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# Executive Compensation Index

May 2016



# About the Index

ERI's Executive Compensation Index is a quarterly report that measures trends in executive compensation using analysis of the companies included in the Russell 3000 index. The Russell 3000 is comprised of 3000 securities traded on U.S. stock exchanges that collectively represent roughly 98% of the investable equity market in the United States. Last updated on June 26, 2015, the Russell 3000 includes 2,986 distinct publicly traded companies. The May 2016 edition of the ERI Executive Compensation Index specifically highlights compensation for the top executive and two other executive titles:

- Chief Executive Officer
- Chief Operating Officer
- Chief Financial Officer

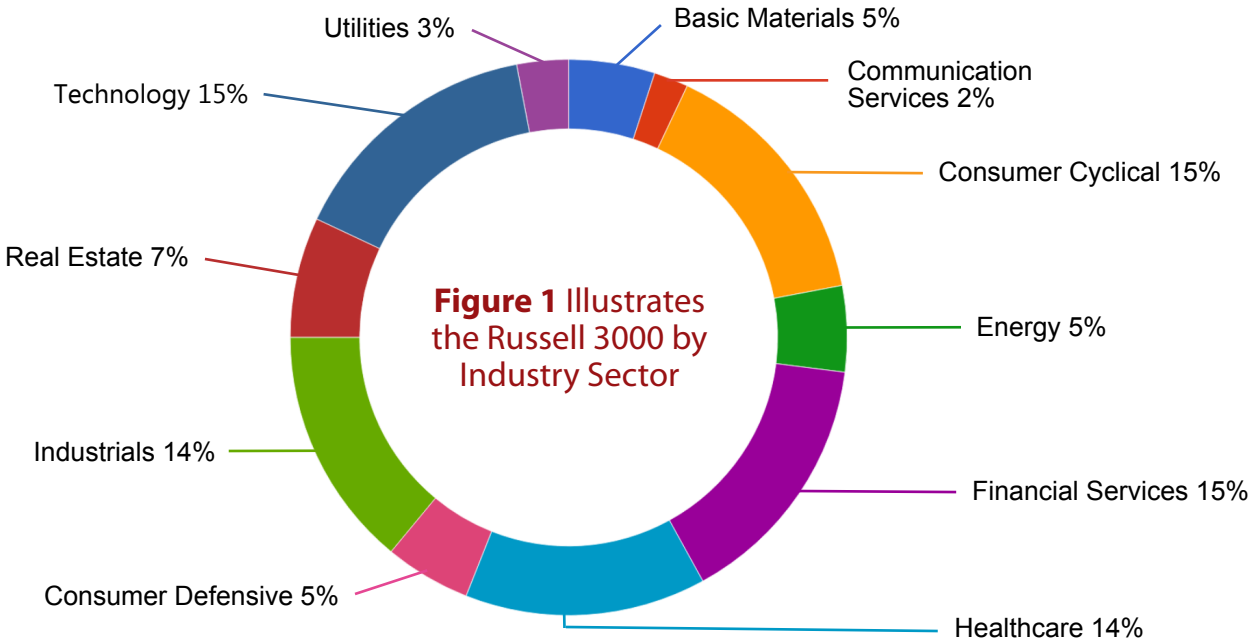
This report will also discuss the fluid landscape for the analysis and benchmarking of executive compensation packages. Analysis of public company disclosures will drive this discussion. To analyze executive pay, the Russell 3000 companies were divided into three groups by the most recent market capitalization. The market cap groups were defined as follows:

- Group 1 Small Cap – less than \$750 million (1,030 companies)
- Group 2 Medium Cap – between \$750 million and \$4 billion (1,120 companies)
- Group 3 Large Cap – greater than \$4 billion (810 companies)

## Company-Level Data

Median revenue for the Russell 3000 increased 3.25% from 2014 to 2015. The median revenue for companies in the index was just under \$890 million in 2014. From 2008 to 2009, median annual revenue dropped more than 12% for this group. Since 2009, median revenue rose more than 25%. Roughly 70% of companies in the index saw positive revenue growth in 2015, while 48% increased revenue by at least 10% over 2014.

