


Essex & Partners

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Emerging from the Meltdown -- Forces that are Reshaping Executive Compensation --

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January 21, 2010

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Overview of the Session

- I. The Economy – What’s Happening Now?**
- II. Key Trends Reshaping Executive Compensation**
- III. Patterns of Total Compensation**
- IV. Translating the Trends into Deals**
- V. Q & A and Discussion**

I. The Economy – What's Happening Now?

<i>Economic Forecasts:</i> ¹	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Global GDP	4.0%	3.2%	-0.8%	3.8%	4.0%
US GDP	2.1%	0.4%	-2.5%	2.2%	2.3%
Inflation (CPI)	2.9%	3.8%	-0.4%	1.8%	2.0%
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Consumer Spending	2.6%	-0.2%	-0.6%	1.2%	1.4%
Business Investments	6.2%	1.6%	-17.8%	-1.4%	4.2%
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Unemployment (US)	4.6%	5.8%	9.3%	Current: 10.5%	10.3%

Source: (1) Wells Fargo Economics Group – Monthly Outlook (August, 2009)

I. The Economy – What’s Happening Now?

Forces that are keeping the economy “unpredictable”:

- 1. Regulatory changes in financial service industry**
- 2. Current and emerging government financial requirements**
- 3. How consumers will spend in the future**
- 4. How/When businesses will begin rehiring**
- 5. Risk versus liquidity in the credit markets**

II. Key Trends Reshaping Executive Compensation

NEW SEC Requirement Regarding Proxy Disclosures:

1. **Assessment of risks associated with compensation policies.**
2. **New reporting format for equity awards.**
3. **Enhanced disclosures regarding directors and their qualifications and connections.**
4. **Description of the Board leadership structure.**
5. **Disclosure on who and how much \$ is spent on compensation consultants.**

II. Key Trends Reshaping Executive Compensation

Implications:

1. **Executive compensation is receiving significant scrutiny regarding its “appropriateness.”**
 - a. The composition of the peer group and other external market comparisons.
 - b. The alignment between the plans and programs with the total compensation philosophy.
 - c. The balance between short-term and long-term incentive compensation.
 - d. The extent long-term (equity) awards are based on performance versus service/time.
 - e. The balance between “relative vs. absolute” performance goals used to determine equity awards.

II. Key Trends Reshaping Executive Compensation

Implications:

2. **The policies for severance and Change-in-Control are facing additional public and shareholder scrutiny.**
 - a. Approximately 50% of public U.S. companies have severance policies related to Change-in-Control.
 - b. The most common payment at termination is between 1x and 2x total compensation (salary + bonus), and they are linked to the timing of non-compete arrangements.
 - c. Frequently, companies accelerate vesting of equity awards at Change-in-Control or at termination due to Change-in-Control.
 - d. Gross up on the tax liability for payments that exceed 280G limits are declining dramatically, and strongly discouraged by shareholder advisory groups (e.g., RiskMetrics/ISS).

II. Key Trends Reshaping Executive Compensation

Implications:

3. **Companies are taking a broader “portfolio” approach to equity and long-term wealth creating vehicles.**
 - a. Increasing the use of restricted stock (or RS units) and stock options.
 - b. Stock options are vested based on time, while RSU’s are vested based on performance.
 - c. Increasing interest in other deferred capital accumulation plans as a diversification to company’s stock awards.
 - d. Comparison of overall run (or burn) rate to industry standards or practices.
 - e. Comparison of overall Shareholder Value Transfer (SVT) to industry standards or practices.
 - f. The costs of current and future equity grants, particularly for underwater stock options.
 - g. The interest in stock option exchange programs has probably passed.

III. Patterns of Total Compensation

*Total Compensation Practices for CEO's in New England Companies**

	Technology	Life Sciences	Financial Services	Consumer Products	Overall New England
Profile of Chief Executive Officer Total Direct Compensation					
<i>Median \$ Revenues</i>	\$193 M	\$73 M	\$60 M	\$525 M	\$210 M
<i>Number of Co's</i>	102	67	55	12	236
Median Salary	\$364,620	\$460,000	\$361,216	\$515,226	\$400,000
Median Bonus Payouts	\$204,750	\$389,400	\$134,319	\$186,384	\$240,000
Median Value of Equity Awards	\$505,793	\$817,000	\$247,906	\$539,225	\$584,380
Total Direct Compensation	\$1,075,163	\$1,666,400	\$743,441	\$1,240,835	\$1,224,380
Distribution of Total Compensation					
Salary	34%	28%	49%	42%	33%
Bonus	19%	23%	18%	15%	20%
Equity	47%	49%	33%	43%	48%

* Source: Most recent proxy filings from 236 New England based companies; data shown by industry. Analysis performed by the Wilson Group.

