

The Directors & Boards Survey: CEO and Executive Compensation 2009

By Robin Ferracone and Todd Gershkowitz

Co-sponsored and analyzed by Farient Advisors LLC



The 2009 **Directors & Boards** 2009 CEO and Executive Compensation Issues and Governance Survey, co-sponsored by Farient Advisors LLC and **Directors & Boards** Magazine, reveals that corporate directors, executives and shareholders believe that excessive executive compensation is a significant issue. However, not surprisingly, most of the survey respondents do not feel as though more government intervention is the answer. Instead, most view “self-help,” particularly in the areas of assessing the effect of the compensation system on risk-taking behavior, improving performance measurement, and strengthening the link between performance and pay as the right path forward.

The degree of change that the survey’s respondents are advocating with respect to executive compensation has begun to translate into changes to programs and practices, but so far, these actions have not matched the



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Methodology and Demographics

This **Directors & Boards/Farient Advisors LLC** survey was conducted in March 2009 via the web, with an email invitation to participate. The invitation was emailed to the recipients of **Directors & Boards’** monthly e-Briefing. A total of 337 usable surveys were completed.

About the respondents

(Multiple responses allowed)

A director of a publicly held company	34.1%
A director of a privately held company	42.5%
A director of a non-profit entity	37.7%
A senior level executive (CEO, CFO, CxO) of a publicly held company	9.9%
A senior level executive (CEO, CFO, CxO) of a privately held company	23.7%
Shareholder	40.4%
Advisor (auditor, consultant, attorney or other board advisor)	33.5%
Academic	7.8%
Other	6.3%

Board service

(Average number of boards respondents serve)

Public	1.16
Private	1.49
Charitable	1.59

Compensation involvement

(Respondent’s role in determining or approving executive compensation)

Compensation Committee chair	13.7%
Compensation Committee member	24.6%
Board member, but not on the Compensation Committee	26.3%
CEO	9.8%
CFO	1.4%
Chief HR Officer	1.8%
Other senior executive	5.3%
Not involved in executive compensation decision-making	17.2%

Revenues

(For the primary company of the respondent)

Average revenues	\$2.2 billion
Less than \$1 billion	69.0%
\$1 billion to \$10 billion	20.7%
More than \$10 billion	10.3%

Total CEO compensation

(in \$US, including salary, bonuses, long-term compensation, benefits and perquisites, for fiscal year 2008)

Average	\$1.945 million
Less than \$250,000	20.5%
\$251,000 to \$500,000	23.5%
\$501,000 to \$999,000	13.0%
\$1 million to \$2.5 million	17.0%
\$2.6 million to \$5 million	10.5%
More than \$5 million	15.5%

level of rhetoric on the subject. Seventy-two percent of the organizations responding are not completely satisfied with the advice they are receiving from compensation consultants, which may account for some of the gap between intentions and actions.

Boards of Directors, Compensation Committees and management all are working to reconcile their current executive compensation programs with the views of their shareholders. In doing so, they often turn to outside advisors for strategic advice and data on external trends. Among survey respondents, the top selection criterion in choosing a compensation consultant is their objectivity.

For the purposes of this analysis, we've filtered out respondents who are not directly involved in executive compensation decision-making in public, private and non-profit organizations, most of which (69%) are members of a corporate board of directors. Of these remaining 289 respondents to the survey, nearly a third (29%) represent organizations with \$1 billion or more in annual revenues—referred to as “large organizations”—and just over two-thirds (71%) represent those with less than \$1 billion in annual revenues—referred to as “small/mid-sized organizations”. We have analyzed the difference in responses between large organizations and small/mid-sized organizations. (The full demographics of survey respondents and selected responses from the entire survey base can be found in the box on page 43.)

Survey Respondents by Annual Revenues and Role

Annual Revenues	%	% that are Members of a Board of Directors
More than \$1 billion	29%	80%
Less than \$1 billion	71%	64%
Total	100%	69%

Executive compensation is considered to be a serious issue, but the issue is “theirs,” not “ours”

With executive compensation in the news virtually every day and at the center of an ongoing public policy debate, more than half of the survey respondents (55%) agree that executive compensation is a significant issue. Approximately a third of the respondents (38%) think that executive compensation is an issue, but only in isolated cases. Only a small minority (7%) of respondents feel that executive compensation is an issue of little significance, fueled by the current financial crisis.