Financial services, technology, and consumer cyclical companies each represent 15% of the index. Not far behind are healthcare and industrials at 14%.



# Chief Executive Officer

Total direct compensation includes salary, annual cash incentive, and the grant-date value of stock and option awards in a fiscal year. This measure of CEO compensation increased by 11%, 13%, and 10% in 2015 for market cap groups 1, 2, and 3 respectively.

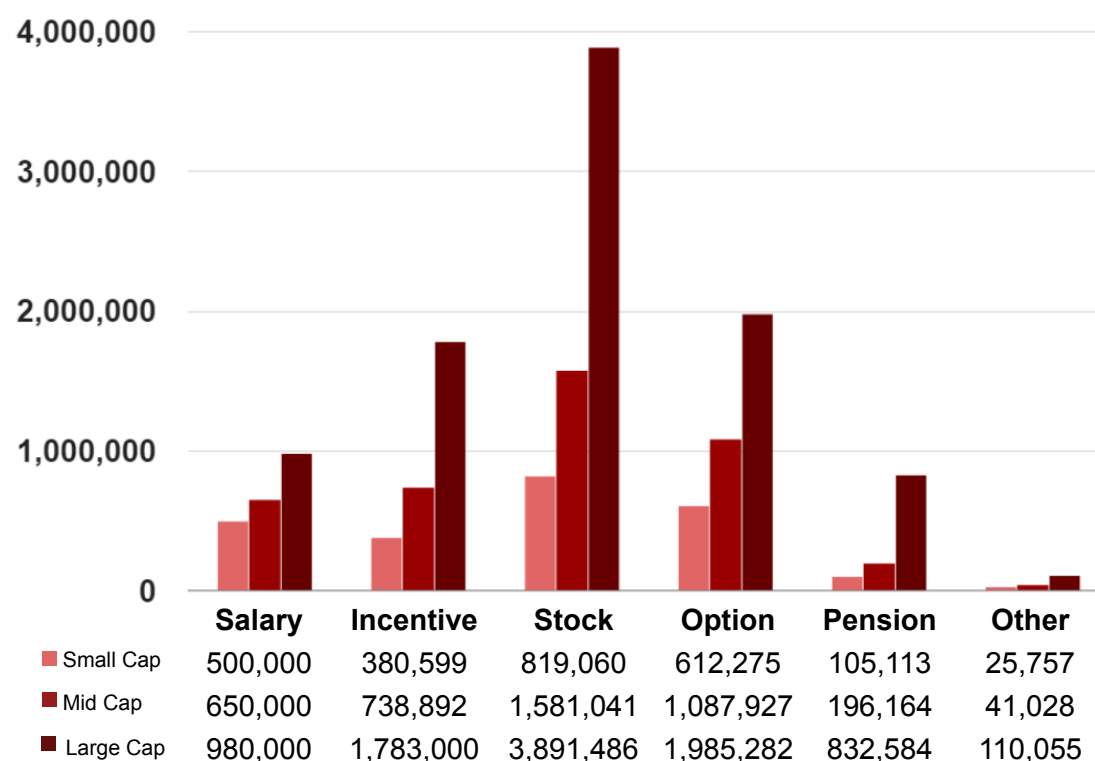
**Table 1 - 2015 CEO Total Direct Compensation**

Market Cap Group	Total Direct Compensation (\$)		
	25th Percentile	Median	75th Percentile
Small	1,069,955	1,869,511	3,202,381
Mid	2,004,291	3,801,650	5,555,637
Large	5,875,251	8,695,703	12,659,156

**Table 1** shows the median total direct compensation for Russell 3000 Chief Executive Officers in 2015

Figure 2 shows values for two other traditional summary compensation table elements. *Pension* refers to above-market earnings in, or direct payouts to, retirement or non-qualified deferred compensation plans. *Other* refers to executive benefits and perquisites (e.g., use of the company aircraft) that are not included in one of the other categories.