III. Patterns of Total Compensation

Total Compensation Practices for CFO's in New England Companies*

	Technology	Life Sciences	Financial Services	Consumer Products	Overall New England
Profile of Chief Financial Officer Total Direct Compensation					
<i>Median \$ Revenues</i>	\$193 M	\$73 M	\$60 M	\$525 M	\$210 M
<i>Number of Co's</i>	102	67	55	12	236
Median Salary	\$271,663	\$296,866	\$187,007	\$234,131	\$260,000
Median Bonus Payouts	\$123,752	\$136,063	\$52,145	\$136,048	\$122,504
Median Value of Equity Awards	\$294,228	\$380,185	\$116,240	\$106,122	\$303,783
Total Direct Compensation	\$689,643	\$813,114	\$355,392	\$476,301	\$686,287
Distribution of Total Compensation					
Salary	39%	37%	53%	49%	38%
Bonus	18%	17%	15%	29%	18%
Equity	43%	47%	33%	22%	44%

* Source: Most recent proxy filings from 236 New England based companies; data shown by industry. Analysis performed by the Wilson Group.

III. Patterns of Total Compensation

*Equity Practices in New England Companies – Comparison by Industries: **

	Technology	Life Sciences	Financial Services	Consumer Products	Overall New England
Prevalence of:					
Stock Options	88%	89%	72%	95%	88%
Restricted Stock or Units	12%	11%	28%	5%	12%
Median Stock Overhang	19%	15%	10%	12%	12%
Median Annual Run Rate	2.2%	2.0%	0.8%	1.7%	1.9%
Median % of Shares Available for Future grants	7%	5%	2%	5%	5%

* Source: Most recent proxy filings from 236 New England based companies; data shown by industry. Analysis performed by the Wilson Group.

III. Patterns of Total Compensation

Implications:

- 1. Salary increases are likely to be similar to overall employees (3% - 4%).**
- 2. Bonus payouts are tied to a combination of Corporate, Business Unit and Individual Performance.**
 - ❖ What does the relative weighting mean – what are the messages?
 - ❖ What are goals based on? What is the target and range of payouts?
 - ❖ How does the payout opportunity balance with “risk” of the corporation?
- 3. Equity participation is driven by changing dynamics.**
 - ❖ The true impact of the role on the long-term value of the corporation.
 - ❖ The ownership guidelines – multiple of salary or percent of ownership.
 - ❖ The level of risk this performance will encourage and reward.
- 4. Executive contracts are declining, being replaced with severance and change-in-control policies.**
- 5. The deals are more contingent on performance, less risk and “vetted” based on shareholder and public scrutiny.**

IV. Translating the Trends into Deals

Considerations for Demonstrating Your Value:

1. **How do you impact THE DRIVERS of strategic success for the company?**
 - ❖ Shareholder value – Share price growth
 - ❖ Market leadership – Revenue growth
 - ❖ Financial performance – Financial, operational and customer-based results
 - ❖ Fulfilling the mission – Capabilities to implement the strategy

2. **What is the frame of reference for setting the performance goals?**
 - ❖ Historical performance
 - ❖ Benchmark or peer group performance
 - ❖ Requirement to meet strategic goals

3. **How does the company “value” the impact of the executive?**
 - ❖ Achieves financial results
 - ❖ Improves the DRIVERS of financial performance (i.e., operational, customer metrics)
 - ❖ Demonstrates leadership competencies – individual initiative vs. team collaboration

IV. Translating the Trends into Deals

1. How does the salary compare to your peers and level of responsibility?
2. What determines your bonus opportunity?
3. What determines your level of equity participation?
4. What is included in your executive perquisites and benefits?
5. What would be the impact of change-in-control and/or termination?

A Thought To Remember

The Chinese Symbol of Crisis:

危机

Danger Opportunity

Our Mission:

“To strengthen the competitive advantages of our clients by aligning all performance based reward systems with the strategies they need to succeed.”

- Develop Total Rewards Strategies to focus time and money
- Link Executives with the Strategy and Shareholders
- Utilize Sales Incentives to Build Market Leadership
- Build Performance Driven Incentive Programs
- Create Performance/Competency Focused Base Pay Programs
- Make Special Recognition Special
- Re-engineer the Performance Management Process

BOARDS OF DIRECTORS

EXECUTIVES

SALES ORGANIZATIONS

TOTAL ORGANIZATIONS

Publications and Resources:

Innovative Reward Systems for the Changing Workplace (McGraw-Hill, revised 2003).

Rewards that Drive High Performance: Success Stories from Leading Organizations (1999).

Variable Cash Compensation: 2004 Survey of Trends and Practices

Special Report: Changes in Variable Pay Programs - 2005

Survey Report: Changes in Equity-Based Compensation Programs - 2006

Special Report: Changes in Variable Pay Program – 2007

Survey Report: Changes for Challenging Times - 2009

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