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Compensation Soars for Wal-Mart CEO Lee Scott: Graef Crystal

Sept. 3 (Bloomberg) -- It took a while, but the greed virus has finally reached the Bentonville, Arkansas, headquarters of Wal-Mart Stores Inc. And Lee Scott, the company's chief executive officer, seems to be testing positive for its presence.

Consider these statistics for the world's largest retailer:

-- Between fiscal 1994 and fiscal 2003, Wal-Mart's net sales rose 263 percent, to \$245 billion from \$67 billion.

-- Between 1994 and 2003, Wal-Mart's diluted earnings per share rose 255 percent, to \$1.81 from \$0.51.

-- Between Jan. 31, 1994, and Jan. 31, 2003, Wal-Mart's total return was 282 percent.

-- But -- are you ready for this? -- between 1995 and 2003, CEO pay rose 1,767 percent, to \$29.8 million from \$1.6 million. That's an ominous sign in a business run on razor-thin margins. Over the long run, you can't be the low-price favorite of the masses and offer your CEO a pay package whose price tag would look high even at Neiman-Marcus.

The 54-year-old Scott has fared much better than his predecessor, David Glass, since becoming CEO in January 2000. Glass's average annual total pay from 1995 through 2000 was \$4.5 million. Scott's average annual total pay from 2000 through 2003 was \$23 million -- or 5.1 times higher.

Free Shares

The primary reason why Scott's pay has risen so quickly is the free share awards. They have boosted total pay mightily and, equally bad, lowered the risk in his compensation package. After all, if Scott's \$13.1 million in free-share awards drop in half -- a disaster for Wal-Mart's shareholders -- he still walks away with \$6.6 million.

Wal-Mart said in its proxy statement filed April 15 that one of the free-share awards, though granted during the company's 2003 fiscal year on Jan. 9, 2003, really represents an award for fiscal 2004. The SEC doesn't agree with this type of reasoning. If the award is made in a fiscal year, that's when it is counted.

I don't agree either. If Wal-Mart's compensation committee wanted to smooth Scott's pay so it didn't look so high in fiscal 2003, it could simply have delayed that \$6.5 million award for 24 days. Besides, how does a compensation committee conclude that a CEO is worth what really is a \$6.5 million bonus before the fiscal year for which it is being awarded has even begun? There must be some clairvoyants among those worthy directors.

Scott's Performance

Of course, one defense for Scott's huge pay in comparison with that of his predecessor might be his performance.

Forget that one. Between Jan. 12, 2000, the day before Scott became CEO, and this Aug. 29, total return was negative 2.1 percent a year. Still, that was 5.8 percentage points better than the negative 7.9 percent a year return produced by an investment in the Standard & Poor's 500 Index.

In comparison, between Jan. 31, 1994, and Jan. 12, 2000, Wal-Mart's total return was 31.6 percent a year. The margin over the S&P 500 Index was a positive 9 percentage points.

Bottom line: Not only did Scott outperform the S&P 500 Index by a smaller margin than Glass, but even more important, he delivered a negative return to shareholders.

Some Comparisons

Glass appears numerous times in various U.S. pay databases I have compiled from 1997 through 2000. After calibrating for the company's immense size, I found that in comparing his pay as Wal-Mart's CEO with that of hundreds of companies in a variety of industries, it was approximately 73 percent below the market.

That was then. Now let's talk about today.

I first compared Scott's pay package for the year ended Jan. 31, 2003, with those offered to CEOs of 11 other major U.S. retailers. Scott's compensation of \$29.8 million exceeded the average of \$10.3 million by 2.9 times. He earned more than 10 of the 11 CEOs, with Home Depot Inc.'s Robert Nardelli receiving more with \$36.2 million.

However, both Scott and Nardelli can be considered outliers, given the huge pay drop-off after you get past them. The third highest-paid CEO, Target Corp.'s Robert Ulrich, earned \$13.8 million.

I also compared Scott's pay with that of 10 CEOs running companies with the largest market caps in the U.S. Wal-Mart was the only retailer in the group.

Here, Scott comes out a bit better. His \$29.8 million pay package is only -- ONLY -- 1.5 times higher than the \$19.7 million average of those CEOs. He was beaten out by Cisco Systems Inc.'s John Chambers, who earned \$39.8 million. Except for \$1 of salary, Chambers' entire pay package consisted of stock options covering 4 million shares, half of them currently under water and the other half a bit above. If one calibrates for pay risk as well as pay size, it seems to me that Scott has the richer pay package.

(Data for those two pay comparisons were obtained from Equilar Inc., an independent provider of executive pay information.)

Credit Due

In evaluating Scott against those 10 major market cap companies in other industries, he needs to be given credit for Wal-Mart being No. 1 in net sales and No. 3 in market cap.

The big problem is that Wal-Mart isn't No. 1 or even No. 3 in net income. It is a much lower No. 7, reflecting the low margin nature of its business.

So far, at least, the huge pay of Wal-Mart's CEO hasn't affected the company's net sales margins. For the year ended Jan. 31, 2003, the return on net sales was 3.3 percent, about the same as it has been since 1995.

That suggests to me that though the greed virus has reached Scott, it hasn't yet affected his upper middle management and middle management subordinates. If it does, watch out.

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The members of Wal-Mart's board compensation committee are:

-- Jose H. Villarreal, chair, partner, Akin, Gump, Strauss, Hauer & Feld LLP

-- James W. Breyer, managing partner, Accel Partners

-- Dawn G. Lepore, vice chairman of technology, operations and administration, Charles Schwab Corp.

-- Elizabeth A. Sanders, management consultant, Sanders Partnership

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