**Figure 2 - Median CEO Compensation by Market Cap Group for 2015**



**Figure 2** displays median values for the four components of total direct compensation, separated by market cap group

## CEO Base Salary

CEO salaries increased across the board in 2015. The small and large market cap group CEOs saw modest median salary increases of 5% and 2% respectively. The median salary for the mid cap group grew by almost 11% in 2015. Median CEO salaries for the three market cap groups were fairly consistent. The typical salary for a mid cap CEO was about 50% higher than his or her small cap counterpart, while the typical salary for a large cap CEO was about twice as high.

## CEO Annual Cash Incentive

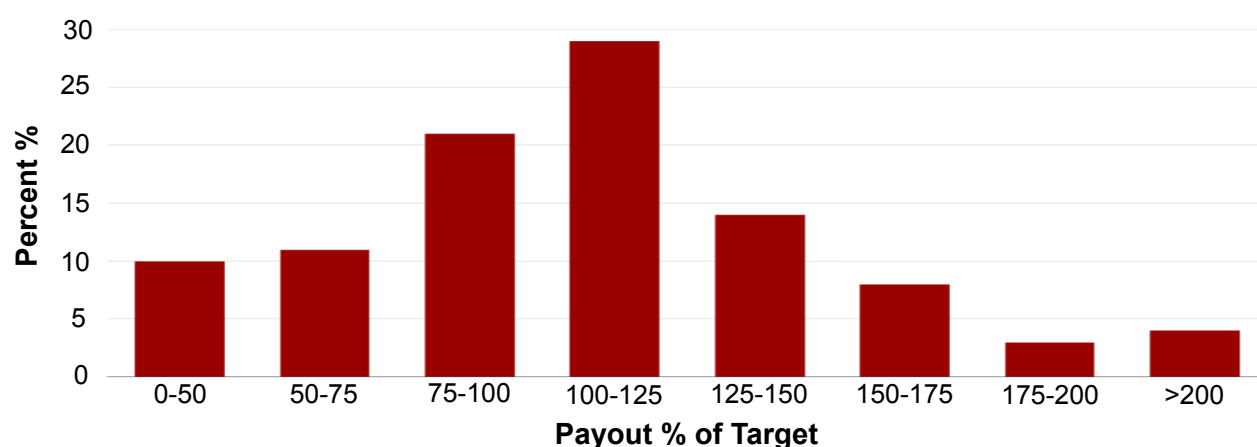
Growth in CEO annual cash incentives differed for all three groups in 2015. The small cap companies saw a decline of 6% in annual variable cash. Mid cap companies saw an 8% increase, and large caps remained relatively flat with the typical payout at around \$2 million.

These types of payouts typically fall into one of three categories. They can be based on individual or company performance in a *reactive* way, in which case the compensation committees make a somewhat subjective decision regarding payout amounts at the end of given period. They can also be *proactive*, in which specific plan targets and performance goals, set at the beginning of a period, determine payout amounts. Lastly, they may not be based on performance at all. Examples of non-performance cash include sign-on and retention bonuses, as well as cash bonuses resulting from a merger agreement. Executive compensation packages often include annual cash incentives with components in more than one of these categories. When this is the case, the proactive piece is reported separately. ERI's Executive Compensation Index refers to target-based and objective-driven cash incentives as "performance cash" and all other cash incentives as "discretionary bonuses."

Discretionary variable cash has decreased steadily in CEO pay packages in the past decade. In 2005, 84% of Russell 3000 CEOs earned some discretionary annual cash bonus. In 2015, that number has dropped to 21%. In an effort to display pay-for-performance, these payouts have largely been replaced by non-equity incentives, or performance cash. In 2015, three out of four Russell 3000 CEOs earned some amount of performance cash.

