

# The Corporate Library's CEO Pay Survey

## *CEO Pay 2004*

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## CEO Pay 2004

Far from demonstrating any restraint or reining in, CEO pay growth doubled in 2004. The median increase in total compensation between 2003 and 2004 was 30.15 percent, compared to 15.04 percent in last year's Corporate Library survey. The latest figure is based on a matched set of 1,522 CEOs who were in the job for the whole of 2004 and 2003. This acceleration in pay growth has affected CEOs outside the S&P 500, more than those within it. Total compensation increases for S&P 500 CEOs are again ahead of their colleagues outside the index – median increases were 33.87 percent and 28.44 percent respectively. But in last year's survey, the differential was much wider – with a median increase of 22.18 percent in the S&P 500 and 13.12 percent outside the S&P 500, showing that pay growth has begun to catch up more in the Small Cap and Mid Cap universe of companies.

Total compensation is made up of total annual compensation, restricted stock grants, profits realized on the exercise of stock options and other long-term incentive payouts, as well as all other compensation, such as retirement benefit plan contributions and life insurance benefits.

In addition, the aggregate increase in total compensation is by far the highest of the three analyses. Base salary for the whole sample went up by a median of 4.08 – still double the rise in everyone else's wages – and total annual compensation went up by a median of 11.77 percent. This shows that it is the growth in the incidence and value of long-term incentive payouts – restricted stock awards, profits from exercising stock options and other long-term incentive payments – that has driven this very substantial increase. In number alone, long-term payments have increased substantially within the matched sample:

- In 2004, 743 CEOs exercised stock options, compared to 588 in 2003.
- In 2004, 527 CEOs received a restricted stock award, compared to 424 in 2003.
- In 2004, 199 CEOs received a payout from another form of long-term incentive, compared to 179 in 2003.

**Note:** Sample sizes differ because outside increases have been excluded from the aggregate analysis.

The aggregate analysis of the total sample is given in *Table 1*.

**Table 1: All CEO Compensation Increases 2003/2004** (Source: Board Analyst/Executive Comp Analyst)

	Base salary increase/ (decrease)	Total annual compensation increase/ (decrease)	Total compensation increase/ (decrease)
Number	1,520	1,522	1,518
	%	%	%
Maximum	420.00	1,436.49	2,948.69
Upper quartile	8.63	37.49	103.38
Average	7.53	25.48	91.21
Median	4.08	11.77	30.15
Lower quartile	0.00	(1.52)	(6.07)
Minimum	(67.43)	(100.00)	(100.00)

In addition to outpacing their colleagues in total compensation increases, CEOs in the S&P 500 also received a higher median increase in total annual compensation (made up of base salary, other annual compensation and annual bonuses). In the S&P 500 the median increase in total annual compensation was 13.12 percent; for non S&P 500 CEOs it was 11.26 percent. While the growth in total annual compensation and total compensation in the S&P 500 was ahead of that outside the group, the differential was reversed for base salary increases. There was only a small differential in the median increase in base salary, with 4.26 percent outside the S&P 500 and 3.7 percent in the S&P 500. In total, some 341 CEOs had a pay freeze between 2003 and 2004. On the other hand, 326 CEOs received double digit salary rises.

For the whole sample, instances where a CEO returned to receiving compensation following a period of pro bono work have been excluded from the increase analysis. CEOs who had taken pay cuts in 2003 and then had their prior rate restored in 2004 were also excluded. For example, Gregory Daily, the CEO of iPayment, moved from receiving a nominal salary of \$12,000 in 2003 and 2002 to a more typical salary of \$300,000 in 2004. The survey did not exclude those CEOs who took pay cuts during or for 2004. In addition, annual and total compensation increases in excess of 3,000 percent were also excluded to prevent aggregate figures being skewed. Nevertheless, the average rise in total compensation was an astounding 91.21 percent.

Aggregate analyses are given in *Tables 2 and 3*.

### Aggregate pay levels

While the median base salary in the S&P 500 creeps inexorably but slowly towards \$1,000,000, all other elements of compensation increase exponentially. While it is claimed that some of these increases are due to increased earnings and revenues, analysis later on in this report shows that there is little real relationship between the ever rising spiral of executive compensation and any value added by management.

