Kissing options goodbye

By Rochelle Garner, illustration by Gil Adams -- 6/15/2003
Electronic Business

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Last year it seemed as if the captains of American industry had outdone themselves in achieving wretched exc
Each new revelation, ranging from the highly inappropriate to the outright criminal, seemed to top the last one. WorldCom had given then-CEO Bernard Ebbers 1.2 million stock options and $366 million in loans to cover ma calls. After Tyco CEO Dennis Kozlowski tried to skirt $1 million in taxes on art purchases, investigators discove that he had commandeered more than $135 million in company funds to buy antiques, real estate and, unbelievably, a $6,000 shower curtain. Kozlowski was topped only by the gang at Adelphia—Chairman and CE John Rigas, his three sons and other executives. The Securities and Exchange Commission described their actions (including hiding bank debts, buying timber rights and building a golf course with company funds) as "o of the most extensive financial frauds ever to take place at a public company."

Yet despite this rogue's gallery of wrongdoing, the nation's lawmakers and regulators have seized on one elem of executive compensation as emblematic of unbridled greed: the stock option. Nearly everyone, it seems—fro the SEC and the U.S. Congress, to the NASDAQ, the New York Stock Exchange, pension funds and the independent Financial Accounting Standards Board (FASB)—is exploring ways to codify how corporations met out options and account for them on financial statements.

One effort particularly appears to be gaining momentum: the move to force public companies to post the cost o employee stock options in their profit-and-loss tables. By contrast, corporations today describe option grants in footnotes of their annual reports.

Expensing options would be a blow to technology companies, their senior executives and their rank-and-file employees. The reason, of course, is that the t industry uses options rather than cash to attract and retain its workforce. Small wonder, then, that the technology industry; its chief lobbying organization, TechNet; and a few members of Congress have rallied to fight changes to generally accepted accounting principles (GAAP) that would affect stock options

Most observers, however, believe that the industry's efforts are too little, too late. The reason? The technology sector stands alone in its battle against expensing options. Companies from nearly every other industry, from aeronautics to consumer packaged goods, financial services and telecommunications have either begun shifting away from options as a major instrument of compensation or are preparing for that change. "With expensing, the electronics indu will be the last man standing, but ultimately it will have to accede. No amount of lobbying will stop it," says Marty Katz, an expert on executive compensatio Mercer Human Resource Consulting, in San Francisco.

Thunderclouds ahead

And so, despite a sea of change now roiling corporate governance and accounting across the country, option grants continue to make up the bulk of CEOs' compensation programs at electronics companies. Consider **Intel Corp.**, Santa Clara, CA, which routinely grants more than 97% of its stock options to employees below the company's top five executives, according to Intel Chairman Andy Grove in his letter in the company's annual report. Intel's five most senior officers typically receive a combined total of 2.5%. These options can represent a considerable chunk of change: Intel has said its 2002 net income would have been reduced by $1.17 billion, or 38%, if the company had accounted for stock options as an expense.

That's just for now. Because although an examination of compensation reveals that little has changed this past year in how the electronics industry rewards and motivates its CEOs, virtually all compensation experts believe that the inevitable option expensing will bring about dramatic changes to executive compensation packages, perhaps as early as 2005.

"A perfect storm is about to happen," says Steve Patchel, senior consultant for human resources consulting firm Watson Wyatt, Santa Clara, CA. The weat fronts of new regulation, depressed stock prices and renewed demands from stockholders—who want to reduce shareholder dilution caused by employee stock option plans—are converging.

It's likely that the FASB—the umpire for U.S. bookkeeping practices—will eventually mandate that companies subtract the cost of options from corporate profits. The key word is *likely*, because this is still no *fait accompli* . The FASB will not announce its decision before the end of the year. And in the interim, I 1372, sponsored by Anna Eshoo, the Democratic representative who represents the northern half of Silicon Valley, and David Dreier, the Republican representative who represents the California foothills north and east of Lost Angeles, would block for three years any new accounting standards the FASB might pass. (See the sidebar, "Expensing Optional," below.) Despite this uncertainty, most observers outside of the technology industry believe that expens is a matter of when, not if.