Figure 3 illustrates CEO payouts from performance-based annual cash incentive plans in 2015. Such plans often have predefined target payouts to give executives an idea of their earning potential before a performance measurement period begins. Of those CEOs that earned performance cash in 2015, 60% received payouts that were equal to or greater than the predetermined plan target. More than one-third of performance cash payouts were 25% or more above target.

**Figure 3 - Performance Cash Payout as a % of Target**



More than 80% of Russell 3000 companies reported using more than one performance measure in determining performance cash payouts in 2015. The most common plan designs included between two and five metrics. Naturally, most plan designs included measures of earnings growth and returns to shareholders, but non-financial goals were reported in about one in ten cases. Where the outcomes could be measured objectively, things like workplace safety and customer satisfaction also affected executive cash incentives. Many companies use a weighted approach, assigning more weight to those performance goals that are considered more important to overall company success.

## CEO Equity Compensation

This report refers to equity-based compensation as falling into one of two broad categories. It is either granted as full-value shares of company stock, or as appreciation awards or options. Equity compensation dollar amounts in this report also refer to the value of the payout at the grant date. This is an important distinction because the eventual wealth realized from an equity award may be very different once the stock award vests or the option is exercised.

In total, the median grant-date value of CEO equity grants increased by double digit percentages for all public company sizes in 2015. This increase was driven not only by higher award amounts for those who earned awards in 2014, but also by a higher percentage of Russell 3000 CEOs earning equity in 2015. Nine out of every ten Russell 3000 CEOs earned some form of equity grant in 2015, up 5% from a year ago.

Within equity pay, full-value stock awards are currently behind only base salary in their likelihood to be included in CEO pay packages. Eight-one percent of Russell 3000 CEOs earned some full-value stock in 2015. That is compared to the 45% who earned appreciation awards. Figure 4 outlines the separation of these equity pay categories since 2007. As of 2015, public company CEOs are roughly twice as likely to receive full-value stock.

