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Paychecks to ponder

By Josh Goldstein
Inquirer Staff Writer

Business was booming last year at Toll Bros. Inc., and chief executive officer Robert I. Toll was well-rewarded for that success.

The Horsham-based home builder's revenue and net income soared, and so did its stock price. And Robert Toll's total compensation - $44 million, more than double his take in 2003 - was the highest among executives of local companies, according to data compiled for The Inquirer by Equilar Inc.

It was not quite as good a year at Merck & Co. Inc. Net income at the pharmaceutical firm that employs 12,000 in Montgomery County was down 15 percent, and the company's stock price fell 30 percent amid withdrawal from the market of the blockbuster pain medicine Vioxx.

Still, chief executive Raymond V. Gilmartin received compensation of $37.8 million, with the vast majority - $34.8 million - realized through the exercise of stock options. Gilmartin's salary and bonus of just less than $3 million was virtually unchanged from 2003. Gilmartin retired this year.

The rewards lavished on executives of Philadelphia-area public companies rose to an average of nearly $800,000 in salary and bonus last year, a 15 percent increase from 2003.

That compares with a 0.7 percent increase, to $40,450, for the average wage earner in the metropolitan area, according to an estimate by the U.S. Bureau of Labor Statistics.

Total direct compensation for the 764 top executives in The Inquirer's annual compensation survey, which includes profits from the sale of stock options, averaged $1.8 million - 18 percent more than in 2003.

Chief executive officers did even better, with average salaries and bonuses of $1.5 million and overall compensation nearing $3.6 million, or nearly 90 times that of the average wage earner here.

Even as the gap between most workers and top executives widens, compensation experts say that a shift is occurring in the way executives are paid - a move that emphasizes and rewards long-term success.

"Companies are going to have a bigger portion of an executive's compensation specifically tied to performance metrics," said Irv Becker, who heads the Hay Group's executive-compensation practice in the region. "That benefits shareholders because the metrics [that] companies are choosing are those that drive the business."

At Toll Bros., for example, Robert Toll's bonus is tied directly to return on equity achieved by the company and is paid in stock, not cash.

Toll would get a bonus only if the return on equity exceeded 10 percent. And because the bonus was in the form of stock, the size of his bonus would grow or shrink along with Toll Bros.' share price.

In the fiscal year ended Oct. 31, Toll Bros. revenue rose 40 percent, to $3.86 billion and its net income was up 57 percent, at $409 million. Shareholders did well, too. Toll Bros. shares rose 26 percent in the fiscal year, from $36.84 to $46.35. They closed Friday at $98.30.

Toll Bros. did so well that Toll and the board of directors reworked his performance-laced pay package to reduce his bonus by $19 million.

"He has been compensated very well," said Joel Rassman, Toll Bros. chief financial officer, "but he has been compensated very well for performance that has been spectacular."

Even as executives' compensation has risen, there have been reminders of the scandals that have led to increased scrutiny of corporate pay and governance in recent years.

This month, two former Tyco International Ltd. executives were convicted of grand larceny, conspiracy, securities fraud, and falsifying business records. Former chief executive officer L. Dennis Kozlowski and former chief financial officer Mark H. Swartz were charged with looting $600 million from the Bermuda-based conglomerate, which is managed from offices near Princeton.

A few days later, Adelphia Communications Corp. founder John Rigas and his son Timothy Rigas were sentenced to long prison terms for conspiracy and fraud.

"Many people believe that the reliance on stock options to reward executives had a role in all of these scandals," said Mary Ellen Carter, assistant professor of accounting at the Wharton School of the University of Pennsylvania.

Some experts say executives with large amounts of stock options are given an incentive to artificially prop up earnings to keep stock prices rising and their gains high.

The scandals, investor anger, and changes in accounting rules have caused a shift in the last few years away from stock options as the major way of providing executives with long-term rewards for their service.

"For many plans, vesting is contingent on meeting various performance measures," Carter said. "That reinforces that the executives must think in the longer-term interests of the company and its shareholders."

Tyco's current chief executive, Edward D. Breen, ranked 22d on this year's survey, with $10.2 million in total direct compensation, including a $1.5 million base salary, a $3.1 million bonus, and restricted stock grants worth $5.6 million.

Breen, who was brought in from Motorola Inc. in 2002 to put Tyco back on course after Kozlowski's departure, did not exercise any stock options in 2004.

Steven Balsam, a professor of accounting at the Fox School of Business at Temple University, however, questions whether changes being made to executive pay are meeting the stated goals.

"My gut feeling is that the majority of restricted stock grants out there are not performance-based," he said.

Balsam said mechanisms such as market-adjusted options would be better-suited to paying executives based on company performance.

"Not only does the stock price have to go up, but it has to beat the market for the executive to be rewarded," he said.

Institutional investors have been pushing boards to put in place pay packages that better align the interests of management with those of shareholders.

"We believe that compensation practices provide a window on the board... and whether or not the people sitting around the table are truly independent and really acting in the interest of shareholders," said Linda Scott, director of corporate governance at TIAA-CREF, a financial-services provider with $345 billion under management.

Two keys are that pay "be related to long-term performance and that it be disclosed in a clear way," Scott said. "I am looking for ABC-123 disclosure, I mean plain English and basic math."

Personal Computing | Special Report: Executive Compensation

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For a searchable database on pay for executives at publicly traded companies in the Philadelphia area, go to http://go.philly.com/execpay

Data for this 12th executive compensation report were compiled by Equilar Inc. and further researched by Inquirer staff member Tricia Cerone from proxy statements and other documents filed with the Securities and Exchange Commission.

Contact staff writer Josh Goldstein at 215-854-4733 or jgoldstein@phillynews.com.