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Comp Consultants Offering Boards Blunt Advice

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As compensation committees meet to develop the executive pay packages for 2009 in the midst of a sharp economic downturn, the comp consultants they rely on for data and analysis are being challenged to find ways that their corporate clients can cap or reduce compensation while retaining valued senior executives.

Executive comp packages that emerge this proxy season may face tough scrutiny from government regulators, legislators and investors.

Consultants themselves have been the target of sharp criticism from corporate think tanks and Congress alike, accused of being willing to authorize unwarranted pay and bonus increases. A recent study by researchers at the **University of Southern California**, “Executive Pay and ‘Independent’ Compensation Consultants” (2008), found that, on average, executive and director pay at companies that hired consultants was double that at those that did not.

“If compensation isn’t kept under control [this year], boards will face very aggressive legislation from Congress,” warns **Thomas Lehner**, director of public policy at the **Business Roundtable**.

Ironically, the weak economy and the Democratic triumph in this year’s elections create pressures that could make controlling pay easier.

“The recession is providing a lot of cover for consultants and some boards to do what they should have been doing all along,” says **David Lewin**, a member of the comp committee at **K-Swiss** and a professor of management at **UCLA**. “It lets them apply compensation discipline.”

Consultants themselves report that this is resulting in a healthier dialogue with clients.

“In a down market, it doesn’t get harder,” says **Melissa Means**, managing director at **Pearl Meyer & Partners**. “We just have to be clearer about the potential downside of any decision a compensation committee makes.”

Key topics on the table will be annual bonus and incentive payments as well as long-term compensation plans.

"There's more openness to discuss zero bonuses or reductions in salary," says **Peter Oppermann**, worldwide partner at **Mercer**. "Boards are being pressed to hold executives' feet to the fire."

Some consultants suggest that market conditions are wreaking havoc with conventional metrics on which comp elements are normally based.

"Finding reliable and accurate comparisons is difficult in this market," says Oppermann. "We're telling clients that they shouldn't have one goal for all management. Differentiation matters."

That said, Oppermann adds there is still concern that if boards tighten or reduce comp too much, eliminating all bonuses and incentive payments, they could be faced with a management exodus. "Talent is still talent," he says. "Headhunters are very active."

Nevertheless, most consultants say that they would not want to reset performance targets to be able to provide some bonus payments.

"I don't believe we will be overhauling any plans in the short term," says **Irv Becker**, national practice leader at **Hay Group**. "If plans were paying for good performance, then it is expected that you might also have a year or two of poor performance and that bonuses may not be paid."

Becker suggests it is typical to design a plan that only pays out target bonuses approximately 60% of the time. "That means that 20% of the time you might be above and 20% of the time you might be below or not have any payment," he says.

Much depends on how comp committees interact with their consultants. The committees themselves are being compelled to practice stronger governance, implementing programs that balance both executive and shareholder interests while meeting regulatory mandates.

In his widely read blog, **Carl Icahn** recently observed, "The failure of a company's board of directors to take charge and adopt responsible executive compensation policies has forced more shareholders to take notice and demand tangible progress."

It has created a circle of pressure, from shareholders to comp committee members to comp consultants.

Comp committees and their consultants are being equally challenged to bring executive pay in line with prevailing economic conditions, knowing that their decisions will be well documented.

"Whatever you do," advises **Jim Barrall**, partner at **Latham & Watkins**, "you know you're going to have to put it in the next proxy in detail."