NEW YORK -- The public's indignation over lavish executive pay has rippled beyond the circles of activist investors and corporate governance watchdogs, who for years have wrung their hands over compensation practices. It has spread even beyond grass-roots community organizers and public policy think tanks to people who make their living in the financial industry, like money manager William Fitzpatrick.

"This is a topic that doesn't really get a whole lot of attention during more benign economic times, but clearly this is something that really got away from us. As a profession, we really kind of fell asleep at the switch here," said Fitzpatrick, who helps oversee about $1 billion at Optique Capital Management in Milwaukee.

Compensation is being scrutinized as never before, especially on Wall Street, where the year-end bonus season is coinciding with a government bailout of finance companies. At a time when the average taxpayer already is feeling stretched, public money is being used to support an industry that paid out $33 billion of bonuses last year. Wall Street itself blames the compensation system for playing a role in the credit crisis by encouraging excessive risk-taking.

Fitzpatrick said there is little he, or his small investment shop, can do to stop the current crop of executives from pocketing every cent promised in their employment contracts. But he expects the runaway pay problem to work itself out, as chastened boards cut more modest deals with the next batch of hires.

Dallas money manager Don Hodges isn't feeling as patient. He has spent the past decade railing against excessive pay packages.

"In a publicly owned company, I think they should have some sort of certification. The CPA does. The lawyer does," said Hodges, co-manager of the Hodges Fund. "I think the answer is to toughen up boards and make them realize they have a responsibility to shareholders."
Executive pay barely registered on Hodges's radar screen during his first 40 years in the investment business. It wasn't until the last decade that he began seeing a pattern of jaw-dropping pay packages, which often seemed disconnected from stock performance.

In 1993, Congress allowed companies to keep taking a tax deduction for executive compensation over $1 million but required that the pay be tied to performance. That helped encourage the giant stock option grants that now make up the bulk of executive pay at many of the biggest public companies.

Meanwhile, corporate boards that were eager to stay competitive routinely offered pay packages that would keep their executives in the middle to upper pay ranges for their industries. That strategy eventually drove up the averages.

But this year, bonuses are likely to be sharply lower on Wall Street. Johnson Associates, a compensation consulting firm, predicts annual incentive pay for senior executives will fall at least 60 percent this year at investment banks, and by 55 percent or more at commercial banks.

But whether that's punishment enough for the industry's critics is a matter of debate.

"Wall Street, when I began my career, had no public companies. They were private partnerships where executives had their personal wealth at stake, and they developed their risk-reward system when it was their own money at risk," said Jeffrey Sonnenfeld, an associate dean at the Yale School of Management. "They've kept that system, but it's other people's money at risk now. That's kind of outrageous."

Congress tried to tackle the pay issue last month in the bill that authorized a financial industry rescue. But corporate governance experts say the bill's pay provisions, which focus primarily on golden parachutes that executives often pocket upon a change in corporate control, are too weak and too narrow in scope to significantly change pay practices.

**Rallying Around Reform**

The lack of reform has fanned the frustrations of grass-roots groups including the Northeast Ohio American Friends Service Committee, which had never used executive compensation as a rallying cry until recently.

Greg Coleridge, a director of the committee, said the pay issue is a new manifestation of economic injustices that have long concerned the Quaker social action group, and one that has struck a nerve with members.

"We have public dollars coming from taxpayers, people who are having an increasingly difficult time in our corner of the world in Ohio, being transferred" to Wall Street, said Coleridge, who works in Cuyahoga Falls, north of Akron. "The leverage these dollars provide gives someone inside government an opportunity, and maybe in fact the responsibility, to provide some kind of limit on executive pay."

The Treasury Department, which got broad authority from Congress to dictate the terms of assistance granted to financial firms under the emergency rescue plan, forced American International Group to freeze the size of its bonus pool for 70 senior executives as a condition of a $40 billion capital infusion. But AIG is planning to pay $503 million in deferred compensation to some senior employees, warning they might otherwise leave the firm.

The Treasury Department, not wanting to discourage healthier firms from accepting bailout money
intended to jump-start lending, has taken few steps to curb pay at the banks being bailed out. The department, however, has barred financial firms that receive capital infusions from deducting from their taxes any executive compensation exceeding $500,000 for each senior executive.

Uncertainty about what role, if any, the government should play in setting corporate pay standards has made it tougher for some activists to find an approach to the runaway pay problem.

"People involved in the movement for economic justice don't necessarily know how to mobilize around this issue," said Andrea Batista Schlesinger, executive director of the Drum Major Institute for Public Policy, a progressive think tank in New York. "Discontent and frustration is only furthered when you have a conversation in the abstract."

The institute held its first ever forum on executive pay this week.

Featured was Jim Keyes, chief executive at Blockbuster, whose novel employment contract required him to buy $3 million of company stock in his first 30 days on the job. He also must take his annual performance bonuses in the form of stock.

When Keyes was hired, Blockbuster was still recovering from a bitter proxy battle with billionaire investor Carl Icahn. Pay was one of the issues Icahn raised in his campaign to install new directors at the movie-rental chain, which in 2004 gave then-chief executive John Antioco a $54 million package that Icahn called "unconscionable."

Cognizant of the history, Keyes went to the board upon his hire last year with the unusual terms he proposed for his contract. It was a twist on a lesson he had learned in his previous job running 7-Eleven, where he said he developed "a sensitivity to the differential" in pay for executives and the hourly workforce they relied on to ring up sales at the convenience stores.

"I recognized coming into Blockbuster that there were questions about employee compensation," Keyes said. "Somewhat selfishly, I knew that I had to sell the investment community a new business strategy for this company, and that the case for change was more easily made if I was seen to be a co-investor with shareholders."

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