

Home Depot offers expensive lesson in curbing execs' pay

While Robert Nardelli's recent departure as chairman and CEO of Home Depot Inc. set off another round of alarms over executive severance packages, there are other lessons to be learned from this shake-up.

Topping the list is the role of the board of directors as the compensation watchdog — specifically, linking executive pay to performance. The board and its compensation committee are responsible for making sure shareholders get what they are paying for from their investment in management.

Home Depot's board obviously did not do enough to limit the excess in Mr. Nardelli's \$210-million compensation package. It should never have agreed to guaranteed bonuses beyond his first year, and his stock awards should have been tied to performance. In the end, the board did ask Mr. Nardelli to give up the guaranteed bonus, and he complied. But when it then tried to link his stock compensation to performance, he balked and was fired. These are moves that should have been made years earlier.

Second, Mr. Nardelli's compensation and severance were a product of the time: He came on board six years earlier, when the trend in executive compensation was to offer huge packages to attract qualified people. That era contrasts sharply with the 2005 hiring of W. James McNerney Jr. as chairman, president and CEO of Boeing Co. According to press reports, his total compensation package after six years of service will be worth about \$53 million.

That Mr. McNerney's potential compensation is one-quarter of Mr. Nardelli's is a hopeful sign. Granted, it is still standard practice to offer large, protective contracts and severance packages to incoming CEOs, particularly those hired from outside. However, there is more rationality these days in executive pay. Mr. McNerney's compensation speaks to the quality of people on Boeing's board, who are concerned with effective governance and sound executive pay. And while the company's board has made a substantial investment

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Donald P. Delves is president of Delves Group, a Chicago-based firm that advises companies on compensation and governance.

in CEO compensation, it seems to be paying off, based on Boeing's performance over the last year.

The world of executive compensation is now a very different place. Since 2002, there have been dramatic changes in corporate governance and compensation committees, which are far more focused on paying for performance. Add to this a required expense for stock options and Sarbanes-Oxley reporting rules.

The last and perhaps most important boardroom lesson of the Home Depot shake-up: While the executive compensation system has not, by any means, been fixed, tougher scrutiny and persistent pressure from investors and the media are working. Boards, in general, are taking stronger stances on CEO pay and performance to safeguard the interests of shareholders. The ideal compensation system is mutually beneficial for executives and shareholders.

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