



THE COMPENSATION CORRECTION CONNECTION

Last Saturday's paper was filled with outrage over the golden parachute given to the outgoing CEO of a failed financial institution. The press has been harping on the "fat cat" over paid bankers who are "getting bailed out" with taxpayer money. Guy Hands of Terra Firma Capital Partners says that a 75% drop in private equity compensation is to be expected. Nearly 200,000 financial services industry positions have been cut since last October, with more on the horizon. David deWeese of Paul Capital was quoted this week in VentureBeat as saying that fundraising for buyout firms is going to be seriously challenged for the next 18 months. I'm not saying that any of the public perception that is being heaped upon the backs of candidates who already feel kicked is deserved, but perception often shapes reality. And, as my personal trainer says – "Like it, don't like it, learn to live with it." Add it all up and there is undoubtedly going to be a correction in industry compensation this year and, likely, through 2009.

For the past several years, compensation has been cycling upward, just like housing prices. We all knew it couldn't continue to increase at that rate indefinitely. Every year, base salaries trended up, bonuses were all but guaranteed and were often multiples of base salaries without regard to personal or firm performance and firms were paying sign on bonuses, moving packages and sometimes making candidates whole on anticipated bonuses they were leaving behind to make the move. Candidates sought their next career in banking, private equity or hedge funds because it was the "hot" sector and they could make a handsome living, but few could articulate precisely what they loved about the work other than the money. Those easy to grab rewards are rapidly fading into memory. There is a compensation backlash whipsawing through the industry and we all need to be prepared to be realists about what "market compensation" means for the foreseeable future.

There is a heavy flow of talented candidates into the job market right now. It means that to be a survivor in this new recruiting market, candidates need to be realistic and be ready to retool. (More about retooling in my next column.) It also means that candidates will need to be prepared to demonstrate what value they will add to the firm they are in to keep their jobs and especially to new employers to be added to the team. There just won't be enough seats at the table to absorb all of the candidates coming into the market and that means an inevitable change in how compensation has been doled out to date. An article in the Wall Street Journal on Monday touted the new breed of CEO's who are willing to agree to have their bonuses and comp packages adjusted downward if the company's performance isn't up to par. Expect the same thing to begin happening in our industry.

Last year several clients decided that bonuses were nothing more than a fiction, that there were no tangible standards upon which bonus amounts were awarded and that candidates had begun to expect them as part of their reliable compensation, not as a reward for superior performance or returns. These clients began turning to a reasonable base salary,

and carry as the measure of reward in their firms (even at the mid and junior levels), all but doing away with bonuses and making long term performance of employees and the fund intimately tied together.

Given that investment cycles are predicted to last longer, that exits will be tougher and that firms will likely have to be tightening their belts with fundraises coming further apart than before (meaning less overlapping management fees), and the competition for a place at the table in firms will be greater, expect compensation to begin cycling downward in this year and throughout 2009. We could very well see firms saying, in effect, this year's bonus is that you get to keep your job.

Take note, this is not a suggestion that firms should have a free license to take advantage of candidates and not reward them for jobs well done. But, to a certain extent, expect that firms will return to the basics of compensation in this industry – your salary is your compensation for doing the basic requirements of your job, your carry is your reward for the long term performance in the fund. Traditionally, private equity has been about the long view and to see results meant putting in the effort and trusting in the result at the end of the game when an investment exited. The past several years of bonus compensation have had little to do with employees' performance and more with private equity trying to attract talent by competing with high salaries and year end bonuses offered by the investment banks. The bulge bracket investment banking compensation model is changing dramatically before our eyes and boutique banking firms and private equity and hedge funds will look to follow suit, returning to their roots of reward for performance.

Some candidates have been quoting to me their "market value" by telling me what they made last year. Market compensation is determined by the current market, just like the value of your house. The industry we all work in is cyclical and that means that it isn't always increasing. It also means that we all need to take a good hard look at what the market is paying based on current conditions and adjust our expectations accordingly. You don't have to do a job if you can't accept that salary, but you should also be aware of what the market **is** willing to pay before you get yourself hung up on compensation issues. There are lots of jobs out there, it just so happens that this industry is experiencing a compensation correction, so last year's going rate may not be indicative of the current rate. Those who can be flexible on compensation, geography and sector will have more opportunities than those who cannot.

Recently, a candidate from one of the failing banks was offered a position at another firm. He replied, "That's a 25% pay cut from what I made last year! I'm worth more than that!" Don't confuse your "worth" with what you are being paid for the work you do.

The two are never the same and you'll be a much happier person if you are doing work you enjoy and not just for the money.