Significance of Executive Compensation as an Issue

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
Significant issue	61%	53%	55%
Not a significant issue broadly, but in isolated cases	34%	40%	38%
Not a significant issue	5%	8%	7%

Notwithstanding their agreement that executive compensation is a legitimate business issue, approximately three-quarters (76%) of respondents indicate that the CEO pay levels in their organizations are “about right.” In particular, large organizations feel as though they would need to pay about the same to recruit a new CEO, while small/mid-sized organizations feel that they would be just as likely to have to pay more. Larger organizations showed more restraint than smaller organizations in 2008, perhaps driven by their larger total CEO pay levels. Larger organizations were more likely than smaller organizations to pay less in 2008 than 2007, and were more likely to withhold bonuses.

Respondent Organizations' CEO Pay Practices and Decisions

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
Current CEO pay is about right	81%	73%	76%
Would need to pay significantly more to recruit a new CEO	31%	45%	33%
Would need to pay about the same to recruit a new CEO	58%	45%	49%
2008 CEO pay greater than 2007	37%	51%	46%
2008 CEO pay less than 2007	41%	20%	26%
Withheld CEO's 2008 bonus	46%	35%	39%

Increased government intervention is not the answer

Most of the survey's respondents feel as though government intervention is not the answer to address the issue of runaway executive pay. Moreover, they feel that, at best, government should establish more rules for those organizations receiving government assistance. Only 17% of large organizations and 30% of small/mid-sized organizations were in favor of establishing

more regulations, indicating that respondents from large organizations are more inclined to allow the free markets to determine how organizations should handle executive compensation, compared to their smaller counterparts.

Views on the Introduction of More Rules and Regulations Concerning Executive Compensation

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
Establish more rules for all organizations	17%	30%	26%
Establish more rules, but only for organizations receiving government assistance	41%	40%	40%
Don't establish more rules	41%	30%	34%

Organizations should focus on increasing accountability for long-term performance

Notwithstanding the sentiment among most respondents that pay levels at their own organizations are about right, most respondents also agree that they can take concrete steps to improve the design and functioning of their existing pay programs and arrest runaway compensation

before it happens. These approaches emphasize increasing executives' accountability for the long-term implications of their decisions.

The top three approaches identified as "likely to be effective" include: eliminate pay-for-failure programs (e.g., rich severance packages, guaranteed bonuses and perquisites); demonstrate the potential impact of pay programs on risk-taking behavior (e.g., ensuring performance measures and goals are risk-adjusted, modeling the impact of different financial scenarios on incentive payouts); and limit the use of pay vehicles that promote excessive risk taking (e.g., stock options, highly leveraged incentive plans with limited or no downside exposure). Respondents also cite strengthening of shareholder oversight (e.g., better disclosures, voluntary adoption of a non-binding shareholder vote on executive pay) as a relatively effective way to address excessive executive compensation, although more small/mid-sized organizations (71%) are proponents of this mechanism compared to larger organizations (42%).

While most respondents feel that stock options should continue to play a role in the executive pay package, they also feel as though the design of stock option programs can be improved to better align stock option

Highest Rated Approaches for Addressing Excessive Executive Compensation

(% of Respondents Rating Approach as Effective)	More than \$1 billion annual revenues		Less than \$1 billion annual revenues		Total
	% Effective	Priority Ranking	% Effective	Priority Ranking	
Eliminate pay-for-failure programs	83%	1	85%	1	85%
Demonstrate the potential impact of pay programs on risk-taking behavior	70%	2	71%	2	70%
Introduce claw-backs to recapture compensation paid if future corporate performance problems can be linked to past executive decisions	70%	2	60%	Not in Top 3	63%
Strengthen shareholder oversight of executive pay	42%	Not in Top 3	71%	2	62%
Limit the use of pay vehicles that may promote excessive risk taking	63%	3	67%	3	66%

Highest Rated Approaches for Improving Stock Options as an Executive Compensation Program

(% of Respondents Rating Approach as Effective)	More than \$1 billion annual revenues		Less than \$1 billion annual revenues		Total
	% Effective	Priority Ranking	% Effective	Priority Ranking	
Vest stock options based on achieving stock price hurdles or other performance criteria	70%	1	77%	1	75%
Hold option gains in escrow subject to additional performance thresholds	66%	2	79%	2	72%
Limit stock option awards as a percent of total compensation	36%	3	50%	3	46%
Discontinue using stock options as a long-term incentive vehicle	16%		31%		26%

gains with long-term shareholder value creation. Stock option design changes supported by the majority of the respondents are to:

- add performance-based vesting provisions such as stock price hurdles,
- and hold option gains in escrow until additional performance thresholds are met.

Only 16% of respondents from large organizations and 31% from small/mid-sized organizations advocate eliminating stock options entirely as a compensation vehicle across all organizations.

