

What Other Executives Earn Affects CEO Comp at Pier 1, Rent-A-Center BASE and BONUS Newsletter, June 2005

In weighing the pay packages of top executives, more committees are considering internal equity: comparing the compensation packages of the top five executives.

Pier 1 Imports, Siebel Systems and Rent-A-Center disclosed in their April and May proxies that they've added internal pay equity to their executive compensation assessments.

Just as committees look outside their companies, using peer groups for benchmarking, experts recommend that they apply the same relative approach inside. "I think it's also important for the board to look at internal equity as well, beyond the traditional approach of looking at peer groups," says Susan Schroeder, a partner at Vivient Consulting. "It's a very good check on benchmarking because you never want to use benchmarking as the be-all and end-all."

Experts say that looking at internal pay equity is useful for comp committees interested in assessing the reasonableness of the pay awarded to the top five executive officers, especially the CEO. Committees that fail to do so while larding on ever higher compensation for their chief executives run the risk of creating an "imperial CEO" scenario, as described in a recent white paper from Workforce Management. The prime example cited in the paper is Bernard Ebbers, former chief executive of scandal-ridden WorldCom.

Committees assessing internal equity typically look at the ratio of the chief executive's pay to that of other officers, such as the chief operating officer or the chief financial officer. Schroeder says there are some rules of thumb in the market. For example, the COO typically gets 60% to 70% of the CEO's compensation, but these are just rough guidelines.

Intel and DuPont have both used internal pay-equity checks on cash compensation for years. At Intel, the comp committee compares the top five executives' cash compensation relative to the 100 highest-paid employees at the company, looking for "internal consistency." DuPont pegs total cash compensation for the CEO at twice that of the number two executive. And indeed, in 2004, DuPont's chief exec received \$3.52 million in base and bonus, while the chief operating officer received half that amount.

Percentage ratios are blunt tools, experts caution. The comp committees of Siebel and Pier 1 don't specify ratios, according to their proxies, but they seek a "reasonable" or "appropriate" ratio of the CEOs' total compensation versus other executive officers'.

Companies that properly use internal pay equity checks assess them within the context of their individual companies, consultants say. "You have to understand your own organization," says consultant Alan Johnson. "A mistake people make is trying to use survey data and ratios as a crutch."

Adds Ann Yerger, executive director of the Council of Institutional Investors: "Structure of pay at different levels should be fair and appropriate. The comp committee should really take a broad analysis."

Using an internal pay-equity check is one way to keep CEO compensation from getting out of control. Blair Jones, senior vice president at Sibson Consulting, recalls a client company that discovered its second-in-command earned just 40% of the CEO's compensation, and so reduced the CEO's pay. "This is one of the metrics that has come up with the new governance focus on compensation," she says.

The chief executive officer has always earned more than other top-five officers. Yet research shows that total CEO compensation — including salary, bonus and equity awards — has edged upward relative to other executives' compensation over the past decade. The median total compensation for S&P 500 CEOs as a percent of compensation for the top five executive officers rose from 39% in 1993 to 43% in 2003, according to an April paper by Harvard professor Lucian Bebchuk and Cornell professor Yaniv Grinstein.

Perhaps because of the intense media scrutiny of skyrocketing chief executive pay, the rise of CEO compensation relative to other executives' pay has moderated in recent years. Total direct compensation for S&P 500 chief executives versus other named executives has remained fairly stable over the past three years. During that time, the median CEO earned roughly 2.71 times the total compensation of the other four top executives, according consulting firm Equilar.

For example, Rent-A-Center's comp committee reviews officers' compensation relative to each other and to other top employees, and compares those ratios to those at peer companies. In 2004, the \$2.3 billion retailer's CEO received compensation that was 2.13 times the average comp of its other four named executives. That may seem lofty, but it was below the S&P 500 median identified by Equilar.

How CEO Comp Compares To Other Executives' Pay

CEOs have always made more than the other four named executive officers. Last year, the median compensation of S&P 500 CEOs, including salary, bonus and long-term incentives, was 2.71 times the average compensation of the other four officers.

Year	CEO Comp as Multiple of Other Officers' Comp
2002	2.68
2003	2.75
2004	2.71

SOURCE Equilar