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## The Morning Risk Report: Why Firms Overpay Executives

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By GREGORY J. MILLMAN

Retention risk is real, but companies may be paying more to fight it than it's worth. "What's swinging this market like crazy is that you have to increase pay to recruit someone and increase pay to retain someone," said Andy Restaino, managing director of the compensation consultancy Technical Compensation Advisors, Inc. Indeed, when companies lose an executive to another firm, they tend to "dramatically raise" the pay of executives left behind, according to [research published](#) last month in the Journal of Accounting and Economics.

The researchers studied 510 cases between 1993 and 2011 in which executives had jumped ship and found that for the executives left behind, the pay raise is about 32%, controlling for company characteristics, mainly because of additional equity-based pay. To some extent this corrects for underpayment, insofar as those executives generally report having had lower than industry-standard pay in the year prior to their job-hopping colleague leaving. But some of it seems to be "overreaction" said Stephen F. O'Byrne, president of the compensation consulting firm Shareholder Value Advisors Inc., because "the remaining executives receive an increase even when their colleague has left for lower pay." In fact, just over a third of job-hoppers had indeed gone elsewhere for less pay.

The potential for this kind of overreaction to ratchet up executive pay levels across firms is easy to see, but it is not blindly irrational. The authors note that excessive pay does diminish retention risk, as overpaid executives are not likely to leave. The additional pay usually comes in the form of equity, which ties recipients more closely to the firm. Moreover, the pay raises generally target those executives with the greatest job mobility. The combination does seem to work, as the data show that "the raise in pay helps to prevent incumbent managers from moving to other firms." As to whether the risk mitigation is worth it to shareholders, opinions may differ. "Sometimes it's more cost effective to pay than continue to recruit people," said Mr. Restaino.

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**EXCLUSIVE ON RISK & COMPLIANCE JOURNAL**

**Zendesk** ZEN -0.26% may have bought into sanctions trouble. Rapidly growing cloud company Zendesk Inc. says a firm it bought may have violated U.S. sanctions. The company's dilemma highlights the complexity of complying with sanctions laws when services are provided over the Internet. The San Francisco-based maker of customer service applications said in a filing Thursday that Zopim, the online chat company it purchased last year, sold subscriptions to people and organizations in countries under sanction.

**Voting rules changing for proxy filings.** Governance activists are making progress in their push to change the way companies count votes on shareholder proposals and, other things being equal, this shift should make it easier to pass them. Yet other things aren't equal, because some major institutional investors, such as Vanguard Group, say they will vote "no" rather than "abstain" on shareholder proposals if companies make the change the activists are seeking.

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