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## Don't Cry for Tech CEOs

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The news may not offer much consolation to investors smarting from last year's stock declines, but tech CEOs suffered a sizeable drop-off in pay in 2002. According to benefits research firm Equilar, the median pay package, excluding options, for tech chiefs shrank 15% last year.

Still, CEO paychecks have held their value far better than many technology stocks. The tech-heavy **Nasdaq Composite** index lost nearly 32% of its value in the same period.

Against the backdrop of sagging profits, shareholder outrage, layoffs and weak morale among rank-and-file workers, there's a growing sense that executive pay packages may need to be reined in further.

"The pay packages are large enough to affect the bottom line and demoralize workers and lower-level management, and leave shareholders with an empty sack," says William Patterson, director of the AFL-CIO's office of investment.

Still, even factoring in salary hikes, overall pay packages fell last year because executives' stock options lost so much value. Options account for the bulk of CEO compensation, contributing about 60% of overall pay in 2001. And last year the value of options dropped 28%.

But don't shed too many tears for tech leaders: The typical options award still represents a whopping sum of money, with a median value of \$7 million.

Some executives took home fat bonuses despite the fact that their company's stock performed even worse than the broader tech index. Among the highest-paid tech CEOs is **IBM's** (IBM:NYSE - news - commentary) Sam Palmisano. In line with his promotion to the company's top position last year, he was rewarded with a cash salary boost of 45% from the prior year. But Big Blue shares finished down 35% in 2002.

Another newcomer, **Lucent** (LU:NYSE - news - commentary) chief Pat Russo, took home \$3 million in cash compensation. She received a \$1.8 million bonus, though Lucent stock nosedived by 87% in 2002.

### Five Highest-Paid Tech CEOs

Company	CEO	Stock Performance in '02	Change in Salary and Bonus from '01	Salary in 2002	Bonus in 2002
IBM	Samuel Palmisano	-35.4%	44.7%	\$1,433,333	\$4,500,000
Intuit	Stephen	27.9	47.1	950,000	3,000,000

	Bennett				
Hewlett-Packard	Carleton Fiorina	-4.2	293.1	1,000,000	2,930,602
Lucent	Patricia Russo	-86.7	--	1,200,000	1,800,000
Ingram Micro	Kent Foster	-28.7	253.1%	1,137,760	1,720,293

Source: Equilar

In general, tech CEOs enjoyed small raises last year. The median salary rose 1.7% to \$800,000, according to an Equilar study of recently filed 2002 proxy statements from 57 tech companies with sales of over \$1 billion last year.

Just over half the CEOs in the group received a bonus, though the median size of the bonus fell 20% from 2001 levels, to \$210,375.

It may come as somewhat of a shock that tech companies handed out bonuses at all in 2002. But the payouts in many cases were based on nonstock-related financial targets determined in autumn 2001, at a time when expectations were extremely low.

"People were nervous about the economy and didn't know how long the slump would last, so [financial targets] in the main were fairly conservative. That means they're easier to hit," explains Jan Koors, a managing director at Pearl Meyer & Partners, an executive compensation consultant.

Incidentally, those hefty executive payouts occur as layoffs continue to mount. In 2001 and 2002, technology companies announced 1.2 million job cuts, estimates Challenger, Gray and Christmas, the outplacement firm. In 2002 alone, the industry outlined plans for nearly half a million layoffs.

#### **Pay Packages Shrank as Stock Options Lost Value**

	<b>Year-over-year change</b>	<b>Median value, 2002</b>	<b>Median value, 2001</b>
Cash compensation	3.5%	\$1,000,000	966,026
Long-term compensation, inc. stock options and restricted stock	-23.8	7,239,680	9,506,716
Total compensation	-15.4	8,800,925	10,397,763

Source: Equilar

Of course, CEOs might argue that layoffs are necessary to create a more efficient work force, positioning a company for improved profit growth.

But with profits still moribund, investors seem to have grown less tolerant of generous pay packages.

A company's compensation policy "tells you instantly whether the board of directors is independent in serving shareholder interests, engaged in active review or captive to the CEO," said the AFL-CIO's Patterson. "Egregiously excessive executive pay is an instant give away."

Other institutional investors pay less attention to raw dollars, scrutinizing compensation in the context of performance. "We're more focused on the fact that it's okay if the CEO makes a lot of money if all the shareholders are making a lot of money," says Elizabeth Fender, managing director of corporate governance for TIAA-CREF, a pension plan provider with \$261 billion in assets.

Given that shareholders haven't made much money lately, TIAA-CREF has been negotiating with companies in which it's invested, asking them to rein in excessive compensation packages that often rely on massive options grants. After successful talks, Fender says the group has withdrawn shareholder reform proposals at seven out of 10 companies.

Related to the rising-tide-lifts-all-boats theory of compensation, another school of thought holds that it's fine to bestow outsized rewards on CEOs who manage to hoist earnings. But CEOs who take a pay cut after their stock price drops shouldn't expect any pats on the back.

As fund manager Bill Nygren noted in a recent speech, it may appear savvy to invest with a CEO who takes a 90% pay cut, when his company's stock has declined 80%. But that's not necessarily the case. "Good idea -- bad conclusion," said Nygren, who runs the Oakmark Select fund. "That's an example of a manager we don't ever want to invest with.

"I would much rather own stock in a company where the CEO's pay doubled because the earnings per share and the stock rose 50%," said Nygren.

Among the companies that likely wouldn't make his cut are those with the lowest-paid tech CEOs. Of the five executives who received the lowest cash pay, four have suffered double-digit stock declines.

Five Lowest-Paid Tech CEOs*					
Company	CEO	Stock Performance in '02	Change in Salary and Bonus from '01	Salary in 2002	Bonus in 2002
Maxim	John Gifford	-13.3%	0%	\$300,000	\$0
GTech	W. Bruce Turner	101.4	81.8	300,000	0
Corning	John Loose	-62.9	-66.7	283,333	0
Micron	Steven Appleton	-54.1	-86	110,777	0
Cisco	John Chambers	-31.4	-100	1	0

\* Of companies that have filed 2002 proxies, with sales of \$1 billion-plus. Source: Equilar

For that matter, don't assume that CEOs who agree to low cash salaries are making big sacrifices.

Last November, **Broadcom** (BRCM:NYSE - news - commentary) CEO Henry Nicholas and chief technology officer Henry Samueli both agreed to cut their paychecks to \$1 starting in 2003, until the company's financial performance improves. They received identical salaries of \$97,741 in 2002.

But the move was largely symbolic, since almost all their compensation comes from options. Last year,

Nicholas and Samuelli each exercised \$2.6 million in options and received another grant of one million options apiece. The grants will be worth \$22 million in 10 years, assuming the stock price appreciates at 5% a year. (Because Nicholas has since stepped down from his post, he will have to exercise his vested options within 90 days after the annual meeting takes place.)

**Cisco** (CSCO:Nasdaq - news - commentary) leader John Chambers also cut his salary to \$1 for fiscal year 2002 and refused to accept a bonus. He even voluntarily cut his options grant by a third, rescinding two million options of a six-million option grant.

But at the time he made that seemingly generous decision, Chambers was sitting on \$77.1 million worth of accumulated in-the-money options, based on the \$11.82 market price of Cisco shares on the last day of its fiscal year.

In short, even though overall pay packages have dropped, there's plenty of cause for investors to lobby for change. As the proxy season gets under way, shareholder activists say that's why fat CEO pay packages are their No. 1 priority for reform.

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