"With expensing, the electronics industry will be the last man standing."
—Marty Katz, compensation consultant, Mercer Consulting

The second pressure system: stock prices that seem to have no bottom. And the third storm front is renewed demands from stockholde to reduce shareholder dilution caused by employee stock option plans.

"Shareholder dilution is a big issue these days, because there's a potentially devastating effect on institutional investors," says Gordon Blasius, vice preside of technology compensation consulting at Radford Surveys, the Aon division overseeing the surveys. It's potentially devastating, because every time a company issues more options, it erodes the value of each slice of the pie of available shares. Pension funds and other large shareholders find this especial problematic at technology companies, which typically allocate more than twice as many shares to employee plans as other industries do.

According to Radford Surveys, the technology industry had an "overhang" rate (options granted plus those available to be granted as a percentage of total

shares outstanding) of 25.3%. In comparison, companies in the S&P 500 had 8.3% total overhang. Ironically, problems worsen for investors when stock pri
rebound and employees begin to exercise their options in numbers, because each new share to reach the market reduces earnings per share.

This explains the growing shareholder revolt, with shareholders voting to have the final decision on whether and when companies can issue new pools of options. Companies that haven't yet faced this motion at their annual meetings—or have convinced shareholders to vote against such a motion—can issue new pools without prior shareholder approval. The expected tightening of rules from the NASDAQ and the New York Stock Exchange, however, will soon eliminate this workaround. Already several companies, including Intel and **Mentor Graphics**, Wilsonville, OR, have announced that shareholders will be ab
approve all future option pools.

Going down?

Today, option grants typically make up 80% of a CEO's annualized salary in the electronics industry, according to executive compensation consultants Pea
Meyer & Partners, New York, NY. The trouble is, most options these days are "underwater," meaning that the trading price is well below the strike price tha
grantees would have to pay to exercise their options. Most companies have attempted to counteract that shortfall by granting greater numbers of options at
lower purchase price.

Surveys conducted by a variety of tracking services show that relatively few companies have substantially upped their chief executives' salaries. Clark/Barc
Consulting, North Barrington, IL, for example, found that the first quarter of 2003 saw executive pay increases averaging in the 3% to 4% range, increases
consulting firm characterized as "the lowest in recent memory." Equilar, a San Mateo, CA, company that tracks and analyzes executive pay, reports that ca
compensation dropped 30.8% within the 71 companies tracked in the Philadelphia Semiconductor Index (SOX), whereas the value of the companies themselves dropped 44%. And according to Aon Consulting, which analyzed nine electronics companies with annual revenues of $1 billion or higher (incluc
Agere Systems Inc., **KLA-Tencor Corp.** and **Xilinx Inc.**), the salaries of seven CEOs either remained the same or dropped slightly. Six of those nine companies paid no bonuses to their CEOs. **Advanced Micro Devices Inc.**, Sunnyvale, CA, for example, gave then-CEO Jerry Sanders a $1.2 million bonu
2001. This year new CEO Hector Ruiz received nothing.

A few CEOs, including Steven Appleton, of **Micron Technology Inc.**, Boise, ID, actually volunteered to take a cut in pay. Appleton's cut was dramatic—he received $110,777 in salary between September 2, 2001, and October 28, 2001, when he elected to forgo salary until Micron achieves positive net income.
has not drawn a salary or received any bonuses since that date. And although he exercised 24,000 shares, valued at $34,200, he did not cash them. Micro
last year granted Appleton 400,000 shares (at an exercise price of $21.11 per share), versus 250,000 shares the year before. Micron shares have been tra
below $10 since the beginning of 2003.

