

CFOs Who Focus on CEO's Pay Find It Rewarding: Graef Crystal

Dec. 31 (Bloomberg) -- If you're a chief financial officer and want to maximize your earnings, what do you do? Well, don't spend a lot of your time trying to increase your company's revenue or its total return to shareholders. Rather, concentrate your energies on getting your ultimate boss, the chief executive officer, a big raise. Your efforts, if successful, will likely be richly rewarded.

That's the main conclusion from a study I conducted of the 2002 total pay of 618 CFOs running U.S. companies with 2002 net sales of \$1 billion or more.

(Total pay consists of the sum of base salary; annual bonus; the estimated present value of stock option grants, measured at the grant date using the Black-Scholes model; the value of free share grants as of the date of initial award; payouts in 2002 under other long-term incentive plans; and miscellaneous compensation.)

The spread in CFO total pay is awesome, ranging from the \$186,000 earned by Jerry Shore of Fred's Inc., a Memphis, Tennessee-based discount retailer, to the \$23.1 million earned by Warren Jenson of Electronic Arts Inc., a Silicon Valley-based software company. The median and average were, respectively, \$1.3 million and \$1.9 million.

Is this startling pay range due to totally random factors, or is there some rhyme or reason operating here? The answer is both.

Two Factors

Two factors -- 2002 net sales and weighted average total return over five years -- combined to account for 29 percent of the variation in CFO pay. Total return was calculated by giving five times the weight to five-year annual total return, four times the weight to four-year annual total return and so forth. All return periods ended Dec. 31, 2002.

To understand the sensitivity of pay to these two factors, let's take the average company in the study, which had 2002 net sales of \$7 billion and five-year weighted total return of negative 2.1 percent a year.

If the company's sales increase by 10 percent, to \$7.7 billion, then other factors being equal, total pay will increase four percent. That's a bit of an incentive, but not much of one.

Things get worse when we examine the influence of total return on pay. If the net sales are held constant at \$7 billion and the total return moves up from negative 2.1 percent a year to positive 5 percent, the CFO can expect to see his pay package increase by a measly 2.6 percent.

Indeed, if the net sales are held constant at \$7 billion, and the total return is increased all the way to 15 percent a year, total pay manages to increase by only 6.2 percent. (Of course, with higher performance, the value of stock option grants and free share awards would eventually boost future CFO earnings.)

Now if net sales and total return account for 29 percent of the variation in CFO pay, what accounts for the remaining variation?

A Third Factor

Well, there is a third factor operating here. If you take account not only of 2002 net sales and five-year weighted total return but also the extent to which the company's CEO earns more or less than what a typical CEO would earn for the same level of net sales and total return, you can now account for 61 percent of the variation in CFO total pay.

Let's go back to our base case, the one where net sales are \$7 billion and total return is negative 2.1 percent a year. For that level of size and performance, our hypothetical CFO can expect to earn \$1.9 million a year. But that's if his CEO also earns an average amount of pay.

Suppose, however, that our CEO is paid above the market, such that his pay package tests out at the 75th percentile, meaning that it exceeds all but 25 percent of other CEOs' pay packages. In that case, our hypothetical CFO's pay rises 35 percent to \$2.6 million. And if our CEO's pay is even higher than that -- say, at the 95th percentile of the CEO pay distribution -- our hypothetical CFO can expect to earn \$3.9 million, an astounding pay package increase of 107 percent.

Consider here our highest- and lowest-paid CFOs. Electronic Arts' Jenson earned 1,436 percent more than the norm, while his boss, CEO Lawrence Probst, earned 237 percent above the norm. (Jenson's pay was buoyed by his having been hired in fiscal 2002 and his having received a front-end bonus and an extra-large stock option grant.)

And in the case of Fred's Shore, his 84 percent below norm pay package was matched by the 94 percent below norm pay package of his boss, CEO Michael Hayes.

