Wages of failure: the ethics of executive compensation

Sociology, Ethics

Executive compensation in the United States is generally appropriate. Note that the lucrative exit package for Bill Hogson is the prevailing market package for a prominent multinational and telecommunications company. High exit compensation packages have the virtue of allowing poor leaders to resign earlier than later to spare the company from further poor decision making. Hogson's poor performance as company CEO attests to this fact.

Performance-based pay is an attractive solution because it motivates managers to work harder. If a manager outperforms, then he/she can expect higher salary grade and other compensations. There is, however, a major drawback. Suppose that a manager underperforms for more than two successive fiscal years. The manager may as well stay on board without the benefit of a lucrative compensation.

This will inflict further damage to the company. This will also shield the company from acquiring the best talents in the industry. An alternative solution is to set the compensation to its market price. The advantage of this alternative is quite obvious. While it motivates managers to work harder, it also pressures them to leave their positions if they underperform.

The long-term effects of CEO performance are not always visible at the end of the fiscal year. For one, the long-termgoalsof the company are usually not viable within a fiscal year. To measure the performance of the CEO or manager, the criteria that should be utilized are the short-term goals of the company.

Performance-based pay mat allow CEOs to artificially inflate stock value in the short-term. The CEO may exaggerate his performance in the short-term

at the cost of long-term goals. Outstanding performance in the short-term does not necessarily translate to positive effects in the long-run.