But not every CEO received less cash in 2002. The reason, quite simply, was that financial performance in 2002 was more predictable than in the *annus horribilis* that was 2001. "CEOs are benefiting from the lowered expectations of 2002," says Jan Koors, managing director of Pearl Meyer & Partners, New York, NY. "Most CEO bonuses are tied to how the company performs to its budget, and the bonuses for 2001 were tied to a year that was worse than anyo
expected it to be. Even though 2002 was not a banner year either, companies were more conservative in setting their budgets—enabling CEOs to hit their performance targets."

The latest proxy statement for Dallas-based **Texas Instruments Inc.**, for example, shows that Chairman, President and CEO T.J. Engibous took home $840,000 in salary and a $500,00 bonus for 2002, compared to an $836,700 salary and zero bonus the previous year. TI also granted Engibous 1.05 millio
options for the year, compared to 842,000 shares in 2001. The proxy of **Motorola Inc.**, Schaumburg, IL, revealed that the company more than doubled the payout, excluding stock options, to Chairman and CEO Chris Galvin. Although Galvin's salary remained the same as in the year before, at $1.28 million, Ga
did reap a $1.5 million bonus for 2002, after receiving no bonus in 2001. Galvin's "other annual compensation," which includes reimbursements for tax liabil
associated with a life insurance policy, more than doubled, to $12,845. In 2001, his "other" compensation totaled $5,232.

Garbage in…

So how will expensing affect corporate results and rewards? Intel offered a preview this past March, when it said 2002 earnings would have been $1.95 bill instead of the reported $3.12 billion, if options had been expensed. The company added that 2001 net income would have been reduced a stunning 80%, t $254 million from $1.29 billion. Intel's argument, of course, is that such accounting practices would harm investors by introducing inaccurate data into earni reports.

The company has a point. The problem starts with the black hole that is the Black-Scholes accounting method of expensing options. "Black-Scholes was devised for options that are freely traded on the market—not for employee options, which aren't traded and can be cashed in only after vesting," says Davic Chun, CEO of Equilar. "Worse, it's a complicated formula that's full of ambiguities, which means that the same company can produce dramatically different numbers of its stock worth."

These inconsistencies show up in a variety of ways. First, there's the little matter of companies' having to predict their stock volatility several years out. This volatility affects value, because an option is worth more when stock prices fluctuate, giving the holder more chances to cash in. Then there's the challenge estimating how long employees will hold onto their options before exercising them. The longer the estimated holding time, the greater the option's apparent expense to the company. Even if all other things are equal, two companies with nearly identical option plans can post dramatically different expenses if one predicts that employees will cash in after 4.4 years and the other estimates that employees will hold their options for 6 years.

"With Black-Scholes, you have to assume a certain amount of vesting and assume a range of stock prices over time," says Dan Scovel, a technology analy with Needham & Co., New York City. "That's basically a formula based on your guesstimate of when options will be redeemed and for how much. Black-Scholes is an art, and people want to make it look like a science."

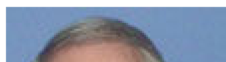
In fact, it's the accounting method's arbitrary aspect that gives expensing proponents their greatest pause. Their answer is for the FASB to come up with a l ambiguous methodology.

"The best answer to the arbitrariness argument is shorter depreciation schedules," suggests Robert Litan, director of economic studies at the Brookings Institution, Washington, DC. "All corporations depreciate equipment on a fixed schedule, and the same point applies to options. To me, the most arbitrary solution is to put an option's value as zero. That is clearly the wrong answer. Everyone knows that options are worth something, or why would someone wo for options and not cash?"

Reward strategically

Today options are the only form of compensation that appears to have no cost to a company. If that changes, as so many observers believe it will, corporat will rethink how they reward their employees and their top officers. The question for electronics workers is whether their companies will mimic the actions of other industries. Already compensation consultants are reporting that some companies outside of the tech industry are reducing eligibility for stock option grants or shortening options' terms to lower their Black-Scholes value.

