't have to perform to become extravagantly wealthy, and executives with incentives to stay didn't have to stay to become wealthier still. Corporate America, in a sense, had gone far beyond the realm of incentives. Boards of directors were no longer *incentivizing* executives. They were *insuring* them — against even the remotest possibility that their executive service would leave them with anything less than a dynasty-sized fortune.

Golden parachutes served as insurance. Grants of restricted stock served as insurance. But the most imaginative insurance of all only began popping up, with any frequency, in the mid 1990s. The insiders called this newest twist "repricing."

Repricing addressed a most aggravating aspect of power-suit life, the annoying reality that stock options do not automatically translate into compensation windfalls. Share prices must rise over time for options to pay off, and share prices, despite an executive's best manipulative efforts, sometimes do not rise. Corporate boards can sidestep this built-in flaw, as we have seen, by going the "restricted stock" route — and rewarding executives with actual shares of stock, not just options to buy. But grants of restricted stock leave unsettled the predicament of option-laden executives stuck at companies with sinking shares. These executives hold worthless paper. How could they be expected to perform nobly, or even stick around, without an option windfall to dream about?

Corporate board compensation committees, fortunately, have the wherewithal to remedy the situation. They can simply cancel existing options and reissue new ones, usually without shareholder approval, "repricing" these new options at a lower price.[156] The compensation committee at Cendant, the financial services giant, did a good bit of this repricing in 1998, after the discovery of what *Business Week* called "massive accounting irregularities" sent the company's shares tumbling, from over $30 to less than $10. That tumble shoved the 25.8 million options held by the company's CEO, Henry Silverman, "underwater." Silverman had been granted the options when Cendant shares were selling in the $17 to $31 range. With the share price at $10, his options had become worthless. But not for long. The Cendant compensation committee, undoubtedly unnerved by the realization their company might soon have a sulking CEO, repriced "a big chunk" of Silverman's options to $9.81. The stock then rebounded to $15, enough to turn Silverman's worthless options into an asset worth over $54 million. Silverman ended the year in ninth place on *Business Week*'s annual list of America's best-paid CEOs.[157]

Repricing does carry risks. Corporate boards that reprice can count on rumblings from shareholder ranks. For some reason, many shareholders cannot understand why executives should get worthless options "repriced" while ordinary shareholders, if they bought a sinking stock before it sank, are simply stuck. In response, repricing corporate boards insist they have no choice. If they didn't reprice, they would no longer be "able to compete." They would "lose employees."[158] And perish that thought, particularly if the employees who might be lost happen to occupy a CEO seat.[159]

The ongoing competition for executive talent, in other words, makes repricings unavoidable, or so goes the corporate spin.[160] Some companies, in their haste to insure executives against any unfortunate eventuality, have even spun themselves into repricing circles. Metro-Goldwyn-Mayer Inc., for instance, repriced the options held by a *former* CEO. But weren't repricings, reporters wondered, a stratagem meant to *retain* CEOs? Why reprice the options of an executive already departed? MGM scrambled for a rationale. The repricing was only fair, a spokesperson finally blustered to *Business Week*, since the company had repriced options for other executives the year before.[161]

MGM-LIKE INANITIES, by the end of the 1990s, had corporate America's image-*meisters* advising boards of directors to steer clear of repricing.

"Option repricing is a justifiable flashpoint for CEO pay critics," *Chief Executive* magazine concluded in 1999. "The simplest rule for boards and compensation committees to follow is never to reprice options. The public relations danger is simply too great and it will only feed the critics' worst suspicions."[162]

Most corporate boards have ended up taking *Chief Executive*'s advice, particularly after the Financial Accounting Standards Board changed the accounting rules. Under the new rules, adopted in the late 1990s, companies that canceled underwater options and replaced them with new repriced opportunities stood to face a "substantial charge against earnings."[163] Some corporations, of course, did try to end run the new regulations. Sprint, for instance, canceled worthless underwater options and promised to issue the employees who held them, in six months and a day, new repriced options. Six months and a day just happened to be the length of time a company had to "wait to avoid extra expense charges under the new accounting rule."[164] But companies like Sprint were careful not to apply this end run to the underwater options held by their topmost executives. The negative public relations fallout would simply have been too great — and, besides, why chance that fallout when the flaws of standard stock option plans could be addressed by so many other less controversial approaches?

