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Pay without Performance: The Unfulfilled Promise of Executive Compensation

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critically evaluate such findings in the context of current recruitment and selection theory. Yet, this book does provide an interesting perspective on the potential forces driving the homogenization of talent in leading companies.

Another thoroughly examined subject in this volume is how young knowledge workers socially construct and manage their employability. Through a series of interviews, the authors focus on assessing not only recent college and university graduates' expectations of finding well-paid and rewarding jobs but also the different strategies employed by graduates in the competition for tough-entry jobs. This assessment leads to the identification of two "ideal types" of graduates—Players and Purists. The Players understand employability as a positional game and market themselves in ways that conform to the requirements of employers. Alternatively, the Purists view the competition as a meritocratic race and focus on finding employment that offers the right fit with their knowledge, skills, and aspirations. This analysis provides insight into how those at the top end of the labor market have responded to changes in employer requirements and the intense competition for top knowledge jobs. The authors also suggest that these differences between the Players and Purists highlight the ethical tension around the question of which routes to success are legitimate. One fertile ethics-related question is whether Player behavior leads to competitive advantage in the quest for top knowledge jobs.

Overall, *The Mismanagement of Talent* presents a compelling alternative view of the "war for talent." Brown and Hesketh unabashedly challenge the dominant discourse of the knowledge-driven economy and provide a critical analysis of current management practice and public policy. While many readers may take issue with the authors' sometimes controversial arguments, I recommend this volume to anyone who is not afraid to follow a provocative exploration of the knowledge-based economy's far-reaching implications.

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Pay without Performance: The Unfulfilled Promise of Executive Compensation. By Lucian Bebchuk and Jesse Fried. Cambridge, Mass.:

Harvard University Press, 2004. xii, 279 pp. ISBN 0-674-01665-3, \$24.95 (cloth).

Every once in a while someone comes out with an important book concerning corporate governance or executive compensation. Like Aldolf A. Berle and Gardiner C. Means's *The Modern Corporation and Private Property* (New York: Harcourt, Brace, and World, 1932) and Graef S. Crystal's *In Search of Excess: The Overcompensation of American Executives* (New York: W.W. Norton, 1991), Bebchuk and Fried's new book is thought-provoking and interesting. It is a very important book and should be read not just by those interested in executive pay or corporate governance but by anyone interested in how corporations work.

The main idea in *Pay without Performance* is that there has been a fundamental breakdown in how executives are paid in the United States. Bebchuk and Fried argue that most researchers of executive pay have focused on the "arm's-length bargaining model," according to which CEOs report to objective, independent board members who, in turn, report to shareholders. This standard principal-agent framework has been used in hundreds of academic papers. Bebchuk and Fried argue that empirical facts point to a very different explanatory framework—a "managerial power" model.

Pay without Performance has four main parts. In the first part the authors describe the "official view" of executive pay, the one most scholars hold. In this view, "boards, bargaining at arm's length with CEOs, negotiate pay arrangements designed to serve shareholders' interests." In stoutly arguing that this model is not "a sufficiently accurate reflection of reality," Bebchuk and Fried marshal a long list of considerations: for example, directors seek to be re-elected to boards; CEOs have power to benefit directors (and vice-versa); boards may favor CEOs for a variety of social and psychological reasons; directors' costs for favoring CEOs are very low; and shareholders have very limited power to countervail these forces.

The second part of the book elaborates the "managerial power" perspective and employs it to explain the "unfulfilled promise" of executive pay. Bebchuk and Fried argue that CEOs use their power "to secure rents—that is, extra value beyond what they would obtain under arm's-length bargaining." Although there are many new reporting requirements for firms, managers and boards are able to "camouflage" executives' compensation. The authors cite evidence that CEOs are more richly paid when

“(1) the board is relatively weak or ineffectual, (2) there is no large outside shareholder, (3) there are fewer institutional shareholders, and (4) managers are protected by anti-takeover amendments.” As further evidence of “managerial power,” they mention such extras as generous severance packages and lucrative retirement arrangements that are given on top of the perks contractually agreed to in advance, and generous executive loans that are often forgiven.

Part 3 continues with the “managerial power” perspective. Bebchuk and Fried argue that there is little link between pay and performance in large American firms. In part, this is due to the fact that bonuses are sometimes not offered for performance, there are bonuses for acquisitions even though they may not be in the best interests of shareholders or related to firm performance, and there is generous severance even for CEOs who “fail.” Moreover, since stock options are not indexed to market prices, CEOs may profit handsomely just by riding a growing stock market; and options are often “re-priced” when stock prices fall and lose their incentive effects.

Although Bebchuk and Fried say that their purpose is to point out problems with the system and not necessarily to provide remedies, the last part of the book discusses a set of potential reforms that they argue would help to improve both executive pay and, more generally, corporate governance. They feel that recent reforms have done some good but that much more can be done. The root of the problem, they argue, is the failure to recognize that boards of directors need a fundamentally different set of “incentives and constraints.” Central to their host of recommendations is the premise that directors are too independent of shareholders (the owners of the firm). According to *Pay without Performance*, little can be done about CEO pay until limits are placed on director independence, including new rules for director compensation, elections, and accountability. These types of reforms, the authors argue, would help lead to more transparency in CEO pay, and would promote compensation that is more closely linked to firm performance.