There's also an irony here. Treating options the same as restricted shares, indexed options or performance shares, for example, can give boards a wider arsenal of compensation tools they can wield strategically for the good of the company.



"A perfect storm is about to happen."
—Steve Patchel, human resources consultant, Watson Wyatt

"Because options don't show up on the profit-and-loss statement, companies have pretty much excluded all the other forms of compensation at their dispos
says consultant Koors. "The accounting tail has wagged the compensation dog for too many years."

One piece to potentially add is restricted stock. Here, companies give employees several shares outright at a defined value that never rises or falls with the market. The restriction is that grantees can't cash in until a predefined time has passed. Their strategic purpose is executive retention.

On a share-by-share basis, restricted stock might have more of an expense than an option, but companies use fewer shares and therefore lower the impac
the bottom line. That's appealing to the company. And it's appealing to the executive, because the stock's value never falls below water. This explains why Apple CEO Steve Jobs recently traded in 27.5 million stock options in exchange for 5 million restricted shares.

A variation of this can be performance-based stock. But instead of time-based vesting—which rewards an executive just for breathing—this form of compensation would set a three-year objective, say, and pay out when the CEO meets that objective. It's this sort of midterm incentive that's been missing
compensation packages, say compensation experts.

"Cash bonuses were supposed to work with long-term incentives, which is why options are granted with a ten-year term. But that changed when we got use
options' being in the money from the moment they were granted," says Koors. "It's not such a bad thing if we let options fall back to the role they were supposed to play and add restricted stock or performance plans with a three-to-five-year range."

In other words, expensing options could actually be beneficial? Yes, if companies take advantage of the freedom it gives them in crafting their compensatio
programs. "This change may not be easy, but it may actually be good," says Koors.

What should happen with options? Argue your point by sending e-mail to feedback@eb.reedbusiness.com.

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Wired*, among others*.

TECHNOLOGY CEO COMPENSATION FOR 2002 VS. 2001
sample of CEO compensation from key industry companies

Name	Year	Salary ($)	Bonus ($)	Options (#)
CHIP COMPANIES:				
Willem Roelandts, Xilinx Inc.	2002	$561,966	0	303,620
Pres & CEO	Change from '01	-16.8%	-100%	+1.21%

Notes: During fiscal 2002, salary was reduced as part of company's payroll reduction program.

Tom Engibous, Texas Instruments	2002	$840,000	$500,000	1,050,000
Chairman Pres, & CEO	Change from '01	.36%	0 in '01	24.7%
W. J. Sanders, Advanced Micro Devices	2002	$916,838	0	0
Chairman and former CEO	Change from '01	-8.3%	-100%	0
Craig Barrett, Intel Corp.	2002	$610,000	$1,070,400	584,000
CEO	Change from '01	6.1%	-.45%	20.5%
Brian Halla, National Semiconductor Corp.	2002	$864,179	$700,000	800,000
CEO, Chairman, Pres.	Change from '01	3.8%	0 in '01	33.3%
Christopher Galvin, Motorola Inc.	2002	$1,275,000	$1,500,000	1,000,000
CEO, Chairman	Change from '01	0%	0 in '01	11.1%
FABS:				
Richard Hill, Novellus Systems Inc.	2002	$709,615	$449,247	300,000
CEO	Change fom '01	2.5%	0 in '01	-.03%
James Morgan, Applied Materials Inc.	2002	$854,058	0	400,000
CEO	Change from '01	5.5%	0	-50%
Kenneth Schroeder, KLA-Tencor Corp.	2002	$492,649	$218,040	341,100
CEO	Change from '01	-11.14%	-77.3%	125.5%
EDA COMPANIES:				
H. Raymond Bingham, Cadence Design Systems	2002	$850,032	$847,515	500,000
CEO, President	Change from '01	0%	-42.3%	0 in '01
Walden Rhines, Mentor Graphics Corp.	2002	$550,000	0	140,000
CEO	Change from '01	1.87%	-100%	-12.5%
Aart de Geus, Synopsys	2001	$400,000	$575,000	85,500
CEO	Change from '00	-7.14%	-4.16%	-88.3%

