

## U.S. Chief Executives' 2003 Pay Was Up Only 1.6%: Graef Crystal

March 31 (Bloomberg) -- The surging tide of pay for U.S. chief executive officers that has been with us for so long finally is showing signs of ebbing. In 2003, median chief executive officer total pay advanced a mere 1.6 percent over year- earlier levels.

The small increase was accompanied by much higher median total shareholder return -- 33.6 percent -- and median earnings per share growth, 16.5 percent.

Those are the principal findings of my review of 188 U.S. companies -- all with current market caps of \$3 billion or more -- that have so far released their 2003 pay numbers.

Heading the list of CEOs with the largest pay packages is Citigroup Inc.'s Sandy Weill, who tipped the scales at \$54 million, a 273 percent increase over 2002.

The CEO who received the largest percentage increase in pay in 2003 over 2002 -- 318 percent -- was James Farrell of Illinois Tool Works Inc. Weill, who stepped down as CEO in October, received an honorable mention in this area, coming in with the third-largest percentage increase -- 273 percent.

The small 1.6 percent increase in 2003 over 2002 didn't mean CEOs walked away empty-handed. On top of a 2003 total compensation package worth \$6.4 million, the median CEO, through either option exercises or a buildup during the year in unexercised option paper profits, or both, saw his wealth from options granted in years prior to 2003 increase by \$8 million.

### Other Findings

In calculating total pay I combined base salary, annual Bonus, my estimate for the present value of stock options granted during the year (measured at the date of grant using the Black- Scholes model), the value at grant of free share awards made during the year, payouts during the year from other long-term incentive plans and miscellaneous compensation. Data for this study were obtained from Equilar Inc., an independent provider of executive pay information.

Here are some other findings:

-- Median base salary rose 4.2 percent, not much higher than base salary increases given to employees generally.

-- Median salary plus bonus increased by a more robust 8.1 percent.

-- Median total pay, excluding the estimated present value of stock option grants, rose significantly -- by 14 percent.

-- Median option present value, looked at by itself, shrank by 24.3 percent.

### Stock Options

The last two findings are key to understanding what's happening with senior executive pay. They show that companies have begun to reduce the size of executive option grants, while offering as a quid pro quo other long-term incentives, principally free share grants.

Companies also are establishing more elaborate long-term incentive plans based on factors such as relative shareholder return, return on capital, growth in EPS and so forth.

Still, the quid pro quo is anemic, given the robust returns and profits generated in 2003.

Why have stock options lost their luster? Two reasons. First, when you get burned, there's a natural tendency to stay away from the stove. CEOs saw many if not most of their stock option grants go under water during the last down market cycle. Given the turnaround in share prices, CEOs turned their back on large option grants at the very time when those grants would have done them the most good.

An even more significant reason, I think, is the Sword of Damocles currently being wielded by the Financial Accounting Standards Board (FASB), which will shortly mandate that every company charge its earnings for the estimated present value of stock option grants. FASB is expected to issue a so-called exposure draft on the subject today.

### Fighting the Fight

The last time FASB fought this fight was in 1993. It was defeated by vigorous lobbying of Congress, principally by the computer and software industries. They typically grant options to all their employees and had the most to lose from a charge to earnings. This time around, industry efforts to stop FASB have so far been unsuccessful. But they are continuing and, if anything, intensifying.

In 1993, Ray Lauver, then a FASB board member, told me about an ancient accounting principle: ``Never measured, never managed." He saw that principle vividly illustrated by companies that hadn't been required to charge their earnings for the cost of stock options, even though they had been made to charge their earnings for the cost of every other form of employee and executive compensation.

In 1993, the folks in Silicon Valley could point to their amazing growth in revenue and stock prices and claim a causal connection with handing out option grants in boxcar quantities. But that same industry had a bit of a problem this time out, because during the last business cycle, all those option grants failed to deliver their supposed motivational magic.

Now, we are witnessing the reverse of Lauver's accounting dictum: ``Measured, managed." It's about time.

### Top 15 Total Pay

This list of the 15 CEOs with the largest total pay packages in 2003 shows that there's little relationship between performance and pay among these CEOs. The median pay of the Top 15 is almost six times higher than median pay of the entire study group. Yet the Top 15's median total return for 2003 of 23 percent is significantly lower than the 34 percent median return for the overall group of 188 companies.

