There is a game played by CEOs with the corporate issuance of lottery tickets. Otherwise known as stock. Stock can be issued in any number of ways, shapes or forms. Warrants, options, restricted or unrestricted stock. No matter what you call it, every CEO hired, is asking for equity knowing that their only goal is to hit the jackpot and create a pool of wealth that puts them in the “fuck you” wealth category. Thats enough money to buy or rent just about anything you can think of and put you in position to never have to work again. You just live off the cash in the bank.

Put another way, every hired CEO is looking to be in a position to look in the mirror , smile and tell themselves they have made it. They are living the American dream. The only way to do that is to grab as much equity equivalents as you can and do everything you can to get that stock price up as high as you can while periodically liquidating the stock and stuffing the cash in your bank account.

There is absolutely nothing wrong with doing so. Any CEO who doesnt take advantage of this golden ticket opportunity is an idiot. In fact, although I don’t have actual numbers, I would hazard a guess that more than 95pct of CEOs hired to run companies with a billion dollar plus public market caps probably do get themselves to the position of having more than 10mm dollars in equity very quickly. While those who manage to hold on to their jobs a while and not screw up too bad, can relatively quickly get past the 25mm dollar in equity mark and reach the 50mm dollar mark with in 10 years. Its actually pretty tough to screw up and not get there if you have any brains at all.

Why ?

Because you have the entire Mutual Fund, Hedge Fun and Brokerage industry doing everything they can to get you there. Think about it.

You can’t turn on CNBC or Fox Business without them cheerleading the market to go up. Every man, woman, child, fund, index or interested party who buys the stock is doing everything they can to get the stock of the company to go higher. They don’t really care how you run the company and they care less about the results of the company than they do about the performance of the stock. Heck, even if they did care, shareholders dont really own anything and have zero say in the company. If you really dig into it, its the ultimate in social networking. Everyone who owns the stock belongs to the fan page or group for the stock and they are telling everyone they can how wonderful the company is and why the stock will go up, all while praying it does so.

Its the American way and it works ! Hundreds of millions of dollars are spent every year by brokerages telling every American that the stock market over time will go up 7pct per year. All you have to do is diversify and hold onto your stock long enough. For better or worse, everyone believes it.

With all of that social networking power, call it stocksourcing behind stocks, how can CEOs not get rich ?

The problem with all of this is that there is a huge disconnect between the CEO and shareholders doing well and those who work for the company doing well

Yes, its true, particularly in markets like we are experiencing now, stocks can hit 52 week, or even multi-year lows.(although more often than not, in spite of low stock prices, market caps have increased).

Yes, its true that CEOs see the value of their holdings shrink. However, unlike lottery tickets whose value goes to zero when you dont hit the number, the CEO equity positions retain their upside and history has shown us that if they go far enough underwater, they will get repriced and /or reissued. All in the name of keeping the CEO happy. So while CEOs may get “less rich” for awhile, the game is stacked so that a downturn gets them happy real fast when the upturn comes.

The disconnect is that there is a big difference between not making Wall Street happy and not making money.

The pressure from Wall Street is to grow earnings forever. Not matter what it takes. This isnt a problem when a company is doing well. EVeryone is happy. But when the economy hits a bump like it has now, when the market is hitting a bump and stock prices are declining, like it is now, the pressure comes. Everyone owning the stock reacts and whats to know what the CEO will do to get the price back up. This, as they say “is where the CEO earns their pay” Unfortunately, what this really means is that everyone who works for that company is at risk. At risk of losing their jobs, benefits, raises, you name it. Its at risk.

All of which is a long winded way of saying that employees live in the corporate cash zone, CEOs and the top few in management live in the equity/lottery ticket zone.

Those in the cash zone always take the first hit. People,places and things that consume cash are the first things to go because cash expenses immediately reduce earnings. If you or anyone like you consumes cash, unless someone upstairs thinks you generate a straight to the bottom line return on the cash expenditure, you are about to become a corporate ghost. Your person, place and thing will be memorialized as a cut to increase earnings mentioned in a press release that wall street will cheer and use to push up the stock price.

What makes me sad about all of this is that I really think that in this country if there truly was a connection between shareholders and management, that if given a choice by **profitable** companies, most of us would choose to hold on to our shares and accept an expanded PE for some period of time in exchange for people keeping their jobs.

I would love to receive an email from a company I own saying something to the effect of:

Dear Shareholder,
We are facing a very difficult decision that we would like your feedback on . Our earnings per share last quarter were 20 cents, and for the entire last year, 80 cents. Because of a downturn in business caused by XYZ factors, we face the choice of making 10 pct less, or cutting headcount and related expenses in order to maintain our earnings and possibly even grow our earnings a couple cents this year.

As a shareholder, we would like to ask you whether you would consider allowing us to retain these valued employees. We recognize that it would require you accepting a PE multiple 10 pct higher than the current market. We hope you would be willing to make this concession. We think that the jobs this will save will return far greater value to shareholders over the long run.

We look forward to your vote.

Personally, Im willing to give a higher multiple in exchange for saving people’s jobs. At least once.

Unfortunately, this of course is a fantasy that can’t happen in this country.

Which brings us back to CEO Pay.

As long as CEOs live in the equity/lottery ticket zone and employees in the cash zone, CEO pay is going to be outrageous relative to everyone else.

The only possible way to change this is to put CEOs in the cash zone. Make companies generate 100pct of their compensation in cash that is 100pct expensable in the quarter paid. Thats not to say they cant own stock. Hell yes they can own stock. But make them buy it either on the open market, or as part of the programs that make stock available to every company employee, on the same terms. They are getting paid enough in cash and if they believe in their ability to run the company, they can put their money where their mouth is. Eliminate all the free lottery tickets. Make them buy stock, options, warrants, whatever, on the same terms as everyone else can.

Shareholders tend to ignore how much stock is given to management, they don’t ignore cash. Companies will always be a lot more stringent with their cash, whether its paid to the CEO or anyone else. CEO cash compensation will go way up, but total compensation will come way down. More importantly , CEOs getting paid huge sums in
cash will stand out like a sore thumb when things arent going so well. They will be treated like everyone else in the cash zone and held far more accountable for their work.

Of course this is all just my opinion, but to me its a good thing for all involved. The rich can still get richer, but everyone shares in the risk.