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HEADLINE: The **Bonus Army**

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BODY:

EVEN those accustomed to Wall Street's otherworldly pay scales gasped last week when Goldman Sachs's 2006 compensation numbers were released: \$16.5 billion, up 40 percent in a year, some \$623,000 per employee. The news triggered shock and envy: Oh, my God. That's obscene! Boy, do I wish I worked for Goldman Sachs.

Pundits asked how such numbers could be justified, whether Goldman's employees were that much more talented than the rest of Wall Street, whether Goldman's shareholders were getting mugged. About the only people who had nothing to say were Goldman's understandably discreet employees. What were they thinking?

Having once been on the receiving end of the Wall Street **bonus** system, I can guess: Some Goldman employees probably felt ecstatic; some fairly paid; and some shafted. (It is ever thus.) For example, word has it that some secretaries fumed about making a total of only \$120,000 while their bosses made millions -- until gently reminded that \$120,000 is great secretary pay. Most Goldman employees probably have a sense of how lucky they are compared to those outside 85 Broad Street. Few probably suffer from the delusion that the bonuses are "fair" in any moral sense: Even with frequent all-nighters, Goldman workers probably earned the best hourly wages in the world (an average of about \$200 per hour, assuming a 60-hour week; the firm's top traders, meanwhile, reportedly made \$17,000 to \$33,000 an hour.) In a country where some people are starving and others are furiously debating a \$1 increase in the minimum wage, such bonanzas provide a startling reminder of the inequities of our free-market economy.

Within a more limited context, however -- pay for performance -- the compensation is fair, and Goldman's employees have every right to view it as such. Capitalism works because it encourages and rewards those who successfully take risks, adapt to change and develop profitable opportunities. Goldman Sachs employees, arguably, are consistently better at those things than any other group of employees in the world. Yes, they have the good fortune of working in a hot industry in a favorable market environment. But they have taken spectacular advantage of both.

This year, even after paying themselves and their other expenses, Goldman's employees generated an average of about \$550,000 of pre-tax profit apiece. This is twice as much as the employees of Lehman Brothers, another strong Wall Street firm (\$228,000). It is more than the employees at G.E. and Microsoft. It is even more than the employees at Google, another fantastically profitable wealth-generation machine.

Goldman's employees even paid themselves less as a percentage of revenue this year than they did last, and less than the employees of other Wall Street firms. Any shareholder who feels mistreated by this performance is a tough shareholder to please.

At the heart of the Goldman profit factory is the annual **bonus** system, which mimics the dynamics of free-market capitalism. Like workers at other Wall Street firms, most Goldman employees receive the vast majority of their compensation in a single paycheck, the amount of which is based on firm, group and individual performance.

The system gives the firm extraordinary ability to invest its resources in the assets (people) that earn the biggest returns -- and to do so without risk, after the fact, when the returns are in the bank. It allows the firm to pay superstars enough that they won't jump to hedge funds and private equity firms, where the upside, believe it or not, is even more extreme. It allows the firm to pay free riders and has-beens next to nothing before it shows them the door.

The **bonus** system also gives the firm the flexibility to cut compensation drastically in bad years without destroying profit margins or firing thousands of loyal employees: Wall Street is notoriously cyclical, and \$16.5 billion of compensation this year could become \$5 billion -- or less -- next year. The system ensures that ambitious employees have an incentive to give their best every year, instead of resting on laurels. And it enables the company (and its shareholders) to develop new products and

businesses without shouldering all of the risks: Think you're the next Robert Rubin/Hank Paulson/Jon Corzine? Want to bet your Goldman career on your fabulous new idea? Be our guest.

Capitalism can't solve all economic problems, as the homeless people poking through trash cans outside 85 Broad Street can surely attest. In fact, to adapt an old adage, capitalism is surely the worst economic system on the planet except for all the others. What capitalism is great at, however, is encouraging successful risk-taking, and this keeps our economy healthy and vibrant. Capitalism is also great at generating immense tax revenue (Goldman's employees will pump almost as much into city, state and government coffers this year as they take home -- some consolation for those who won't be getting \$623,000 checks in their stockings.)

In any case, to see the embodiment of our economic system in action -- for better and worse -- one need look no farther than Broad Street.

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