SOURCE: COMPANY REPORTS

Expensing Optional

Eight years ago, the technology sector fended off a decision from the Financial Accounting Standards Board (FASB) to expense options in corporate profit and-loss tables. It might not succeed this second time around. That's because in 1995 companies from across industries formed a united front to block expensing from becoming a generally accepted accounting principle (GAAP). Today Silicon Valley pretty much stands alone as it battles a move that other consider inevitable. The tech world makes some compelling arguments. Among the most outspoken, and most articulate, is **Intel**.

"Expensing puts a large, noncash item into the computation of earnings," says Jim Jarrett, Intel's vice president for worldwide government affairs. "If we ha started expensing back in 1995, when there was a choice between expensing and footnoting, we would have incurred billions of dollars in charges against our earnings, but about $3 billion of that would have been for stock and options that are underwater and will probably never be exercised. That's $3 billion that's totally illusory."

Intel has publicly asserted that it will not expense options. It has said, though, that it will provide the same expanded disclosure "in plain English" proposed the TechNet lobby organization. Enhanced disclosure includes:

- Providing tables and charts that show options' dilutive effect on earnings per share
- Showing the dollar value of all options above water
- Giving a summary of options granted to the top five officers

Reps. David Dreier (R-CA) and Anna Eshoo (D-CA) seek to codify this "plain English" disclosure with their bill H.R. 1372, introduced in March in the U.S. House of Representatives.

Many observers consider the effort silly. "This is not really new or extra information. The only difference is that it's all in one place, and companies would report it quarterly instead of annually," says Paul Hodgson, senior research associate with The Corporate Library, Portland, Maine. "Companies' 10-K annu reports already have to say, 'This is the EPS if we don't expense options, and this is the EPS if we do.' You can't get more plain-English than that."

But the Dreier-Eshoo bill aims to do more than just codify the kind of "plain English" disclosure pushed for by the TechNet lobby. It also forbids the SEC fro recognizing for three years any new accounting standards related to stock options while the SEC evaluates the effectiveness of the new disclosure requirements. The bill also requires the Department of Commerce to study the impact employee options have on the U.S. economy.

"Stock options have helped so many rank-and-file workers buy a home and send their kids to school," says Rep. Eshoo. "Options have a salutary economi effect on the country, and I want to keep them in place. The FASB has clearly stated that it doesn't take into account economic considerations, but the Congress should."

Because the bill would involve the SEC and the Department of Commerce, it must pass through both the Financial Services Committee and the Energy an Commerce Committee before it can be sent to the House floor. The next step would be finding a sponsor on the Senate side to introduce similar legislatior Both bills would then have to meet in the middle.

This is not a speedy process. In the meantime, the FASB has said that it will release an "exposure draft" on expensing at year-end and then invite commer on actions the FASB could take. Based on that timetable, the FASB expects to issue final guidance in March of next year.—*R.G* .

Methodology

ELECTRONIC BUSINESS' Top 40 Highest Paid Executives ranking is based on information gathered from the EB Top 300 companies' DEF-14A or proxy statements. Only EB 300 companies that derived at least 50% of their total revenue from electronics were considered for the Top 40 listing.