These alternative approaches were soon proliferating across the corporate landscape. Some companies with sinking share prices simply issued their executives stuck with underwater options huge new quantities of options, at an attractive low price.[165] Other boards gave executives more time to exercise their options, a move designed to give underwater options a chance to float back to the surface. In 1999, for instance, Sears gave CEO Arthur Martinez and other top executives an extra year to get the company's share price up. The company's incentive goals, Sears spokesperson Peggy Palter told the *Chicago Tribune*, needed to be "more realistic."[166]

But time extensions, as welcome as they might be, couldn't insure underwater executives an option payoff, one big reason why some boards opted for more direct guarantees. The ever-imaginative directors at Philip Morris, for their part, started paying executives "dividends" on their option grants, a most thoughtful gesture since the company's shares, worth over $58 in 1998, were down by more than half two years later. The dividends — on shares the executives did not actually own and might never own, if they chose not to exercise their option — didn't bring the Philip Morris shares above water, but executives, *Business Week* pointed out, could at least "look forward to a quarterly check."[167]

Other companies tried to insure their executives against option anxiety with a neat little trick known as the option "reload." Executives blessed with reloadable options would automatically receive new options whenever they exercised old ones. Executives with reloadable options could make money, and lots of it, despite precipitous drops in their company share price. "Executives at Alcoa, American Express, Morgan Stanley Dean Witter and Sprint," the *New York Times* reported in 2001, "all were able to cushion their losses because they reloaded their options back when their shares were flying high."[168]

But even reloads don't *guarantee* windfalls at the end of the option rainbow. To *fully* insure that options pay off, a company would have to agree to pay an executive even if the company's shares do not rise. No company, of course, could possibly agree to reward an executive who *fails* to raise the company's share price, could it? Nonsense. We live in a free country. Corporations can do anything they want, even explicitly promise to reward an executive for failing. Some businesses, the *Wall Street Journal* reported early in the new century, were actually protecting executives against stock depreciation "with guaranteed cash payments if their stock price fails to reach a certain level."[169] Amazon, for instance, lured Joseph Galli from Black & Decker with a $7.9 million cash bonus and 3.9 million stock options. Amazon *guaranteed* that the options would generate a $20 million payoff. If Amazon's shares didn't jump enough to enable Galli to cash out a $20 million personal profit, the company promised to give Galli the $20 million outright.[170]

No one, of course, demanded the heads of the Amazon directors who had approved the Galli deal. Those directors were merely playing the game as corporate America had come to expect it to be played. Companies throughout the United States, *Business Week* noted early in the new century, are "frantically piling on more options and scrambling to make sure their execs come out on top — no matter what happens to their share prices."[171]

Close observers of corporate America could only shake their heads.

"It's insane to think that these 'incentives' worth millions of dollars are buying anything extra," charged former pay consultant Graef Crystal. "When it comes to pay, too many of these guys have no off-button — that's the greedy part."[172]

Who could argue?

BACK IN THE EARLY 1990S, amid the first major rumblings about overpaid CEOs, reformers advanced a host of specific proposals to end executive excess. At the time, the typical CEO at a major American corporation was earning about $2 million a year — more than three times what executives were making in the early 1980s. What could be done to bring this excessive pay under control? Executive incentive plans, *Business Week* urged, should be simplified. Limit executives to "a salary, a bonus, and a single stock-option plan that encourages ownership." To make sure that corporations don't pass options out cavalierly, change the accounting rules and make all options count as charges against earnings. Require executives to hold on to their stock for some extended period of time. Disclose to shareholders exactly what executives are making.[173] Could changes like these really rein in executive pay? *Business Week*, even back in 1992, wasn't particularly sanguine.

"Compensation is a complex and controversial issue," the magazine noted. "Few critics agree even about the precise nature of the problem, let alone its solutions."

But those critics, in the early 1990s, had caught the nation's attention. Executive pay had become an *issue*. In 1992, even candidates for the White House, both Democratic and Republican, felt compelled to express their concern.[174] That concern, in the next year, would actually translate into action. In 1993, the new President, Bill Clinton, signed into law legislation that denied corporations the right to deduct from their income taxes any executive pay over $1 million. The Securities and Exchange Commission, in the same spirit, mandated that companies must reveal more information about just how much their executives are making. Reform finally seemed to be "taking hold."[175] One group that had been railing against excessive CEO pay, the United Shareholders Association, actually "declared its mission accomplished" and closed up shop.[176]

The release of the next year's executive pay statistics seemed, at first glance, to confirm that move's wisdom. In 1994, executive pay would indeed fall, by 25 percent from the previous year.[177] But 1994's modest executive pay levels, *Business Week* would unhappily conclude the following year, represented merely the "calm before the storm." Pay levels had dropped, the magazine explained, because few executives had bothered to cash out their stock option incentives in 1994, an understandable decision since the year's "weak stock market made their options less lucrative." Any surge in the stock market, *Business Week* predicted, would inevitably trigger another wave of windfalls.

The 1993 executive pay reforms, most analysts soon agreed, had made no appreciable difference. Corporate America had not kicked the high-pay habit. In fact, the most visible of the 1993 reforms — the $1 million tax deductibility cap on executive pay — actually fed that habit. The cap, it turned out, only applied to an executive's base salary. Stock options and any other "performance" incentives were all exempted, and that gave corporate boards an even greater incentive to shovel options into executive pay plans. And even the $1 million cap on straight salary could be sidestepped. Corporate boards could simply "defer" salary above the $1 million limit until after an executive retired. At that point, the cap would not apply.[178]

The irrelevancy of the 1993 reforms would come into still sharper relief after the release of the annual executive pay figures for 1995. Average big-time CEO pay, noted consultants at Pearl Meyer, would leap to $4.37 million for the year, up 23 percent over 1994. "Performance-based" incentives, the pay category exempted by the 1993 deductibility cap, accounted for almost all that increase.[179]

Once again, critics from within corporate America raised their voices in protest.