**Figure 4 - Percentage of CEOs Earning Stock Option Awards by Year**

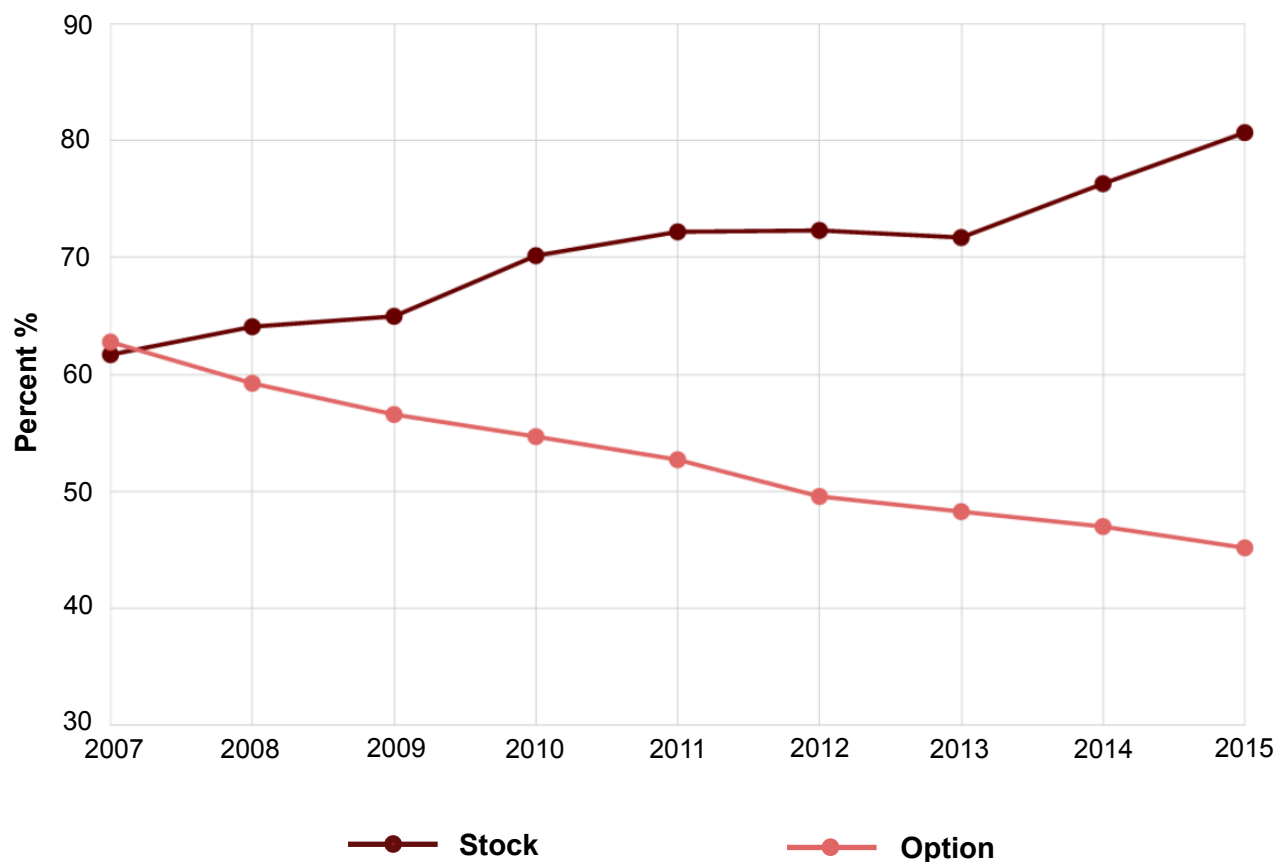
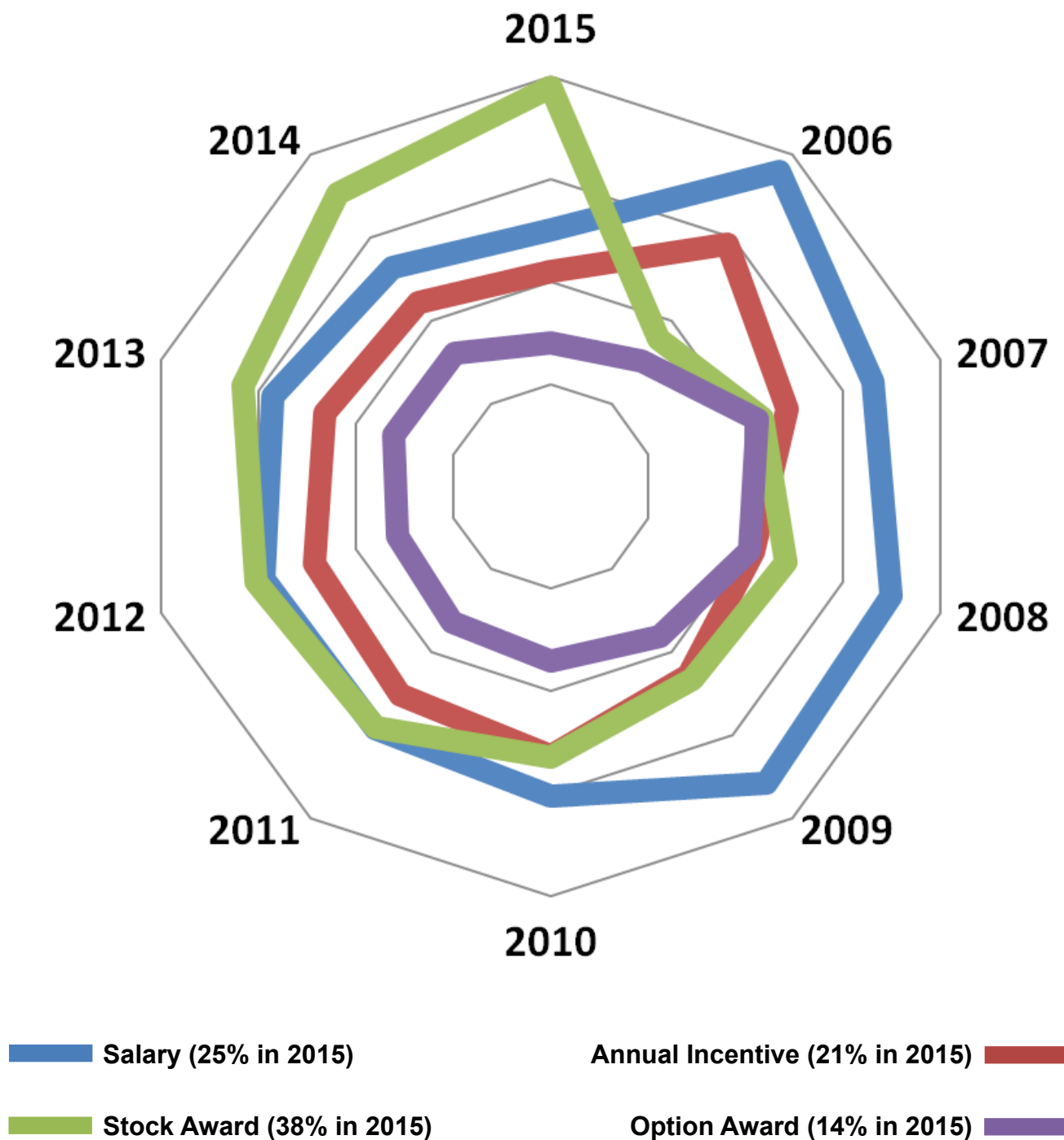