Total compensation is based on the sum of the following figures: base salary, bonuses, value realized from stock options exercised and other compensatic
Other compensation includes (but is not limited to) things such as relocation allowances, housing allowances, contributions to defined employee contributi
benefit plans, reimbursement for tax liability, insurance premiums, imputed interest on re-paid loans, bonuses paid on commencement of employment and
automobile allowances. The value of restricted stock awards or grants are not included in these calculations.—*Reed Research Group*

ELECTRONIC BUSINESS' HIGHEST-PAID EXECUTIVES (2002)

Rank	Name (age)	Title	Company	Salary	Salary change 2001-2002	Bonus	Bonus change 2001-2002	Other compensation	Other comp. change 2001-2002	Value realized (aggregated options exercised)	Value Realized change 2001-2002	Total	Tota char 2001 2002
1	Michael S. Dell, 38	Chairman & CEO	Dell Computer	$925,962	4%	$347,236	-79%	$34,499	27%	$80,998,080	-59%	$82,305,777	-59%
2	Irwin Mark Jacobs, 68	Chairman & CEO	QUALCOMM	$950,019	1%	$800,000	33%	$360,879	3%	$61,440,000	*	$63,550,898	3,267
3	Kevin B. Rollins, 50	President & COO	Dell Computer	$721,154	5%	$243,389	-79%	$11,904	85%	$39,020,075	-7%	$39,996,522	-8%
4	Thomas M. Siebel, 50	Chairman & CEO	Siebel Systems	$1	0%	$0	*	$0	*	$34,586,250	-80%	$34,586,251	-80%
5	Scott G. McNealy, 47	Chairman, President, & CEO	Sun Microsystems	$100,000	0%	$487,500	*	$63,964	177%	$25,237,174	*	$25,888,638	20,93
6	Craig R. Barrett, 63	CEO	Intel	$610,000	6%	$1,070,400	0%	$134,900	-49%	$17,570,300	2%	$19,385,600	1%
7	John F. Gifford, 61	Chairman, President, & CEO	Maxim Integrated Products	$300,000	0%	$0	-100%	$0	*	$15,962,947	-72%	$16,262,947	-73%
8	Christine B. Hoberg [1], NA	CFO	NVIDIA	$200,000	0%	$0	-100%	$0	*	$15,652,987	127%	$15,852,987	120%
9	Paul Wahl [2], 50	President & COO	Siebel Systems	$600,000	-7%	$0	*	$516,135	*	$13,568,063	-61%	$14,684,198	-59%
10	Richard E. Belluzzo [3], NA	President & COO	Microsoft	$568,723	21%	$350,000	0%	$13,680,042	524%	$0	*	$14,598,765	385%
11	John W. Thompson, 53	Chairman & CEO	Symantec	$700,000	17%	$481,250	-46%	$90,850	19%	$12,622,661	3,219%	$13,894,761	616%
12	Paul D. Bell, 42	SVP, Europe, Middle East & Africa	Dell Computer	$444,231	14%	$188,798	-58%	$7,513	-97%	$13,102,250	NA	$13,742,792	1,174
			Affiliated										

