Second of Two Part Series on CEO Compensation,
Part 1 was on Stock Options

More on CEO Compensation, SOX Committees of Independent Directors, Taxing CEOs, and Shareholder Rights

Weekly CEO/Business Leader Poll by COMPAS in *Canadian Business* for Publication Week of June 4th, 2012

COMPAS Inc.
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1.0 Introduction

Following the report of the Institute for Governance of Private and Public Organizations on stock options, we asked questions about how CEO compensation should be structured, the effectiveness of the SOX-ordained Committee of Independent Directors, and what should be done, if anything, about high compensation.

Over the longer term, the CEOs and business leaders on the COMPAS business panel are

- ❑ increasingly favourable to mainly salary-based compensation (table 2.1), and
- ❑ much less convinced than in the past that the SOX required Committee of Independent Directors will actually protect shareholders against compensation hungry CEOs (table 2.2).

Meanwhile there has been a jump in support; albeit still minority support, for discouraging excessive compensation through higher marginal tax rates (table 2.3). Panelists continue to believe in the importance of strong legal rights for shareholders.

These are the key findings from this past week's Internet survey of CEOs and business leaders on the COMPAS panel. The weekly business survey is undertaken for *Canadian Business* magazine.

2.0 Details

Table 2.1: From the perspective of the interest of shareholders, some people say that CEO compensation should be salary-based to deprive the CEO of an incentive to create short-term profits, real or imaginary. Other people say that CEO compensation should be equity-based because CEOs are hired, after all, to increase shareholder value. Should CEO compensation be… (%)

	JUNE 2012	JUNE 2007	JUNE 2005
A combination of salary and equity or stock options	45	68	66
Mainly salary based	45	22	23
Mainly equity-based	4	8	6
Entirely salary based	7	1	1
Entirely equity-based	0	1	1
Don't know/Refused	0	1	4

Table 2.2: Under Sarbanes-Oxley requirements, CEO compensation must be determined by a committee of independent directors. Which of the following opinions about this requirement is closest to your own[1] (%):

	JUNE 2012	JUNE 2007	JUNE 2005
A good innovation but not sufficient on its own to fully protect shareholders against compensation-hungry CEOs	54	34	47

[1] The wording of the 2007 question began with "Under changes to corporate law, CEO compensation should be determined…". The wording of the 2005 question began with "Under Sarbanes-Oxley requirements,…".

	JUNE 2012	JUNE 2007	JUNE 2005
A good innovation that will protect shareholders against compensation-hungry CEOs	22	48	41
A poor innovation that is inadequate to address the problem of inflated compensation	16	12	9
Don't know/Refused	8	6	3

Table 2.3: On a 7 point agreement scale where 7 means strongly agree and 1 strongly disagree, how much do you agree that wrong or excessive payment to public company CEOs is a problem that…

	MEAN	7	6	5	4	3	2	1	DNK
Should be addressed by stronger legal protection for the rights of shareholders									
June 2012	4.9	25	17	24	8	12	9	4	0
June 2008	4.8	18	23	20	14	6	8	7	4
Can never truly be solved except perhaps on a case by case basis									
June 2012	4.6	13	28	19	17	7	6	10	1
June 2008	4.8	16	23	19	12	11	6	5	7
Should be addressed by imposing higher tax rates on top income earners									
June 2012	3.7	18	10	11	10	18	10	25	0
June 2008	2.7	6	4	9	11	13	14	39	5

Based on your experience, are there better forms of incentive pay for executives in your opinion?

Long term growth and performance would be good measures for a CEO's worth to a company.

Business Week, years and years ago, measured CEO pay to that of its workers. The multiply was such that Business Week concluded this would become a major issue that would border on the obscene and so it has. It's a good ole boys club, wherein boards say it's required to get the best to be competitive. BS! The business world lives to work within a 90 day clock. Creative accounting abounds!

Yes. The long term strength and consistency of earnings should be key performance indicators.

5 year weighted average of stock price or earnings.

The best people in any field of endeavor usually cost more and often times they are worth it. Consider what is paid to professional athletes and how much wealth they produce for their owners. Then consider what a top performing CEO is paid and how much wealth they can produce. Maybe it's best to just leave it up to the Board of Directors to figure out what the CEO is worth.

Yes, if the company increases sales and/or margins with consideration as to the local, regional and/or world economy, compensation should be provided as a bonus (primarily with much lower stock options), based on the percent increase of performance.

Incentives, such as stock options, should have a reasonable delay factor and generally, incentives should focus the CEO on building for the long term.