The book is exceptionally well written and clear. The authors succinctly present their main argument early on, then dedicate the rest of the book to elaborating and supporting it. If one ignores the endnotes, the reading is very smooth, quick, and easy, suiting it for a mass audience. Readers who are already familiar with the cor-

porate governance literature are not left high and dry, however, because the extensive endnotes—497 of them following only 216 pages of text—provide plentiful details. Poring through these notes is somewhat grueling, but it is essential for anyone who wishes to evaluate the validity of Bebchuk and Fried’s claims. The nature of the literature they cite in support of a given argument, for example, can itself be revealing: sometimes they refer to papers published in the best journals in economics, law, and finance, sometimes to newspaper accounts; sometimes they refer to only a part of an academic study, or to a study that is out of date in the light of recent governance reforms.

The book’s main weakness, I believe, is too heavy a focus on the thesis that “managerial power and influence have shaped the executive compensation landscape.” In comparing the explanatory power of the “arms-length bargaining” model to that of the “managerial power” model, the authors imply that the former is practically worthless and the latter almost full-purpose. For example, to support their claim that “boards often lower the goal posts when it appears that CEOs are unlikely to achieve their designated targets, or indeed have already missed them,” Bebchuk and Fried cite anecdotal evidence and an article from the *New York Times*, but not convincing academic empirical support. The strain of trying to fit all relevant phenomena into the “managerial power” framework is also clear, for example, in some rebuttals of other scholars’ criticisms. For example, Kevin J. Murphy argued that new CEOs are likely to have less power when they negotiate their pay package than do continuing CEOs, who may be more entrenched (“Explaining Executive Compensation: Managerial Power vs. the Perceived Cost of Stock Options,” *University of Chicago Law Review*, Vol. 69, 2002). This is certainly a plausible and empirically testable idea. But rather than accept it and move on, Bebchuk and Fried maintain that negotiations with these new CEOs “still have deviated substantially from [the arm’s-length] model.” Another example is an issue raised by Brian Hall and Kevin J. Murphy in “The Trouble with Stock Options” (*Journal of Economic Perspectives*, Vol. 17, 2003): whereas new, stricter disclosure requirements that were instituted in the early 1990s should have slowed CEO pay growth if the “managerial power” model is correct, in fact CEO pay continued to escalate. Bebchuk and Fried counter that other circumstances that also were changing at the time (such as anti-takeover defenses) “more than offset the effect

of better disclosure”—but they support this claim with no empirical tests.

One can easily agree with the main points Bebhuk and Fried make and with the reasonableness of several of their recommendations without being convinced that all roads lead to the “managerial power” theory. Speaking for myself, I would have found the book more persuasive if the authors had reined in their horses at certain points.

This stimulating book raises many questions that can inspire future work. For example, what accounts for the big difference in pay-setting between the United States and the rest of the world? Will the new exchange reforms make a big difference, and if so, how big, relative to the extent of the changes Bebhuk and Fried advocate? Will Sarbanes-Oxley, the 2002 act regulating corporate financial record-keeping and providing penalties for its abuse, make much of a difference in the long run?

Bebhuk and Fried’s book is important for a variety of reasons. First, it carefully articulates the difference between the often-relied-upon “arm’s-length bargaining” framework and the “managerial power” perspective. Second, it neatly organizes a wealth of new evidence on executive pay in America today. Not only do the reference section’s 257 entries comprise a comprehensive listing of important academic studies, but the authors also present scores of anecdotes illuminating the “facts on the ground”—actual CEO pay plans and corporate governance situations. Third, the book is accessible to a wide audience. Even though there have been many recent reforms in corporate governance (Sarbanes-Oxley, for example, and new regulations affecting stock exchanges), this clear, forceful book will doubtless fuel additional reforms and academic studies in the corporate governance arena. The book has helped spark many new papers already, and I feel this is just the beginning.

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Corporate Governance and Labour Management: An International Comparison. Edited by

Howard Gospel and Andrew Pendleton.
New York: Oxford University Press, 2005.
325 pp. ISBN 0-19-926367-1, \$99.50 (cloth).

Ever since the fall of the Berlin Wall and the dissolution of the USSR, social scientists have paid increasing attention to the cross-country differences in socio-economic institutions that define “varieties of capitalism” (the term Peter Hall and David Soskice adopted for the title of their influential 2001 book) among the advanced capitalist societies. In examining the linkages between corporate governance and labor management, a distinction has conventionally been drawn between two main varieties: market or outsider systems (exemplified by the United States and United Kingdom), and relational or insider arrangements (exemplified by Germany and Japan). As Howard Gospel and Andrew Pendleton observe in their introductory chapter to *Corporate Governance and Labour Management*, a comparative survey of the evolving links between corporate governance, finance, and labor management is timely. First, high-profile corporate scandals have prompted a re-evaluation of the effectiveness of corporate governance arrangements and reforms, proposed or actual, in several countries. Second, in the context of the globalization of financial and capital markets, intensifying international competition in markets for products and services, and growing cross-border mobility of productive capital, the future of some national models—primarily of the relational variant—has been questioned. Put another way, whether relational systems of corporate governance and labor management are converging on the market-oriented Anglo-Saxon model has been widely debated.

This volume has two main objectives: to bring together analysis of systems of corporate governance and labor management both over time and in different national contexts (specifically, in eight advanced capitalist societies); and to explore how corporate governance and labor management interact to create distinct national configurations. In pursuing the latter objective, the contributors are alert to the impact that labor can have on corporate governance—something that is more apparent in the economies of continental western and northern Europe and Japan than in the Anglo-Saxon countries. The opening chapter also maps out more ambitious tasks. One is to go beyond the “oversimplified” (p. 14) distinction between market and relational systems to a more nu-