"Compensation inflation is running riot in many corner offices of Corporate America," *Business Week* editorialized. "This has simply got to stop."[180]

But the riot didn't stop. After 1995, in fact, the riot spilled totally out of control. In 1996, executive compensation at the 365 top corporations tracked by *Business Week* rose an average 54 percent.[181] In 1997, average executive pay soared again, to $7.8 million, up 35 percent over 1996. In 1998, the pay parade would march on to even loftier heights. Average chief executive pay topped $10 million for the first time, jumping 36 percent.[182] Top executives, the *Wall Street Journal* reported, cashed out their largest stock option profits ever in 1998. And those option profits figured to swell even higher in the years ahead, since over two hundred major companies had handed their CEOs "megagrants," stashes of stock options worth at least three times an executive's annual salary and bonus.[183] Executives, thanks to such megagrants, were now counting their windfalls not by tens of millions, but by the hundreds. The Gap's chief executive, Millard Drexler, saw his personal bottom-line jump $494.6 million in 1998, a total that included base pay, bonuses, exercised stock options, and unrealized gains on accumulated stock options.[184]

The next year, 1999, brought more of the same. The top twenty CEOs in the United States, *Business Week* reported, averaged $112.9 million each, and that average did *not* include the value of unexercised stock options.[185]

Just how much incentive, angry observers from outside the business community asked, did executives need anyway?

"Is someone not going to work for you if he gets $50 million instead of $100 million?" wondered Tim Smith, the director of the New York-based Interfaith Center on Corporate Responsibility. "How rich do they have to be?"[186]

WOULD ANY PLAYER IN CORPORATE AMERICA have the moxie to step up to the plate and challenge greed in the suites? Reformers, by century's end, saw only one possible countervailing force with enough muscle to make a difference: the institutional investing community. By 2000, America's institutional investors — mutual funds, pension funds, university endowment funds — controlled half the U.S. equity market.[187]

These investors, corporate America's most savvy insiders understood, could pull the plug on incentive excess any time they so chose.[188] In the boom years, they chose not to. Part of that reluctance, noted Robert A. G. Monks, a pioneer shareholder advocate, may have been personal. University decision makers, for instance, routinely "pal" around with the corporate executives they ought to be confronting. But a big part of that reluctance also reflected pure institutional conflict of interest. Universities would rather not upset their corporate contributors.[189]

Other conflicts of interest also come into play. By law, every corporation that sells stock to the public must publicly report to — and face — shareholders once a year. Shareholders can bring resolutions on executive incentives to these annual meetings. Shareholder votes then determine whether these resolutions pass or fail. They usually fail. Why? Mutual funds and other large institutional investors typically give voting responsibility for their holdings to money managers. These money managers vote these shares, almost always, to support corporate management positions.

This pro-management bias may be unavoidable. From the money manager perspective, after all, every corporation could be, someday down the road, a client looking for a new outfit to manage its pension money or 401(k). Why vote against a management position and risk alienating a potential client?[190] And money managers who *already* manage a corporation's retirement fund are seldom going to vote against that corporation, on behalf of some other institutional shares they may manage. Why risk losing a current client?[191]

So no one risks anything.

"We are all victims," financial analyst Marcy Kelly told the *Wall Street Journal* in 1999, "of the excesses and greed the institutional investors allow to take place."[192]

By century's end, some institutional investors were trying to undo the damage. The nation's largest pension system, TIAA-CREF, adopted new policy that called on boards of directors to adopt only "rational" executive compensation policies.[193] America's other giant pension fund, the California Public Employees' Retirement System, also started flexing more muscle. In 1999, Bank of America CEO Hugh McColl took home $76 million, in a year when Bank of America axed nineteen thousand jobs. CalPERS, in protest, vowed to withhold its support from four directors seeking re-election to Bank of America's board.[194] CalPERS, the pension fund's president, Sean Harrigan, would tell Congress in 2003, "is deeply concerned over what appears to be an attitude of entitlement in the executive suite of corporate America."[195] The California pension giant, Harrigan added, would be developing — and sharing — analytical tools that "help identify on a more systematic basis where compensation abuses are occurring."

But few activists within the institutional investment community see these stirrings as a sign of significantly more accountable corporate days to come. One reason: The shareholder resolutions that institutional investors can bring before annual corporate meetings are not binding on corporate boards. Companies can legally ignore shareholder resolutions, even if they pass. In 2002, for instance, ninety-eight shareholder resolutions gained majority support at corporate annual meetings. Corporate boards, reports the Council of Institutional Investors, ignored eighty-four of them.[196]

What corporate managements cannot legally ignore are the votes cast by shareholders for board of directors candidates. Institutional investors have the power, should they ever choose to organize collectively, to depose corporate boards that shower millions upon their executive elites. But corporate governance rules work against that organizing. Opposition candidates for corporate boards, to have their supporters counted, must print up and get into the hands of shareholders their own ballots, an incredibly costly process.

