

## **An Idea Gone Haywire: Linking Executive Pay to Sales**

By Gretchen Morgenson  
July 14, 2002  
The New York Times  
(PFD File)

**WHY would Bristol-Myers Squibb use incentives to induce its wholesale customers to buy more products than they needed last year, a practice that may have resulted in overstated revenue at the company? The Securities and Exchange Commission is investigating the company, which has said that its sales practices are proper.**

**And why would Merck & Company include in its revenue in recent years \$14 billion in co-payments that consumers made for prescriptions that the company did not actually receive and that did not show up in net income? Kenneth C. Frazier, general counsel at Merck, said the methodology accurately reflects the company's results, and that the revenue recognition is appropriate.**

Both questions may share this answer: during the market boom, investors paid close attention to sales growth, and rising sales became crucial to rising stock prices.

**But there's another, troubling answer to the queries. In both companies, executives stood to benefit personally by higher revenue because of the way in which their compensation was calculated.**

**According to Merck's proxy statement, executive bonuses are determined by comparing growth in revenue and earnings per share to those of its peers in health care. Recording** an extra \$14 billion in sales — 10.5 percent of the company's total sales in the relevant period — cannot have hurt those comparisons.

And last year, Bristol-Myers started a new long-term incentive plan that based payouts partly on sales growth. Previously, they were based on total shareholder return versus its peers and earnings growth.

On Thursday, the company said that regulators were scrutinizing last year's sales for potential overstatement. Richard J. Lane, the former president of the company's worldwide medicines group, left Bristol-Myers in April when its chairman announced that wholesalers were holding hundreds of millions of dollars in excessive inventories of company products and that this year's revenue would fall as a result.

A spokeswoman said the company would not comment on whether Mr. Lane would be returning any of the \$2.145 million restricted stock award given to him as part of his long-term compensation last year. He also made \$1.25 million in salary and bonus. Mr. Lane did not return a call seeking comment.

Then there is [WorldCom](#). In determining its top executives' bonuses last year, the proxy says, the company assessed revenue, earnings and the market value of its common stock. But it also used an unusual measure: billings by WorldCom under service agreements with its customers. Customer billing records are among the documents that the S.E.C. requested from WorldCom last March as part of its investigation into the company's accounting practices.

**It is far too simple to conclude that executive compensation plans can serve as a road map to where corporate cheating might go on, but it is becoming distressingly clear that the pay-for-performance philosophy that was supposed to align executives' interests with shareholders' has been badly distorted. "Pay for pretense" may be a better name for it, given some of the accounting shenanigans that have emerged.**

William R. Thomas, who runs the **Capital Southwest Corporation**, a publicly traded investment company in Dallas, is deeply troubled by what he calls the corruption of capitalism by officers and directors of big corporations and dismayed that few chief executives have vowed to eliminate the rot.

**"Their unbridled greed is poisoning the system that has been the source of our nation's wealth," he said. "The impending takeover of corporate America by self-serving elitist managers may prove to be far more damaging to capitalism than anything Karl Marx could have conceived."**

Amen.