Hiring Consultants

The lesson is clear: When you as a CFO arrive at work at 9 a.m. on a typical day, spend your first six hours figuring out how to get your boss a raise. Then if you're not totally exhausted, devote the last two hours to an attempt to increase net sales and total returns.

Does this incentive to increase your boss's pay extend only to CFOs? How about generals counsel or heads of human resources? Other research I have conducted over the years produced the same result, namely, that getting your boss a raise, no matter what your job, can be deeply rewarding.

Consider here that it is often left to the CFO and the chief human resources officer to hire the company's pay consultants. It is these same consultants who, after performing an extensive study and then submitting a large bill for their time, appear before the board compensation committee with a set of recommendations that, more often than not, will cause the CEO's pay to increase mightily.

Then once the smoke clears, the compensation committee is encouraged to tighten up the gap between the CEO and his major subordinates by giving them goodly sized raises.

It is this unholy conspiracy that suggests strongly the need for compensation committees to hire their own consultants and to make sure that those consultants have absolutely no ties to management. Clean hands should be the order of the day.

The tables below show the 15 most relatively overcompensated CFOs and the 15 most relatively undercompensated CFOs. The columns ``Percent Above Market" and ``Percent Below Market" measure the extent to which the CFO is paid more or less than what an average-paying company of the same size and total return would offer its CFO. (Data for this study were furnished by Equilar Inc., an independent provider of executive pay information.)

The 15 Most Relatively Overcompensated CFOs

Company	CFO	Actual Total Pay (000)	Percent Above Market
Electronic Arts Inc.	Warren Jenson	\$23,058	1436%
Monster Worldwide Inc.	Michael Sileck	\$7,954	778%
Adobe Systems Inc.	Murray Demo	\$7,644	589%
Lab. Corp. Of America	Wesley Elingburg	\$9,733	520%
Intel Corp.	Andy Bryant	\$19,203	441%
North Fork Bancorp.	Daniel Healy	\$5,082	334%

Cablevision Systems Corp.	Andrew Rosengard	\$6,630	328%
Robert Half Intl. Inc.	Keith Waddell	\$5,194	317%
Griffon Corp.	Robert Balemian	\$4,425	291%
Bear Stearns Cos.	Samuel Molinaro	\$8,706	288%
Health Net Inc.	Marvin Rich	\$10,391	284%
Occidental Petroleum	Stephen Chazen	\$7,932	239%
MBIA Inc.	Neil Budnick	\$3,506	233%
Equitable Resources Inc.	David Porges	\$3,537	224%
Analog Devices Inc.	Joseph McDonough	\$4,032	211%
	Low	\$3,537	
	Median	\$7,644	
	Average	\$8,509	
	High	\$23,058	

The 15 Most Relatively Undercompensated CFOs:

Company	CFO	Actual Total Pay (000)	Percent Below Market
Great Plains Energy Inc.	Andrea Bielsker	\$313	-76%
R.R. Donnelley & Sons. Co.	Gregory Stoklosa	\$413	-77%
Weis Markets Inc.	William Mills	\$296	-77%
Outback Steakhouse Inc.	Robert Merritt	\$327	-78%
Payless Shoesource Inc.	Ullrich Porzig	\$326	-78%
Avnet Inc.	Raymond Sadowski	\$455	-79%
Tecumseh Products Co.	David Kay	\$219	-80%
Old Republic Intl. Corp.	John Adams	\$294	-81%
O'Reilly Automotive Inc.	James Batten	\$211	-81%
Autoliv Inc.	Magnus Lindquist	\$324	-82%
New Jersey Resources	Glenn Lockwood	\$261	-83%
Caseys General Stores	Jamie Shaffer	\$231	-83%
Rent A Center Inc.	Robert Davis	\$233	-84%
Fred's Inc.	Jerry Shore	\$186	-84%
Echostar Communications	Michael McDonnell	\$257	-87%
	Low	\$186	
	Median	\$294	
	Average	\$290	
	High	\$455	

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