13	Jeffrey A. Rich, 42	CEO	Computer Services	$525,000	5%	$1,050,000	5%	$13,751	129%	$12,039,759	20%	$13,628,510 18%
14	Jen-Hsun Huang, 39	President & CEO	NVIDIA	$400,000	0%	$400,000	0%	$0	*	$12,156,307	*	$12,956,307 1,520
15	Richard S. Hill, 51	Chairman & CEO	Novellus Systems	$709,615	2%	$449,247	*	$24,779	-20%	$11,184,439	-14%	$12,368,080 -10%
16	Sanjay Kumar, 40	President & CEO	Computer Associates	$1,000,000	11%	$0	*	$29,362	-5%	$10,977,750	96%	$12,007,112 84%
17	Thomas A. McDonnell, 57	President & CEO	DST Systems	$575,000	0%	$977,500	6%	$194,434	80%	$10,164,143	-63%	$11,911,077 -59%
18	R. David Schmaier, 39	EVP	Siebel Systems	$400,000	-7%	$500,000	*	$0	*	$10,758,740	-68%	$11,658,740 -66%
19	Timothy D. Cook, 42	EVP, Worldwide Sales & Operations	Apple Computer	$563,829	25%	$0	-100%	$8,025	2%	$10,710,393	*	$11,282,247 1,075
20	Fred D. Anderson, 58	EVP & CFO	Apple Computer	$656,631	0%	$0	*	$11,000	50%	$10,122,169	*	$10,789,800 1,524
21	Jerald G. Fishman, 57	President & CEO	Analog Devices	$850,374	-1%	$0	-100%	$3,874,196	65%	$5,894,725	-55%	$10,619,295 -36%
22	Joseph A. Marengi, 49	SVP, Americas	Dell Computer	$439,040	3%	$193,539	-61%	$8,974	-65%	$9,940,000	-20%	$10,581,553 -21%
23	Pirooz Parvarandeh, 42	Vice President	Maxim Integrated Products	$200,000	0%	$0	-100%	$0	*	$10,143,091	217%	$10,343,091 154%
24	Fred van den Bosch, 56	CTO & EVP, Advanced Technology Group	VERITAS Software	$480,000	20%	$300,000	0%	$2,500	0%	$9,274,642	-59%	$10,057,142 -57%
25	P.J. Curlander, 50	Chairman & CEO	Lexmark International	$846,438	8%	$1,250,000	720%	$5,100	0%	$7,940,043	55%	$10,041,581 65%
26	Kenneth L. Schroeder, 57	CEO	KLA-Tencor	$492,649	-11%	$218,040	-77%	$1,000	-99%	$8,970,000	235%	$9,681,689 126%
27	Daniel P. Burnham, 56	Chairman & CEO	Raytheon	$1,065,278	4%	$2,000,000	33%	$198,778	8%	$5,785,650	*	$9,049,706 235%
28	Craig A. Conway, 48	President & CEO/Director	PeopleSoft	$1,000,000	0%	$1,920,000	-17%	$0	*	$5,892,541	-50%	$8,812,541 -42%
29	L.V. Gerstner, Jr.[4], 61	Chairman	IBM	$2,000,000	0%	$1,500,000	-81%	$370,465	-3%	$4,713,286	-96%	$8,583,751 -93%

30	Craig J. Mundie, 53	SVP; CTO, Advanced Strategies & Policy	Microsoft	$347,172	20%	$280,000	70%	$6,000	8%	$7,026,150	NA	$7,659,322	1,567
31	Thomas A. McCullough, 60	EVP & COO	DST Systems	$475,000	0%	$665,000	8%	$81,368	3%	$6,364,685	-47%	$7,586,053	-42%
32	Sidney Harman, 84	Executive Chairman of the Board	Harman Int'l Industries	$941,667	6%	$950,000	90%	$159,576	110%	$5,330,150	*	$7,381,393	403%
33	Steven D. Haynes, 51	Vice President, Worldwide Sales	Xilinx	$256,119	-12%	$0	-100%	$9,282	191%	$6,890,443	-27%	$7,155,844	-27%
34	Lawrence F. Probst III, 52	Chairman & CEO	Electronic Arts	$611,023	3%	$985,000	363%	$810	-18%	$5,453,000	-75%	$7,049,833	-68%
35	Russell M. Artzt, 55	EVP	Computer Associates	$750,000	0%	$0	*	$29,362	-5%	$6,051,651	*	$6,831,013	775%
36	Michael R. Cannon [5], 50	President & CEO	Maxtor	$875,000	4%	$0	*	$5,669,132	118,007%	$0	*	$6,544,132	676%
37	Kent Kresa, 65	Chairman & CEO	Northrop Grumman	$1,365,264	13%	$5,000,000	67%	$87,463	-5%	$0	-100%	$6,452,727	-6%
38	Robert V. LaPenta, 57	President & CFO	L3 Communications	$625,000	15%	$750,000	15%	$39,287	15%	$5,029,000	*	$6,443,287	424%
39	John W. Loose, NA	Former CEO	Corning	$283,333	-67%	$0	*	$6,022,203	2654%	$0	*	$6,305,536	490%
40	Itsik Danziger, 52	President	Comverse Technology	$168,287	-6%	$0	-100%	$44,088	-4%	$5,982,962	-71%	$6,195,337	-70%