Over the first half of 2003, various public interest groups lobbied hard for rule changes significant enough to democratize corporate board elections. Midway through the year, in July, the federal Securities and Exchange Commission did announce a series of reforms in that direction. But the SEC's changes, even fully implemented, would leave a solid majority of corporate board members, at least three-quarters, "elected" as they always have been elected, in shareholder voting that lacked even the basic trappings of democracy.[197] Insiders would continue to call the corporate shots.

INSTITUTIONAL INVESTORS OPERATE, ultimately, in a business environment where all the "incentives" encourage them to play lapdog, not watchdog. Still, throughout the 1990s, corporate America didn't need to count on conflicts of interest or rigged corporate governance rules to keep potential whistle-blowers quiet and ineffective. Something else, something stronger, gave corporate America a blank check for incentive outages. Something else guaranteed that ridiculously overpaid executives would have no trouble swatting away whatever brickbats came their way. That something else would be the great stock market boom that closed out America's twentieth century. "Good times" made the irrationality of executive excess actually seem rational.

Incentives, after all, are about outcomes. Those who extend incentives intend certain outcomes to take place. If those outcomes do take place, the incentives have succeeded. In the 1990s, the incentives so profusely extended to America's top executives certainly seemed to have succeeded. Shareholder value had unquestionably been increased. Great rewards *for* executives, just as intended, had inspired great deeds *by* executives.

Critics could — and did — dispute this simple-minded cause-and-effect between booming executive pay and booming share prices. To no effect. Share prices were *up*. Executive pay was *up*. The simple-minded, insisted corporate America, were those who disputed the link. And those who disputed the link could only mutter in frustration. The corporate case for excessive incentives would remain credible and powerful, they understood, so long as share prices kept climbing.

"When everybody is making money," conceded one pay critic, Nell Minow, "it's hard to get people upset because some people are making too much."[198]

But what would happen if share prices stopped climbing? If executives were indeed compensated for performance, as corporate America's flacks constantly insisted they were, then executive pay ought to stop rising if stocks started stumbling. Conversely, if stocks seriously stumbled and executive pay continued soaring, who could honestly claim that stock options and retention bonuses, that restricted shares and golden parachutes, that excessive executive incentives, in all their generous glory, "worked" — or were necessary to make America "work"?

A falling stock market, in short, would either confirm that corporate America had finally come up with an incentive system that linked pay and performance or expose that system as a fraud. Which would it be?

The curious, at century's end, would not have to wait long for an answer. In 2000, the millennial year, share prices fell. By every measure, shareholder value plunged. The S&P 500 index, the standard benchmark of corporate well-being, dropped 9 percent. The Nasdaq composite index, the prime thermometer for hot high-tech companies, fell 39 percent. The Dow Jones industrial average, the yardstick for America's most stable companies, down 5 percent. Mutual funds overall, down 15 percent.[199]

Precious few corporations dodged the dip. For shareholders, 2000 was absolutely and undeniably a year to lament. And for America's top executives? What kind of year did they enjoy? The answer would come the following spring.

IN THE 1990S, SPRINGTIME STARTED giving birth to a new media ritual. Every spring, after corporations released their required annual financial statements, major media outlets in the United States would tally up the year's executive pay statistics and rank order the nation's most generously rewarded CEOs.[200] Nationally, *Business Week*, the *Wall Street Journal*, the *New York Times*, the *Washington Post*, *Forbes*, *Fortune*, and *USA Today* all published annual executive pay studies, each one charting a slightly different set of executives, each one defining compensation slightly differently. At the regional level, the *Chicago Tribune*, the *Baltimore Sun*, the *Philadelphia Inquirer*, the *Seattle Times*, and nearly every other major metropolitan newspaper generated local executive pay scorecards, each one spotlighting the biggest local CEO compensation winners.

In the spring of 2001, all these media listmakers essentially had one question on their minds: Would CEO pay reflect the stock market's wretched 2000 — or would CEO pay continue on its merry way? The answer stunned even the most jaded Wall Street observers. Despite the wretched market, executive compensation would once again soar.