**Note:** Sample sizes differ because outside increases have been excluded from the aggregate analysis.

**Table 2: S&P 500 CEO Compensation Increases 2003/2004** (Source: *Board Analyst/Executive Comp Analyst*)

	Base salary increase/ (decrease)	Total annual compensation increase/ (decrease)	Total compensation increase/ (decrease)
Number	374	373	373
	%	%	%
Maximum	928.42	1,231.60	1,782.55
Upper quartile	7.70	38.09	109.10
Average	8.90	28.33	93.19
Median	3.70	13.12	33.87
Lower quartile	0.00	0.00	(6.01)
Minimum	(50.00)	(94.30)	(100.00)

**Table 3: Non S&P 500 CEO Compensation Increases 2003/2004 (Source: Board Analyst/Executive Comp Analyst)**

	Base salary increase/ (decrease)	Total annual compensation increase/ (decrease)	Total compensation increase/ (decrease)
Number	1,148	1,149	1,147
	%	%	%
Maximum	420.00	1,436.49	2,948.69
Upper quartile	9.13	37.03	101.59
Average	7.88	24.57	90.78
Median	4.26	11.26	28.44
Lower quartile	0.00	(2.43)	(6.14)
Minimum	(67.43)	(100.00)	(97.38)

**Note:** Sample sizes differ because outside increases have been excluded from the aggregate analysis.

In the S&P 500, median base salary is \$978,500, based on 454 CEOs (see *Table 5* for details). Median annual compensation is now \$2,456,495 and median total compensation is nearly \$6,000,000. The maximum total compensation – beating out last year’s highest by a considerable amount – was \$230.6 million. Outside the S&P 500, levels are at about half those in the largest companies (see *Table 7* for details). Median salary is \$575,000 based on 1,389 CEOs, with annual compensation at \$1,037,905 and total compensation at a median of \$1,879,256.

Taking the whole sample together, based on 1,843 CEOs, median base salary was \$650,000, median annual compensation was \$1,243,020 and median total compensation \$2,436,190 (see *Table 4* for details).

In a new analysis for this series of surveys, median target total compensation – stripping out long-term incentive payouts and profits from stock options but adding in the grant date value of stock options – gives a figure of \$4,550,974 for S&P 500 CEOs. This, lower than 2004’s actual payouts, shows that compensation is shifting modes of delivery; and that other forms of long-term incentive than stock options may make up more of the total in future years. Similarly, outside the S&P 500, median target total compensation is \$1,369,869, again lower than 2004’s actual figure (see *Tables 9* and *10* for details).

*Table 9* also provides aggregate details of grant date values of stock options, both those given by companies and The Corporate Library’s own valuation. Inevitably, even though they were calculated using a fairly modest valuation method, The Corporate Library’s valuations are consistently higher than those given by companies. Although not based on a matched sample, aggregate option values in both the S&P 500 and in the small and mid-cap universe are consistently higher, indicating that the reduction in the value of stock option grants seen between 2002 and 2003 was something of a blip, despite the impending inevitability of option expensing.

### Individual total compensation increases – S&P 500

The highest total compensation increase of all was experienced by the CEO of Cisco Systems, whose total pay went up by more than 4 billion percent. In 2003, John Chambers, the CEO, received only his salary of \$1, but in 2004, he received a bonus of \$1.9 million and exercised stock options with a profit of just over \$38 million. This increase has, of course, been excluded from the aggregate analysis, as have four of the other highest increases. At almost all of the other top 10 increases in the S&P 500, the very high rises were due to the exercise of stock options, with substantial profits in the latest fiscal year, ranging from just over \$5 million at Ford to almost \$70 million at Caremark. Ford's increase was also caused by the 2004 award of a substantial restricted stock grant, worth nearly \$12 million. At only one company, Micron Technology, was the substantial increase due to the reintroduction of the full range of compensation. In 2003, the CEO of Micron Technology received only \$48,476, consisting of profits on the exercise of a small number of options. In 2004, he received salary, a bonus for 2004, a deferred bonus for 1997, and some other benefits. The paragraphs below describe the actions by the compensation committee that led to the normalization of the CEO's compensation arrangements:

“Steven R. Appleton's annual base salary was set at \$800,000 in July 2000 and was based primarily on Mr. Appleton's overall and anticipated performance, the Company's performance and the Compensation Committee's assessment of the compensation practices of other semiconductor manufacturing companies. This was the first increase in Mr. Appleton's salary since July 1997. In June of 2001 base salaries of Company officers were reduced by ten percent as a result of industry conditions and Company performance. Similarly, in October of 2001, base salaries for Company officers were reduced by an additional ten percent. At the time of the second reduction, Mr. Appleton reduced his base salary to \$0 until the Company returned to profitability. In fiscal year 2004, following a return to consolidated, net after-tax profitability in its first fiscal quarter, the Compensation Committee reviewed Mr. Appleton's base salary. Based on recommendations of professional compensation advisors,