Organizations need to improve the alignment between performance and pay

Decision-makers agree that they face vexing issues when it comes to establishing executive compensation programs and setting pay levels. Top challenges center on the performance measurement system and its link to pay. These challenges are consistent with respondents' views on what organizations in general should do to address excessive executive compensation. In particular, the top priority of both large and small/mid-sized organizations is to determine whether the right performance measures are in place. The second and third priorities are to: set relevant goals; and strengthen the relationship between pay and performance. Overall, 69% of survey respondents advocate taking specific steps to improve the degree of alignment between performance and pay.

Top 3 Highest Priority Compensation Challenges

	More than \$1 billion annual revenues		Less than \$1 billion annual revenues		Total
	% of Respondents	Priority Ranking	% of Respondents	Priority Ranking	
Determine whether the right performance measures are in place	31%	1	27%	1	29%
Set goals that are relevant to participants, as well as sensitive to shareholders	23%	2	15%	3	18%
Strengthen the relationship between pay and performance	14%	3	26%	2	22%
Total of Top 3 Highest Priority Challenges	69%		69%		69%

About a quarter of organizations are trying to maintain their overall approach to compensation strategy. **However, when changes are warranted, they are focusing on the performance measurement system and the use of long-term incentive vehicles.**

Top 3 Approaches Organizations are Implementing to Address Executive Compensation Issues

	More than \$1 billion annual revenues		Less than \$1 billion annual revenues	
	% of Respondents	Priority Ranking	% of Respondents	Priority Ranking
Change performance metrics	49%	1	36%	2
Change long-term incentive vehicles	43%	2	24%	Not in Top 3
Stay the course	40%	3	39%	1
Change compensation strategy	24%	Not in Top 3	27%	3

Compensation consultants play a key role

In terms of advice and counsel regarding the design and management of executive compensation programs, almost all (94%) large organizations and 40% of small/mid-sized organizations retain executive compensation consultants. Approximately half (54%) of large organizations and a third (32%) of small/mid-sized organizations retain separate consultants for the Compensation Committee and management. Large companies expect a high degree of engagement with their consultants.

Use of and Engagement with Compensation Consultants

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
Formally engage a compensation consultant	94%	40%	57%
Retain separate consultants for the Board and management	54%	32%	43%
Expect high degree of engagement with consultant	67%	22%	45%

A third (33%) of large organizations and a quarter (23%) of small/mid-sized organizations are completely satisfied with their compensation advisors. There is room for improvement in that only just over half of the respondents (55%) are somewhat satisfied and 17% are not entirely satisfied with their compensation advisors.

Satisfaction with Current Compensation Consultant

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
Completely satisfied	33%	23%	28%
Somewhat satisfied	58%	52%	55%
Not entirely satisfied	9%	25%	17%

However, relationships between organizations and their consulting advisors are slow to change in that approximately two thirds (66%) of all organizations have used the same compensation advisor for three or more years.

Tenure with Current Compensation Consultant

(% of Respondents)	More than \$1 billion annual revenues	Less than \$1 billion annual revenues	Total
More than 5 years	27%	30%	28%
3 to 5 years	39%	36%	38%
1 to 3 years	25%	24%	25%
Less than one year	9%	10%	9%

Regardless of their size, Compensation Committees rely heavily upon compensation consultants for data to inform the executive compensation design and decision-making processes. However, the Compensation Committees of large organizations are more inclined to use consultants as strategic advisors, partners and sounding boards than the Compensation Committees of small/mid-sized organizations. This may be a function of the cost of engaging a highly strategic advisor.

Role of Compensation Consultant (Highest Ranked)

(% of Respondents Rating Approach as Effective)	More than \$ 1 billion annual revenues		Less than \$1 billion annual revenues		Total
	% of Respondents	Priority Ranking	% of Respondents	Priority Ranking	
Data provider to Compensation Committee	81%	1	81%	1	81%
Strategic advisor and partner to Compensation Committee	63%	2	48%	2	56%
Sounding board, opportunistic advisor to Compensation Committee	61%	3	46%	3	54%

Conclusion

The results of this survey demonstrate that organizations are aware of the issues underlying the public debate and furor over excessive executive compensation and that Boards of Directors, Compensation Committees and management have identified a number of solutions (e.g., increasing accountability for long-term performance, improving the degree of alignment between pay and performance) that should be self-imposed, rather than government-mandated. It is incumbent on compensation consultants to help facilitate this process by offering objective, strategically-based guidance on how to best design and implement new approaches to executive compensation that increase executives' accountability for the long-term implications of their decisions and strengthen the relationship between executive performance and pay.

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