Figure 5 summarizes how the mix of CEO total direct compensation has changed since 2006. This represents a timeline of which pay components have dominated CEO pay packages over the past 10 years. The most notable transition has been away from fixed pay and toward variable or at-risk pay. Full-value stock awards have risen from 17% to more than one-third of the total value of CEO pay packages. Through the volatile years following the 2008 recession, fixed cash base salary was easily the largest component. More recently, however, more investor attention to pay-for-performance along with an improving economy has led to the increased importance of equity and variable cash.

**Figure 5 - CEO Pay Mix 2006 to 2015**



# Chief Operating Officer

The large cap group saw the largest increase to median total direct compensation at more than 13%. The small and medium cap groups saw median increases of 6% and 3% respectively.

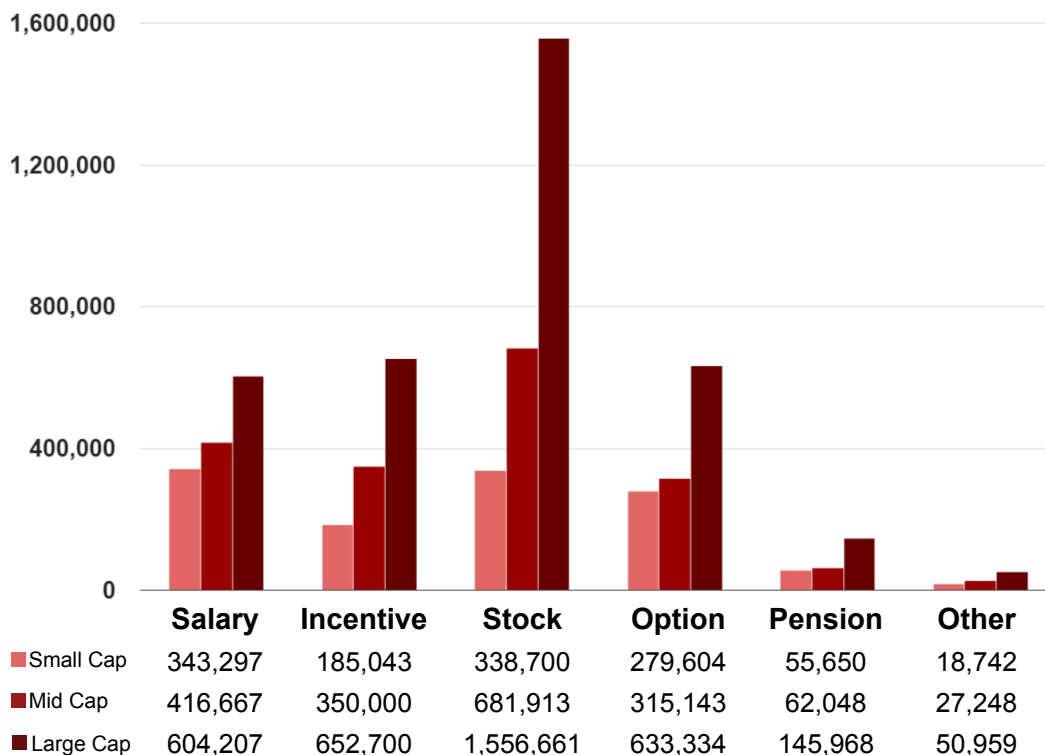
**Table 2** shows the median total direct compensation for Russell 3000 Chief Operating Officers in 2015