In 2000, the *New York Times* reported, chief executives averaged 22 percent raises in salary and bonus — and took home new grants of stock options worth an average $14.9 million. In total compensation, the CEOs at the two hundred corporations the *Times* surveyed averaged more than $20 million.[201] *Business Week* looked at 365 top corporations — and found the same upward momentum. The average CEO, the magazine reported, "earned a stupendous $13.1 million last year."[202] The *Wall Street Journal* reported an 8.2 percent total pay increase.[203] *USA Today*, looking at a different corporate sample, estimated that top executives in 2000 saw their personal bottom lines boosted by 62 percent, to a $36.5 million average.[204]

"Falling stock prices, disappointing earnings and other bad news," the *Washington Post* told readers, "don't seem to be hurting the compensation of many U.S. executives."[205]

Did rising CEO pay *averages* conceal slumping paychecks in those specific industries hit hardest by Wall Street's downturn? Good question. The San Jose *Mercury News*, the newspaper of record in Silicon Valley, offered an answer. Few industries had enjoyed 2000, the year of the dot.com collapse, less than high tech, the paper noted. Over the course of the year, Silicon Valley's 150 top firms saw their shares drop 20 percent.[206] But tech execs did not share that pain. They registered, in fact, their best year ever. The area's top eight hundred-plus executives walked off with $4.8 billion in 2000, averaging just under $6 million each, more than twice what they received the year before.[207]

Individually and as a group, nationally and regionally, across the board and industry by industry, top executives did exceedingly well in 2000 — and no one, a *Washington Post* analysis made clear, could reasonably consider their immense good fortune a reward for performing well. The "base pay" for executives in 2000, the straight salary they received just for showing up at the office every day, accounted for just 10 percent of total executive pay, the *Post* pointed out.[208] This base pay brought the executives the *Post* studied an average of $1.13 million for the year. The remaining 90 percent of the pay executives received, about $9 million, came from *incentives* of various sorts. In other words, America's top executives received, on average, $9 million for "performance" in a year when their performance, by every standard measure, reeked of absolute failure.

Compensation consultants who had in earlier years defended executive excess as "logical and fair" didn't bother trying to justify the stunning new numbers.

"I'm actually a little disappointed," Ira Kay of the Watson Wyatt Worldwide consulting firm told the *New York Times*.[209]

Corporate America's watchdogs, for their part, felt betrayed. Veteran shareholder activist Nell Minow had, earlier in her career, actively pushed for stock option incentives. The more options executives held, she and like-minded reformers had believed, the more attention executives would pay to shareholder interests.

"In my young and innocent days, I really did think that stock options would be a good thing," Minow noted after the release of the 2000 executive pay figures. "But what did I know?"[210]

How did incentives meant to "align" executives with shareholders end up keeping executives floating high while shareholders sank? Options, America discovered in 2000, gave executives as much cushion to coast as incentive to perform. By cashing out options awarded in previous years, executives could comfortably ride out a year or two of poor share price performance.

In the new century's first year, executives would cash out options by the mega-millions, with the most megas going to executives with enough "vision" to sense what the future might bring — or enough inside knowledge to get out while the getting was good. In Silicon Valley, Intel's top five executives exercised over 3 million options in the first half of 2000, "more than seven times the number of options they had exercised the year before," noted San Jose's *Mercury News*. These shrewd option moves gained the five executives $160 million by September, just three weeks before Intel started announcing bad news about sales.[211] By the end of the year, Intel shares would be down a third.[212]

Executives at Cisco Systems played the same option games. CEO John Chambers alone scored $156 million by unloading options early.[213] Together, the top half dozen executives at Cisco cashed out almost 7 million options before Cisco shares peaked in late March 2000. They cleared $307.8 million in option profits.[214]

Not all executives, of course, could match the exquisite sense of timing of the power suits at Intel and Cisco. With the stock market sinking, some top executives did indeed find themselves holding millions of options they could no longer exercise at a profit.[215] Many options executives had considered surefire windfalls at the start of 2000 had become, by year's end, no more valuable than lottery tickets. In lotteries, of course, most people lose. But corporate America was not about to let executives lose out, even if they had underperformed. In boardroom after boardroom, companies did everything they could, the *Washington Post* reported, "to give their top executives a helping hand."[216]

Out of Black & Decker's helping hand came a million new options for CEO Nolan Archibald, five times more options than he received in 1999. Black & Decker shares had dropped 25 percent. Lucent Technologies doubled the annual option grant award to CEO Richard McGinn. Lucent shares were off 81 percent. In 2000, overall, companies awarded CEOs 55 percent more stock options than the year before.[217]

Other corporate boards went back to the future in 2000 and blessed their executives with simple, old-fashioned cash bonus incentives. That took some doing, since executives over the course of the year hadn't done much worth rewarding. Still, corporate boards were able to rise to the challenge. Some awarded executives bonuses "for implementing Y2K computer bug initiatives." One company actually gave its CEO a bonus for "making sure transition managers were in place once the CEO retired." Overall, CEO bonuses jumped 21 percent in 2000 and added almost $2 million to the typical top executive paycheck.[218]

THE AMAZING CEO PAY FIGURES FOR 2000, careful business observers realized, would be no one-year anomaly. CEO pay figured to stay high well into the new century, even if the stock market kept stumbling. Top executives still sat, these observers explained, on millions of unexercised options, many originally granted while share prices were still rising. Share prices had since peaked — and fallen — but good chunks of the unexercised option stashes would generate sizable profits should stocks up tick even slightly.