1 On April 29, 2002, Ms. Hoberg began a leave of absence, and Mary Dotz was named CFO on an interim basis.
2 Mr. Wahl resigned from Siebel Systems effective March 31, 2003.
3 Mr. Belluzzo resigned as the company's President and COO in May 2002 and resigned from the company in August 2002.
4 Mr. Gerstner was CEO until March 1, 2002 and Chairman of the Board until January 1, 2003.
5 Mr. Cannon resigned from his positions as President and CEO of the company effective January 6, 2003.
* Figure for 2001 was $0, therefore percentage change could not be calculated.
N/A = not available or not applicable
SOURCE: REED RESEARCH GROUP

Anatomy of a Paycheck

Almost universally, the compensation committees of electronics companies say they reward and motivate their senior executives with a combination of sal performance-based bonuses and long-term incentives. You won't see any fat pension plans, à la Jack Welch's retirement package from General Electric. Instead, the technology industry relies on options and bonuses to support CEOs in their halcyon years.

Outwardly, these three ingredients always appear the same. Salary generally represents the smallest chunk of the

potential compensation pie, especially for the CEO. Performance-driven bonuses are there to provide motivation for one year. Long-term incentives, typica in the form of option grants, aim to link the executives' goals with those of shareholders over a period of several years. The last two components are intenc to reward CEOs for attaining short- and long-term financial results.

But delve deeper into the specifics of those compensation plans, and you can glean a company's philosophy on executive behavior and corporate governance. Take **Intel**, long known for its aggressive, straight-from-the-hip (and lip) corporate culture. The company has put overarching emphasis on incentive pay, with a reasonable base salary (relative to the rest of the industry) and a substantial cash bonus tied to company performance. And although nearly everyone at Intel works on a base-plus-bonus formula, that variable pay becomes a larger percentage of total compensation as people climb the corporate hierarchy.

Intel measures performance by taking into account a combination of corporate operations and specific annual goals—such as chip design wins or a successful product rollout—that are weighted and scored to give the final payout. For CEO Craig Barrett, such goals include the introduction of a major product line, such as this year's Centrino wireless chip, and the company's overall financial health. And every year he receives a performance review from independent directors on the board. He also receives 0.36% of the available stock options. "And there's nothing else. No employment contracts, no golden parachutes," says Jim Jarrett, Intel's vice president for Worldwide Government Affairs.

Now consider **Mentor Graphics**. There, CEO Walden Rhines' salary has remained relatively stable over the past several years, growing from $504,700 in 2000 to $539,900 in 2001. But Rhines can potentially rake in a huge cash bonus if he meets the company's expectations for a given year's operating incor (a measure of efficiency). "If the company achieves less than 85 percent of that income, the CEO gets zero bonus," says Gary Rebello, Mentor Graphics' \ president of human resources. "At 85 percent and above, he gets some portion of that pay. He has to meet the full plan to get the full bonus." So in the banner year that was 2000, Rhines took home a $1.7 million cash bonus. In 2001, that bonus shrank to $158,500.

But what's unusual about Mentor is the way it grants options to its most senior officers. That's because Mentor is one of only a handful of companies in the entire tech sector with a formal program that encourages executives to buy stock. At Mentor, the more stock the senior executive has bought outright, the larger the grant of options for the year. "If the executive has $500,000 base pay and owns stock worth 25 percent of that base pay, we will give him more options than we would have with the standard distribution," says Rebello. "Of course, as the stock price fluctuates, executives might have to buy more sha to get the value up. We think it's healthy for them to be shareholders, not just optionees."

Others apparently agree. "Investors are not pleased that high-tech executives don't own a lot of their companies' shares," says Steve Patchel, senior consultant for human resources consulting firm Watson Wyatt, Santa Clara, CA. "There's increasing pressure from the larger pension funds to force that ki of ownership."—*R.G* .

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