**Table 2 - 2015 COO Total Direct Compensation**

Market Cap Group	Total Direct Compensation (\$)		
	25th Percentile	Median	75th Percentile
Small	528,750	837,030	1,420,999
Mid	911,930	1,481,526	2,376,846
Large	1,956,442	2,946,216	4,457,001

The values in Figure 6 should be interpreted as the median for those Russell 3000 Chief Operating Officers earning some compensation in the given form in 2015. The typical equity grant was about 10% higher in 2015 for COOs in all three Russell 3000 market cap groups. These large equity payouts account for the bulk of the total direct compensation increase for this group in 2015. Base salaries grew moderately in 2015 for all three market cap groups, with the small cap group leading the way at 5.7%. Cash-based performance incentives increased for the smallest companies, but decreased for the largest ones. The median variable cash payout was 5% lower in 2015 for large cap company COOs.

**Figure 6 - Median COO Compensation by Market Cap Group**



**Figure 6** displays median values for the four components of total direct compensation, as well as medians for the Pension and Other columns defined in the CEO section of this report

# Chief Financial Officer

Median total direct compensation grew more than 13% for top financial officers at the smallest companies analyzed. Total direct compensation increased 10% and 5% for medium and large cap companies respectively.

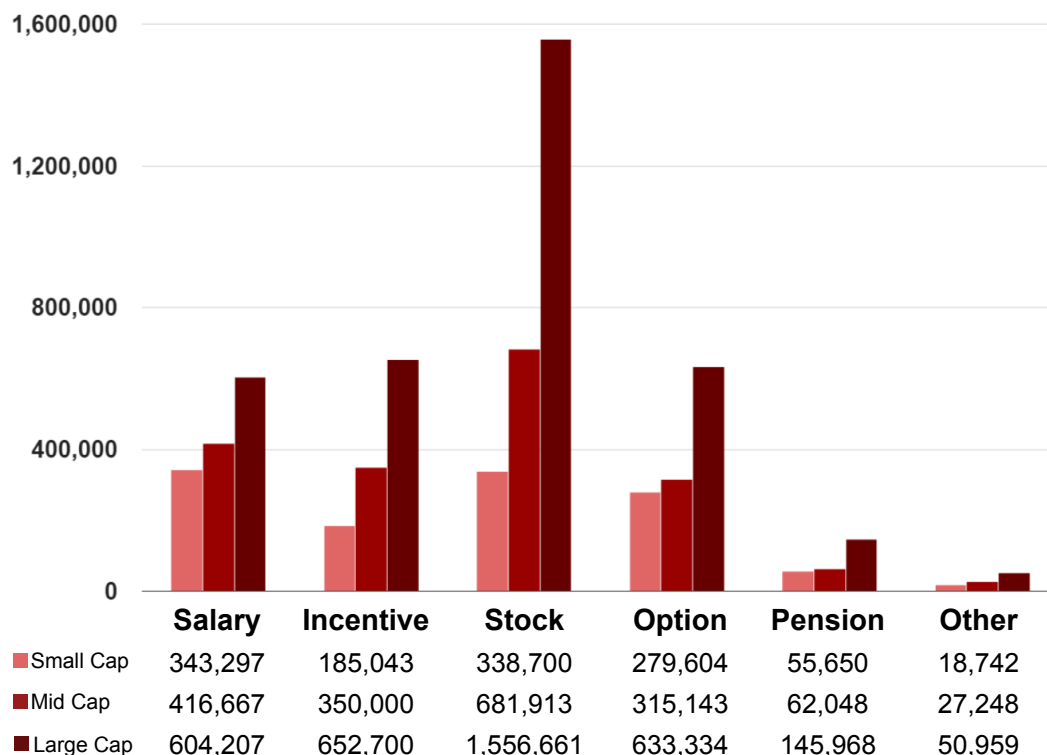
**Table 3** shows the median total direct compensation for Russell 3000 Chief Financial Officers in 2015