"Local executives will likely keep winning the options' jackpot for years to come — regardless of how their stock performs," concluded Silicon Valley's *Mercury News*.[219]

The first executive to hit that jackpot, after 2000, would be Larry Ellison, the CEO of software giant Oracle. In January 2001, Ellison cashed out options granted him in earlier glory days and pocketed $706 million.[220]

Corporate boards took one other little-noticed step, as the new century began, that promised to keep executives in compensation clover for years to come. They redefined the "long" in "long-term" compensation. Throughout the 1990s, top executives had received both annual and "long-term" pay. Salaries and bonuses would come annually, new options and other stock incentives would be awarded once every several years. With share prices rising, as they did throughout the 1990s, these "long-term" plans left CEOs suitably satisfied. Salaries and bonuses guaranteed them a healthy annual cash flow, and, as share prices rose, their options that had not yet vested became more valuable year by year. In 2000, with share prices suddenly falling, everything changed. Executives, in effect, were stuck with "long-term" incentives that now offered no incentive. A most intolerable situation. In response, executives started demanding new long-term incentives *every year*. And corporate boards graciously agreed.[221]

Annual "long-term" incentive awards hand top executives — passionate golfers all — what amounts to performance mulligans, executive suite do-overs.[222] Your company's share price down? If you're the CEO, no need to worry. Your thoughtful board of directors will give you a new batch of options, all exercisable down the road at the current low share price. And if share prices sink even lower next year, your board will give you still another batch of option incentives, all exercisable at an even lower price. Your board, in effect, will keep lowering the performance bar until it finds a height you can jump over — and win the windfall that is your due.[223]

Corporate boards would go a long way down this mulligan road in 2000. The new "long-term" incentive plan deals cut over the course of the year were worth, on average, 49 percent more than the long-term plans set in 1999.[224]

"In other words," the *New York Times* would note in 2001, "2003 is already looking like a good year for executive pay."[225]

SHAREHOLDER VALUE WOULD CONTINUE to droop in 2001 and 2002. Executive compensation would not. In 2001, at the two hundred major companies surveyed by the *New York Times*, profits would be down 35 percent. Median CEO pay at these same companies: up 7 percent.[226] In 2002, a repeat performance. At the one hundred top corporations analyzed by *Fortune*, pay for "middle-of-the-road" CEOs jumped 14 percent, to $13.2 million, in the same year the S&P 500 sank over 22 percent.[227] But these ample CEO pay figures, insiders knew, actually understated the rewards heaped upon America's top executives. Upon America's executive class, over the previous dozen years, corporate America had created a veritable parallel incentive universe, an amazing array of perquisites, or "perks," each one explicitly intended to make life at the top as worry-free as turn-of-the-millennium life could possibly be.

These perks, corporate America believes, make sound business sense. Perks, the argument goes, free executives from life's inconveniences. Executives, freed from daily distractions, have no "incentive" to think about anything else other than corporate success. Perks pump performance! Consequently, within corporate America, no consideration for the welfare of top executives has become too small to be overlooked.

Do executives need help keeping up with life? How about a person, or two, to help? In 1998, MBNA Bank handed CEO Charles Cawley $144,415 for "personal assistants." In 1999, Cawley's personal assistants cost MBNA $159,055. The next year, MBNA's expenditure for CEO assistants dropped to just $123,022. Perhaps Cawley made up the difference from his own pocket. He did take home, in 2000, about $45 million.[228]

Every major U.S. corporation also reimburses executives for whatever financial planning services they might require. In 2000, Citigroup gave chairman Sandy Weill $74,000 — almost twice the income of a typical American family that year — to pay experts to do his personal financial planning. Those experts undoubtedly had their hands full. In 2000, Weill earned $28.2 million in pay and restricted stock, made $196 million more by cashing out options granted in previous years, and collected grants of new stock options valued at $301.7 million.

Executive perks, all together, now add tens of millions of dollars into executive pockets each and every year. These perks, most inconveniently, also add to executive tax liabilities, since many of them count as "income" at income tax time. This poses a problem. How can executives feel appropriately incentivized if they have to pay taxes on their perks? Many corporate boards don't bother finding out. They simply hand their executives the extra cash they need to offset any taxes that might be due on the perks.[229]

Despite such thoughtful gestures, taxes still present an enormous aggravation for America's top executives, the prime reason why corporate boards have perfected still another perk, the most lucrative executive perk of all: "deferred compensation."

