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Genentech's Levinson Is a Pay-Performance Rarity: Graef Crystal

March 17 (Bloomberg) -- Arthur Levinson, the chief executive officer of Genentech Inc. is a rarity: His pay matches his performance. And compared with chief executives of similar sized companies, he not only earns more than the vast majority, he outperforms virtually all of them.

For the year ended this past Dec. 31, Levinson received:

-- A base salary of \$860,000.

-- An annual bonus of \$1.2 million.

-- An option covering 320,000 shares and carrying a strike price of \$84.10 a share. I estimated the present value of this option to be \$11.9 million on its grant date.

-- Miscellaneous compensation of \$80,000.

In total, Levinson earned \$14 million last year.

To put that figure in perspective, I looked at 181 U.S. companies with 2002 net sales between \$2.3 billion and \$4.3 billion. Genentech's 2003 net sales were \$3.3 billion, right in the middle of the range.

The data from 2002 were adjusted higher based on median increases between 2002 and 2003 in various forms of pay. These adjustments were derived from an analysis I made of pay trends for 87 early reporting U.S. companies with market caps of \$3 billion or more.

(Equilar Inc., an independent provider of executive pay information, furnished data for both these analyses.)

\$14 Million Package

Here's how Levinson came out:

-- In base salary, Levinson's \$860,000 figure ranked him in the 66th percentile of the 181 CEOs, meaning that his salary exceeded that of all but 34 percent of the CEOs in the group. (For the 87-company, year-over-year group, median base salary increased 3.6 percent between 2002 and 2003.)

-- In base salary plus annual bonus, Levinson's \$2.1 million ranked him in the 63rd percentile of the group. (For the year-over-year group, median base salary and annual bonus increased 13.4 percent.)

-- In total pay, his \$14 million package placed him in the 92nd percentile, higher than all but 8 percent of the other CEOs. (For the year-over-year group, median total pay increased 6.8 percent.)

A 92nd percentile ranking is way up there, but before the brickbats start flying, let's look at his performance.

182 Percent Return

Although Levinson has been CEO since July 1995, I have measured the company's performance from

July 17, 1999, the date when it was fundamentally recapitalized. Between that date and last Friday's close, cumulative total return was 344 percent. That compares with a negative 14.7 percent for the Standard & Poor's 500 Index. Had Genentech been a member of that index, its stock price appreciation would have ranked it in the 99th percentile -- higher than all but five companies.

And in the year ended this past Dec. 31 -- the year for which Levinson earned \$14 million -- the company produced a total return of 182 percent, far surpassing the 30 percent return on the S&P 500 Index.

Shareholders who have held their stock since July 19, 1999, have had a roller coaster ride. Volatility levels have been 2.8 times those of the S&P 500 Index.

I doubt any of those long-term riders have had a negative word to say, given how rewarding their journey has been

Uncomplicated Package

Along the way, Levinson has reaped some significant option gains. Since becoming CEO in 1995, he has received \$104 million of gains. And as of this past Dec. 31, he was sitting on unexercised options with paper profits of an additional \$156 million.

Levinson's pay package has been quite uncomplicated. His only long-term incentive has been stock option grants. He hasn't had squishy free-share grants, where you make money even if the stock price falls. Nor has he had any of his stock options repriced during some earlier times when the stock price wasn't doing so well. Moreover, since 2000, his grants have always occurred in September of each year, thereby eliminating the possibility of obtaining an attractive strike price at a time when the stock price is down.

It's a compensation package that shows how the system is supposed to work. If you perform heroically, you'll be paid in the same fashion. And if you don't, forget receiving much compensation. If only that applied to the large majority of CEOs out there.

The Usual Antidote

I am reminded of a client who called me when I was a compensation consultant. ``Get over here fast. There's something wrong with our long-term incentive plan," he said.

When I asked what was wrong with it, he replied: ``It's not paying off!"

In fact, there was nothing wrong with the plan; it was equating non-performance with non-reward.

Sadly, there are too many CEOs out there who are primed to believe that the antidote to plans not paying off is to bring in their pay consultants and come up with something that does pay off.

That's not the way Levinson has played the game. He's made a huge amount of money. And he's deserved it.

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Last Updated: March 17, 2004 00:00 EST

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