**Table 3 - 2015 CFO Total Direct Compensation**

Market Cap Group	Total Direct Compensation (\$)		
	25th Percentile	Median	75th Percentile
Small	473,413	757,725	1,159,500
Mid	854,010	1,361,543	1,994,424
Large	1,846,483	2,749,858	4,144,484

Base salaries remained largely unchanged for this group compared to 2014. Large increases in equity payouts were the main driver of the universal increase in total direct compensation for this group. The median total cash compensation only grew 3%, 1%, and 3% for the small, medium, and large cap groups respectively. The typical equity award grew in value by double-digit percentages across the board in 2015.

**Figure 7 - Median CFO Compensation by Market Cap Group**



**Figure 7** breaks down total direct compensation for Chief Financial Officer into its respective components



## One Step Closer to CEO Pay Ratio Disclosure

The 2016 proxy season is in full force and companies are switching from resistance to preparation when it comes to the new CEO pay ratio disclosure rules coming in 2017. Beginning next year, companies will be required to report a ratio comparing the total direct compensation of the CEO to that of the median employee. They will also be required to display total shareholder return alongside executive compensation in an effort to suggest executive pay is, or is not, largely tied to company performance.

In light of these coming changes, the May 2016 installment of the Executive Compensation Index is a good opportunity to revisit the idea of *realized* versus *realizable* executive compensation, and to highlight the differences seen in the in 2015 fiscal year.

This conversation underlines the real value of executive equity compensation. What is granted and what is actually realized can often be quite different. In their annual proxy statements, public companies disclosure in summary compensation tables the grant-date fair value of equity awarded in a given period. This measure can be thought of as only realizable income. In other words, it represents an estimate of the potential wealth gained by the executive in some future period. The actual wealth gained resulting from a stock award vesting or an option being exercised, what is realized, can be quite different than the grant-date estimate from several years back. Fortunately, companies also provide data on realized equity compensation in a given period. Table 4 summarizes typical amounts in these categories over the past two years. Since these values come from the same period, the awards granted are not the same as the awards vested. So this table is not meant to suggest that, on average, full-value awards were less valuable at vest than they were at grant. Table 4 states that the median grant-date value of stock awards for Russell 3000 CEOs was just over \$2 million. That is one way of measuring the wealth gained from employment. Another measure, providing an answer \$170,000 less, is the amount of vested stock in 2015. When analyzing executive equity pay, it is important to make the distinction between these two measures.

**Table 4 - Median CEO Equity Compensation**

Year	Full-Value Stock Awards (\$)		Appreciation Option Awards (\$)	
	Realizable	Realized	Realizable	Realized
2015	2,004,010	1,833,465	1,877,453	2,088,890
2014	1,946,477	1,516,447	1,762,281	2,277,570

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### Executive Compensation Index – May 2016

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