All 401(k) plans — the deferred pay plans open to average corporate employees — are subject to strict limits. A plan participant can defer and invest, tax-free, only so much salary each year. In 2002, for instance, no employees, be they CEOs or stock boys, could defer more than $11,000 in earnings through a company 401(k) plan. Yet individual CEOs that year, unlike average employees, were able to defer taxes on many millions more than that $11,000. And how is that possible? Under current law, corporations can establish special pay deferral plans only open to top executives. No limits apply to these plans. Executives can shelter as much of their cash compensation as they please.[230] Individual tax-avoiding CEOs, the *Wall Street Journal* reported in 2002, have turned these deferral accounts into parking lots for "tens of millions of dollars."[231] Just how many dollars overall have poured into deferred executive pay accounts? The estimates, the *New York Times* notes, run from "the tens of billions" to "the hundreds of billions."[232]

In theory, all these dollars in executive deferral plans sit at risk. If a company goes belly-up, an executive could lose every deferred dollar.[233] Corporate boards have moved, predictably, to eliminate this unfortunate risk. They simply reimburse executives for the cost of insuring their deferred pay stashes. One example: The CSX transportation company handed CEO John Snow — later named U.S. secretary of the treasury by President George W. Bush — $421,000 to offset the cost of insurance Snow bought to guarantee his deferred pay should CSX be taken over by another company.[234]

Corporate deferred pay thoughtfulness doesn't end here. Corporations don't just sit on the money executives divert into their deferred pay accounts. They pay interest on it, at higher than standard market rates. General Electric, in the mid 1990s, guaranteed CEO Jack Welch a sweet 14 percent on his deferred pay dollars.[235] G.E. could be even sweeter. In 2000, Welch's last full year before retirement, General Electric gave him $65.5 million in pay and restricted stock as well as new options that could be worth as much as $274 million. Welch realized another $57 million by exercising options already in his pocket.[236] Was all that enough to show G.E.'s appreciation for services rendered? Not by a longshot. G.E. shelled out another $1.3 million to pay Welch's life insurance premiums.[237] God forbid he should drop dead and leave his heirs without a meal-ticket.

"Why does an executive need to be so well compensated and then have all these various and sundry things paid by the company?" Ann Yerger, the research director at the Council of Institutional Investors, would ask at century's end. "Most of us pay our expenses out of our own pockets — that's what our salary is for."[238]

Added Jamie Heard, the head of Proxy Monitor, an adviser for institutional investors: "There's just one word for most of this — greed."[239]

AMID THE PERKS, AMID THE OPTIONS, amid the bonuses, amid the greed, corporate America has continued to insist, right into the new century, that rich rewards remain absolutely essential to business success. How else, if not with lavish incentives, can tip-top performance be coaxed out of America's executive suites? Year after year, corporations have kept pumping up the windfalls, dumping millions upon millions on executives already sated with billions. By early in 1998, for instance, Dell Computer CEO Michael Dell already owned $2.34 billion worth of his company's shares.[240] Enough incentive? Apparently not. The Dell board awarded CEO Dell options worth $33.5 million in 1998 and another $105.4 million worth in 1999.[241] "We pay for performance here," a Dell flack proudly proclaimed, "and Michael is a phenomenal CEO."[242]

But what possible purpose, asked *Business Week* columnist Allan Sloan, could more options serve — "other than enriching Michael Dell"?

"He already owns 190 million shares, his name is on the building and his $16 billion stake offers him ample incentive to get the stock price up," Sloan observed. "Will he defect to Gateway or Compaq if he doesn't get options?"[243]

"How much more incentive do you need," adds Patrick McGurn of Institutional Shareholder Services, "when you already own billions of dollars' worth of stock?"[244]

Is it true, a business journalist asked Tyco International chief executive L. Dennis Kozlowski at a CEO forum, before his 2002 tax evasion indictment, "that at a certain level it no longer matters how much any of you make, that you would be doing just as good a job for $100 million less or $20 million less?"

"Yeah," replied Kozlowski, "all my meals are paid for."

So why was he still striving for tens of millions more? In the game of life, Kozlowski explained, the money is "a way of keeping score."[245]

At the turn of the century, Kozlowski would by no means be the only top executive "keeping score." "How much the boss makes," *Business Week* would note, "has become something of a scorecard."[246] A scorecard with a difference. Most games we play at some point end. In bridge, you make rubber, you win. In baseball, you score more runs in nine innings, you win. In basketball, you hit more points by the final buzzer, you win. But the game never ends in corporate America. No buzzer ever sounds. No CEO, consequently, can ever make enough to win. Some other CEO is always just ahead, waiting to be caught. Some other CEO is always right behind, threatening to catch up. In this game without end, no incentive reward can ever be enough. CEOs will always need more. On corporate America's playing fields, under current rules, they'll always get it.

Some observers felt these rules would change, and dramatically so, after Enron's collapse late in 2001 triggered over six months of almost daily corporate scandal headlines. The rules would actually change, somewhat, the summer after Enron, with the passage of the Sarbanes-Oxley corporate accountability bill. This legislation did ban a host of accounting and corporate governance practices that had contributed, over the years, to executive excess.[247] But the Sarbanes-Oxley reforms would place no quick or meaningful brake on executive incentives. That became readily apparent a year later, when news reports tallied the first executive pay scorecards for the 2003 corporate fiscal year.[248]

At H.J. Heinz, the ketchup king, top executive W. R. Johnson saw his bonus jump 316 percent in 2003 at the same time the company's shares were sinking nearly 29 percent. Annual incentives at Heinz, the company insisted, reflect "clear performance measures aligned with the creation of shareholder value."