The 15 CEOs with the Largest Pay Packages in 2003:

| Company                       | CEO             | Total Return | Total Pay (millions) |
|-------------------------------|-----------------|--------------|----------------------|
| Citigroup Inc.                | Sanford Weill * | 42%          | \$54                 |
| Bear Stearns Companies Inc.   | James Cayne     | 14%          | \$40                 |
| Cisco Systems Inc.            | John Chambers   | 48%          | \$35                 |
| Occidental Petroleum Corp.    | Ray Irani       | 53%          | \$29                 |
| Intuit Inc.                   | Stephen Bennett | -2%          | \$28                 |
| Kb Home                       | Bruce Karatz    | 55%          | \$28                 |
| Toll Brothers Inc.            | Robert Toll     | 80%          | \$24                 |
| Lehman Brothers Holdings Inc. | Richard Fuld    | 18%          | \$23                 |
| Cendant Corp.                 | Henry Silverman | 113%         | \$23                 |
| Anheuser Busch Companies Inc. | Patrick Stokes  | 11%          | \$23                 |
| Goldman Sachs Group Inc.      | Henry Paulson   | 23%          | \$21                 |
| PG&E Corp.                    | Robert Glynn    | 100%         | \$21                 |
| Lockheed Martin Corp.         | Vance Coffman   | -10%         | \$21                 |

|                      |                  |      |      |
|----------------------|------------------|------|------|
| Procter & Gamble Co. | Alan Lafley      | 2%   | \$20 |
| Union Pacific Corp.  | Richard Davidson | 18%  | \$19 |
|                      | LOW              | -10% | \$19 |
|                      | MEDIAN           | 23%  | \$23 |
|                      | AVERAGE          | 38%  | \$27 |
|                      | HIGH             | 113% | \$54 |

\*Served as CEO for majority of year.

#### Top 15 Largest Increases

Here is a list of the 15 CEOs who received the largest percentage increases in their 2003 pay, as compared with their 2002 pay.

The 15 CEOs with the Largest Pay Increases in 2003 vs 2002:

| Company                              | CEO                      | 2003<br>Total<br>Return | 2003<br>Pay<br>Increase |
|--------------------------------------|--------------------------|-------------------------|-------------------------|
| Illinois Tool Works                  | James Farrell            | 31%                     | 318%                    |
| Franklin Resources Inc.              | Charles Johnson          | 43%                     | 287%                    |
| Citigroup Inc.                       | Sanford Weill *          | 42%                     | 273%                    |
| Kohls Corporation                    | Lawrence Montgomery      | -15%                    | 247%                    |
| Humana Inc.                          | Michael McCallister      | 129%                    | 233%                    |
| SunTrust Banks Inc.                  | Phillip Humann           | 29%                     | 221%                    |
| Intuit Inc.                          | Stephen Bennett          | -2%                     | 185%                    |
| Reebok International                 | Paul Fireman             | 34%                     | 176%                    |
| Dominion Resources Inc.              | Thomas Capps             | 21%                     | 159%                    |
| PG&E Corp.                           | Robert Glynn             | 100%                    | 134%                    |
| Clear Channel<br>Communications Inc. | Lowry Mays               | 26%                     | 128%                    |
| Golden West Financial                | Herbert & Marion Sandler | 44%                     | 114%                    |
| Carnival Corp.                       | Micky Arison             | 27%                     | 109%                    |
| PPG Industries Inc.                  | Raymond LeBoeuf          | 32%                     | 109%                    |
| Autozone Inc.                        | Steve Odland             | 27%                     | 99%                     |
|                                      | LOW                      | -15%                    | 99%                     |
|                                      | MEDIAN                   | 31%                     | 176%                    |
|                                      | AVERAGE                  | 38%                     | 186%                    |
|                                      | HIGH                     | 129%                    | 318%                    |

\*Served as CEO for majority of year.

It may be naive to think that just because CEO pay moved hardly at all in 2003, it will continue to do so. So far as I know, CEOs' greed glands haven't undergone any significant shrinkage.

But there's the specter of charges to earnings. Combine that with a huge increase in corporate governance activism by large institutional investors and maybe -- just maybe -- we'll begin to see some rationality injected into determining senior executive pay.

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