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The mathematics of executive compensation.

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In 2006—that was just two years ago, when Wall Street still existed—the fifth highest-paid CEO in the United States, according to [Forbes' annual roundup](#) [2], was a man named Richard Fuld. Fuld sold enough shares in his company to make himself \$122 million that year. This wasn't unusual for him: In five years, he'd reaped close to \$376 million in total pay.

The company that Fuld ran once was one of the leading investment banks in the country. It was called Lehman Bros. It is now defunct.

In the annals of outrage over executive pay, Richard's Fuld's nine-figure payouts will occupy a fat chapter. It's people like Fuld who make a bailout of financial companies so hard to swallow for many—and why the bailout bill comes with caps on CEO pay. How could someone who messed up so badly have gotten paid so much for doing that?

An even better question: How come this kind of thing happens so often? Scanning the ranks of the highest-paid CEOs, one discovers a surprising number of them come from the losingest big corporations. Look, there's Yahoo's Terry Semel, in the top 10 for both 2006 and 2007. Hey, over there—Countrywide's Angelo Mozilo! No. 10 in 2006 and, stunningly, [the seventh best-paid CEO in 2007](#) [3], well into the mortgage bust.

In fact, the very nature of CEO compensation almost guarantees that this pattern will repeat itself over and over. During a company's successful years, the chief executive's compensation will look fairly reasonable, his stock price will be rising, and he'll be hailed as a corporate hero. Then his pay will rise as his company tanks. Imagine a chart of share prices rising quickly and then turning down. Now superimpose on it a chart of chief executive pay, rising first slowly and then shooting up like a glorious hockey stick.

There's no official name yet for this oft-repeated phenomenon, so we'll call it the Fuld Curve. Naming it after him seems like the right sort of honor—one of the few he can't buy.

How does the Fuld Curve come about? First, you need to remember that CEOs get paid in stock and options. The more outrageously hyped and overvalued their companies' shares are, the more their compensation packages are worth. And guess what happens after several years of through-the-roof performance? The run of

luck runs out, and the performance goes back to just average-that's "[regression to the mean](#) [4]." Or, worse, the market wises up, and the share price goes to a lot worse than average-that's the bursting of a bubble.

This is the key to understanding the shape of the Fuld Curve. Early on, a chief executive gets what looks like a reasonable paycheck. He amasses a big pile of shares and sees them rise in value. He is hailed as genius by the press. Then the stock price reaches its zenith just as he has several years of fully vested shares and options, and he starts selling. And selling, and selling. The charts come out with those neat columns with eight- and nine-figure payouts under "compensation" and minus signs under "performance." Thus yesterday's star becomes tomorrow's overpaid goat.

On top of this, whatever their abilities at running the show, when it comes to deciding when to sell shares, CEOs are no dummies. They buy when they're confident in their company's future and sell when they're not. That's not always sinister: Occasionally a CEO simply knows when the market expects him to sell an impossible numbers of widgets. (Though, when execs hide stock sales, [watch out](#) [5].)

But sometimes chief executives have very good and plain reasons to think that things aren't going to last. In that case, their stock sales (and total "pay package") accelerate even more quickly as the share price drops. In honor of Countrywide chief exec Angelo Mozilo's binge of stock selling in 2007, you can think of this as the Mozilo Multiplier to the Fuld Curve. Just don't read into this any suggestion that a man who ran the biggest mortgage company in the country would have some inkling of what was going on. That would be ... oh, heck, that would be *common sense*.

Is there a solution to the problem of the Fuld Curve? Claw-back provisions that make CEOs repay ill-gotten gains would help. But don't count on them helping much: The market does a very good job of overhyping companies even without CEOs' meddling with their numbers. And the realities of proving executive misdealing make claw backs mainly symbolic. Longer vesting periods for shares and options can help, too-but then, if they take longer to make money, CEOs tend to want, and get, more shares.

Unfortunately, the problem of overpaid, nonperforming chief executives will be with us for a long time. CEOs like to imagine that they're doing a job few can do better. We don't get to find out they weren't any good at it until long after, when the horse has not only left the barn but plunged down the stock chart, deep into a ravine.

(Photo of Richard Fuld, Chairman and C.E.O. of Lehman Brothers by MANDEL NGAN/AFP/Getty Images)

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<p>Chadwick Matlin and James Ledbetter argued that the government should have bailed out Lehman Bros. Richard Beales said that Warren Buffett's dealmaking skills should be enlisted by the government. Timothy Noah mentioned compensation packages as one of the reasons that Washington hates Wall Street. Daniel Gross commemorated the fall of the Big Swinging Dick. BSD coiner Michael Lewis said that one benefit of the crisis was that Wall Street execs would get to spend more time with their kids.</p>

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