At Applied Micro Circuits, a computer parts maker, share values dropped 59 percent in fiscal 2003. The company rewarded CEO David Rickey with 8 million new stock options. This option generosity, potentially worth $56.6 million, would "serve as a meaningful incentive," the company explained, "for employees to remain."

At cereal giant General Mills, share prices actually increased in fiscal 2003, by 3.3 percent. The company's directors, to show their gratitude, upped CEO

Stephen Sanger's bonus 73 percent and threw in new options worth $35.4 million. These rewards, General Mills asserted, were "reasonable in light of performance and industry practices."

Late in August 2003, two weeks after these outrages surfaced, one familiar and well-respected figure in corporate America, Richard C. Breeden, would release what he hoped would be an antidote to over two decades of executive incentive excess. Less than a year earlier, the federal judge overseeing fraud charges against WorldCom, the telecom giant that had gone bankrupt midway through 2002, had asked Breeden, a veteran corporate consultant and a former chairman of the federal Securities and Exchange Commission, to recommend reforms to fix the deeply troubled WorldCom.

Breeden took his task to heart. He saw an opportunity, as WorldCom's official "corporate monitor," to fix what ailed all of corporate America, not just one company. And what ailed WorldCom and the rest of corporate America, Breeden concluded, was an incentive system run totally amuck. WorldCom encapsulated everything wrong with corporate incentives.[249] Lavish stock option grants had made WorldCom CEO Bernard Ebbers one of America's richest men. WorldCom relished handing out "retention" grants as well. The company had incentivized Ebbers and other WorldCom executives with a retention "slush fund" that totaled nearly a quarter-billion dollars. Golden parachutes — $50 million for Ebbers alone — and sumptuous perks also abounded. All these incentives, Breeden noted in his August 2003 report to U.S. District Court judge Jed Rakoff, did not encourage excellence. These incentives, instead, had encouraged a "reckless pursuit of wealth." And that reckless pursuit, Breeden found, had "created a climate conducive to the fraud that occurred," a fraud that ultimately cost investors $200 billion in share value.

The fix? Breeden recommended, and U.S. District Court judge Rakoff subsequently ordered, nothing less than the wholesale dismantling of WorldCom's entire executive incentive structure. In the new MCI, the company that would arise from WorldCom's bankruptcy, stock options would be banned for five years — and could not be reinstituted unless shareholders approved their use in advance. Retention bonuses and "all personal use of corporate aircraft and other corporate assets" would also be prohibited, and executive severance agreements would be subject to strict limits.[250]

Breeden's report would not reject totally corporate incentive orthodoxy. The new MCI, his report would note, would need pay incentives to "ensure that compensation is linked to superior performance." Toward that end, Breeden encouraged the MCI board to consider performance targets that link executive pay directly to profitability, growth in market share, and several other specific yardsticks. But Breeden would not completely swallow corporate America's pay-for-performance mantra. Even the most outstanding performance, his report would caution, must not be used to justify levels of compensation that violate "overall reasonableness."

To ensure this "reasonableness," Breeden proposed his most unexpected recommendation of them all. The new MCI board, his report declared, must set a lid on "total compensation from all sources" for its top executive, a "maximum dollar amount for any single year." Breeden would set this maximum — the first ever for the CEO of a major American corporation — at a generous level. The MCI chief executive, he noted, should receive "not more than $15 million" a year, though the board, he added quickly, would "be free to set a lower number."[251]

WorldCom's new incentive structure, Breeden urged business leaders at the official release of his 149-page report, ought to become a model for every major American corporation.

"We hope all of corporate America," he noted, "will look at it very carefully."[252]

Other observers, that same summer of 2003, would echo Breeden's call for a cap on executive pay. *Washington Post* business columnist Steven Pearlstein, for one, called excessive pay "the original sin of corporate malfeasance," the incentive that "warps the judgment and the ethics of executives."[253] He implored shareholders at America's largest corporations to insist that annual executive pay be limited, for the next five years, "to $1 million in salary and fringe benefits, $1 million in performance-based bonuses and $1 million in restricted stock." Only this sort of $3 million cap, Pearlstein noted, "would end the arms race that companies use to justify sky-high pay."

Corporate America's movers and shakers would blissfully ignore Pearlstein's cap proposal — and Breeden's as well. They would, instead, spend 2003 arguing that the entire corporate reform movement triggered initially by Enron's collapse made higher executive pay more necessary, and justifiable, than ever.

"CEOs," noted Ralph Ward, the publisher of *Boardroom Insider* newsletter, "are saying that because of reforms, there's more risk and more time on the job, and that justifies more pay. Boards tend to go along with that."[254]

In other words, later for incentives. In post-Enron America, top executives simply *deserve* more.

Our society's most generously rewarded, to be sure, have always felt they deserve more. Do they? We take that question next.