



Feature Article

Compensation Trends for Technology Executives

Doug Sayed, Applied HR Strategies

Since the late 1990s, executive compensation practices in technology companies have changed in response to a number of factors. First, the economy has transitioned from the end of "The Bubble," through a severe recession, and now into a nascent recovery. During this period, there was also the Enron scandal, followed closely by WorldCom and others, which resulted in a far greater focus on corporate governance, in accountability regarding executive compensation practices, and the Sarbanes-Oxley Act of 2002.

Now more changes are in store. Below are a series of observations about current trends in the executive compensation arena that are impacting executive compensation planners, board compensation committees, and the executives who participate in these compensation programs.

- In 2003, there was modest growth in base pay for all CEOs, but increases in the Northwest lagged behind the national average. Unlike the previous two years, base pay started to move up again in 2003 and 2004. According to the Wall Street Journal/Mercer 2003 CEO Compensation Survey, a survey of the 350 largest public company CEOs, median base pay for CEOs increased 3.8% in 2003, vs. 2002.

But according to the NW Executives in Technology Survey, the median increase in base pay for Northwest CEOs was only 2.1%. Assuming the economy continues to do well, it's likely that this growth rate will pick up some pace. As the technology sector starts to pick up steam in 2004, executive pay growth in the sector may well exceed executive pay growth in general industry overall.

- Total cash compensation is growing even faster. With profits growing rapidly over the past year and short-term cash incentives (STI) paying out at a higher levels, total cash compensation (excluding conversions of options) is growing smartly. According to the Wall Street Journal/Mercer Survey, total cash compensation for large public company CEOs was up a median 7.2% in 2003, vs. 2002. The NW Executives in Technology survey showed a more modest overall 1.3% increase in median total cash compensation for CEOs in the Northwest technology industry.

The increases in base and total cash compensation over the past year have been quite modest, considering that profits as well as most company's stock prices were up substantially year-over-year. It's likely that the greatly increased focus on executive compensation, and especially to excesses in this area, have held down increases somewhat. One sign of this is that in the WSJ/Mercer survey of CEOs compensation, over one-third of companies did not increase CEO base pay in 2003 from the previous year.

- Greater numbers of executives received a cash bonus in 2003 vs. 2002. In the 2003 Executives survey, only 45% of company CEOs received a cash bonus in 2002, a drop from past years. While precise comparative data from 2000 and 2001 is not available, this was certainly a drop from previous years, when the majority of eligible executives received a cash bonus. In 2003, a clear majority of CEO's received a bonus, and this trend filtered down to the entire executive team. In the 2004 survey, approximately two-thirds of CEOs received a cash bonus in the past year, and the percentage will likely be even higher next year, as the tech sector recovery continues. In large public companies the percentage is even higher, with over 85% receiving a cash bonus in the most recent fiscal year.

- Executives are receiving fewer stock “mega-grants.” (First a definition: an options mega-grant has a face value of at least eight times an executive’s salary and bonus. A mega-grant of restricted stock has a face value of at least two times salary and bonus. Face value is the market price of the stock at the time of the grant, multiplied by the number of shares granted).

Public companies have dramatically scaled back on giving mega-grants, which became increasingly common in the late 90s and very early in the 2000s. In 2003, 12% of all CEO option grants were mega-grants, vs. 28% in 2001, a drop of more than 50% in two years. Overall mega-grants (including restricted share grants) dropped to 16% of CEO grants in 2003, down from 27% of all CEO grants in 2001.

While mega-grants are more difficult to define for pre-IPO companies, it appears that there is a similar trend is away from extremely large grants in these companies as well.

The shift to expensing of options, increased shareholder opposition, tougher corporate boards and an increased focus on what is perceived by many to be excessive executive compensation practices are playing a role the reduced tendency to give extremely large equity grants to executives.

- Option grants in general are dropping and so is potential dilution. The size of options grants for executives and non-executives alike have been dropping for the past two years after peaking in 2000 and 2001. The overall drop in options grants varies significantly from company to company, but could be as high as 25% +/- overall for companies with broad-based options programs.

Many factors have impacted this, but it’s a trend that is likely to continue. The WSJ/Mercer study showed that overhang has dropped somewhat at the largest companies, especially for those at the higher end of the scale, as we see fewer excesses in option granting practices.

Annual “burn rates” (the percentage of shares outstanding granted each year) are dropping too. For the 350 largest companies, the annual burn rate has dropped from 1.9% in 2002 to 1.6% in 2003. For small to mid-level capitalization public technology companies (median \$213m in revenue), a 2003 study by Presidio Pay Advisors reports that the annual burn rate dropped 30% to 2.2% in 2002, from a 3.3% average for the three previous years.

- The mix of executive pay elements is shifting. Recent data shows shift in the mix of pay elements comprising the total executive pay package:
 - A drop in the number of shares granted to executives (and non-executives), and in the face value of option grants.
 - But an increase in the use of full-value share vehicles, primarily restricted stock. This is more of a trend in public companies currently, but it is likely to impact pre-IPO organizations eventually.
 - The long-term incentive (LTI) portion of the total pay mix is dropping somewhat. It topped out in 2000, and has dropped modestly as a portion of the total pay mix, as companies cut back on options grants and stock prices have fallen from peak levels.
 - A slight increase in base pay and cash short-term incentives (STI) as a proportion of the total pay mix. This is caused in part by the drop in LTI value, and in part by the increase in STI/bonus payments, along with modest increases in base pay.

With the focus on executive compensation practices and the stock expensing requirement right around the corner in 2005, we will likely see a continuation of the drop in equity-based LTI as a percentage of the total executive pay package and a larger portion of the equity mix to restricted stock, at least in public companies. It is also likely that we will see increased usage of other long-term incentive vehicles such as performance shares and performance unit plans in the next few years.

- Board of directors’ compensation is still increasing. Greater regulatory requirements and

shareholder desire for increased accountability is leading to greater demands on board members in general, and on audit and compensation committees in particular. As a result, compensation is increasing for board members, with much of the increase coming in the form of cash compensation. **Note:** Applied HR Strategies has done a significant amount of research on board compensation recently and will release more information on this topic in the coming months.

*This article is an excerpt from the 2004 edition of the Northwest Executives in Technology Salary Survey, an annual survey of executive compensation in Northwest-based technology companies. Doug Sayed is founder of Applied HR Strategies, a Seattle area human resources and compensation consulting firm devoted to serving high growth firms in the Puget Sound region. Applied HR Strategies is publisher of **The Seattle All-Technology Salary Survey**, the **Northwest Executives in Technology Salary Survey** and the new **Northwest Biotech & Health Technology Salary Survey**. For more information about the company or its surveys, visit their website at <http://www.appliedhrstrategies.com/> or contact Doug at doug@appliedhrstrategies.com.*

[Membership](#) | [Sponsorship](#) | [Contact Us](#) | [Terms of Use](#) | [Site Map](#) | [Home](#)

Northwest Entrepreneur Network

P.O. Box 40128, Bellevue, WA 98015-4128
Phone: (425) 564-5701 **Email:** info@nwen.org

© Copyright 2003 Northwest Entrepreneur Network
All Rights Reserved