It should be a basic appropriate salary and a bonus arrangement for performance above and beyond expectations.

Yes, a pay for short and long term performance.

There is a blend of salary and bonuses based on what is needed for the company, in both the long and short term. All bonuses should have a three year vesting period to help (or force!!) CEO retention.

I think that you have covered them all!

It should be performance based.

Why are CEOs considered to be overpaid, when hockey players make more, do not work as hard, and are less likely to be unfairly treated by scapegoating shareholders?

Bonus based on performance over an extended period.

Bonuses from pre-determined goals as set and passed by the board.

Not necessarily. Each variation has its own drawbacks.

It should be purely performance. It seems there are sometimes large scale reductions in the workforce to improve bottom line, which actually reduces overall product or customer service performance and reduces the value of company.

There is really never a fully correct method of compensation. CEOs want a high salary, generous stock options and bonus programs. An added factor should be that CEOs (and directors) need to be shareholders. That puts their money at risk. Options should be fairly priced, be less in numbers issued and with a shorter term. That again will force CEOs etc. to exercise the options sooner or pass, if not in the money. Again, money is at risk. Options should not be re-priced ever. They stand as they are. No one person should have options that exceed 10% of the allowable options.

Yes, performance agreements.

Yes, in some specific situations.

Besides the annual salary, the equity portion should be held in a trust account for a medium-term period, prior to final release, in order for protecting shareholders from any phony and false short-term results.

Incentive pay should be just that, an incentive and not just part of the package. So, it should be tied to objective predetermined goals reached. It should be paid on whatever terms that were pre-negotiated with the individual involved.

Incentive compensation should be performance based over a 3 year time period. This allows for growth strategies and vagaries of the markets to determine positive results.

> Just about anything other than stock options is a better form of incentive pay. The problem is that as long as options are legal, management will demand them and point to competing firms that offer them. I really liked Brascan's compensation plan that required executives to buy several years' pay worth of shares (they offered the executives loans to assist with this). By doing that, the executive is TRULY aligned with shareholders - they benefit on the upside, but also feel the hurt if the stock slides. Other than that, pay them a fair wage and let them get on with the job. A good CEO's ongoing performance should be intrinsically motivated, rather than motivated by the next bonus or the home run opportunity with options.

The following verbatim comments provide a nuanced sense of respondent opinion:

> Canada will not be immune to the Euro collapse. The hole in the boat is on the verge of getting larger and the bailing pail is getting smaller.

> You keep asking about the Canadian economy. It will not significantly improve until either the US economy handles their debt, Canada quits propping up a failing US dollar, or a new World Trade currency is created with all other currencies floating against that currency (and not controlled by the US). We go through some turmoil and get the problem dealt with or the US completely defaults on their debt and we have a currency crisis instead of only the US having a deflation, followed by a super Inflation problem. There is no other option.

> It seems to presuppose that the norm is overcompensated, "money-hungry" CEOs. CEOs, as all other employees, should be fairly, appropriately and competitively compensated. Yes, there are abuses and, yes, there are unethical, unscrupulous CEOs/executives/board members—and these individuals should be seriously held to account—

but we should not lose sight of the shareholder and overall economic value of well-run corporations.

We have lost most of our manufacturing because of the rise in investment in the oil sands, causing a high Canadian dollar, but the USA has recently been found to have many times more oil than the Middle East. The Canadian oil sands are a temporary boost to our economy - not a long term safe wealth generator. We need to invest in new global class innovation in manufacturing - like my own company. We are currently locked in to an imagined permanent source of wealth, which is not what it appears to be.

Canadian CEOs, as a group, are highly overpaid; however, if we legislate this away, all the good ones will become highly overpaid American CEOs.

Sadly, CEOs and their advisers are much smarter than the people who create rules to try and curb CEO and executive pay. It is a real shame that we don't have much of a "shareholding class", who are willing to hold compensation committees to account for having given away the store over the last 20 years.

3.0 Methodology

The COMPAS web-survey of CEOs and leaders of small, medium, and large corporations was conducted May 25 – May 30, 2012. Respondents constitute an essentially hand-picked panel with a higher numerical representation of small and medium-sized firms.

Because of the small population of CEOs and business leaders from which the sample was drawn, the study can be considered more accurate than comparably sized general public studies. In studies of the general public, surveys of n=76 are deemed accurate to within approximate 11.2 percentage points 19 times out of 20. The principal and investigator on this study is Conrad Winn, Ph.D.