**Table 4: All CEO Compensation Levels 2004 (Source: Board Analyst/Executive Comp Analyst)**

	Base salary	Annual bonus	Total annual compensation	LTIP payout	Option value realized	Restricted stock	Total compensation
Number	1,843	1,826	1,843	242	841	654	1,843
Maximum	\$4,980,000	\$30,402,451	\$55,007,300	\$36,907,589	\$229,951,741	\$31,300,038	\$230,553,721
Upper Quartile	\$900,000	\$1,229,339	\$2,170,106	\$2,131,517	\$5,717,366	\$2,472,094	\$5,828,426
Average	\$711,383	\$1,026,741	\$1,831,581	\$1,749,247	\$5,859,190	\$2,260,570	\$5,744,038
Median	\$650,000	\$550,000	\$1,243,020	\$879,428	\$1,873,440	\$1,122,161	\$2,436,190
Lower Quartile	\$454,000	\$176,032	\$743,415	\$370,319	\$534,610	\$445,487	\$1,118,578
Minimum	\$0	\$0	\$0	\$690	\$3,180	\$2,994	\$0

and taking into account the factors listed above under the heading “Base Salary,” and the Company’s return to consolidated, net after-tax profitability, the Compensation Committee reinstated Mr. Appleton’s base salary to its “pre-reduction” level of \$800,000.

“Mr. Appleton did not earn any cash bonus payments pursuant to the Company’s executive bonus plan for fiscal 2001, 2002 or 2003. For fiscal 2004, Mr. Appleton earned a cash bonus of \$671,458 based on his pre-determined percentage of the established bonus pool arising out of consolidated, net after-tax profits (as described under the heading “Executive Bonus Plan”). On December 23, 2003, Mr. Appleton received the fifth and final installment of the performance bonus related to fiscal 1997 in an amount equal to \$211,908, the payment of which was conditional upon the Company’s profitability.”

### Are these increases justified by performance?

It is very clear why Mr. Appleton received this substantial increase in total compensation; the company returned to net after-tax profitability triggering normal salary payments and the payout from the bonus based on this metric. But what about the other CEOs in the top 10 list? Does anything about their companies’ performance justify some of the highest increases ever seen? Given that a proper functioning pay for performance system is usually put forward by commentators as justification for increases in CEO compensation, it will be an interesting experiment to look at these highest increases and compare them with each company’s actual performance. As most of the largest increases are based on profits from stock options, and it is often impossible to know when the original option was granted, it is also difficult determine an appropriate long-term performance measure or time period over which to measure performance. For the sake of argument, however, let us look at a return on invested capital measure over the five year period from 2000 to 2004 to see if, at the same time as taking substantial reward out of the company, CEOs have ensured that they have added substantial value to their company.

**Table 5: S&P 500 Compensation Levels 2004** (Source: *Board Analyst/Executive Comp Analyst*)

	Base salary	Annual bonus	Total annual compensation	LTIP payout	Option value realized	Restricted stock	Total compensation
Number	454	454	454	116	251	199	454
Maximum	\$4,973,073	\$17,273,290	\$21,579,495	\$36,907,589	\$229,951,741	\$31,300,038	\$230,553,721
Upper Quartile	\$1,100,025	\$2,296,514	\$3,536,342	\$2,482,866	\$10,543,400	\$4,292,181	\$13,023,129
Average	\$1,009,494	\$1,954,379	\$3,080,181	\$2,393,940	\$10,922,164	\$3,816,031	\$11,712,621
Median	\$978,500	\$1,383,281	\$2,456,495	\$1,381,961	\$3,922,474	\$2,350,014	\$5,988,433
Lower Quartile	\$781,290	\$755,000	\$1,619,026	\$602,274	\$1,017,451	\$1,249,710	\$3,425,112
Minimum	\$0	\$0	\$0	\$72,059	\$3,180	\$16,283	\$0

## Performance analysis – where’s the disclosure?

The first thing that is noticeable about the companies in *Table 6* is the astounding lack of disclosure or even commentary on long-term performance. Apart from Micron Technology, whose compensation changes are discussed above, only National Semiconductor – whose compensation committee report is almost a template of how to do it properly – has any kind of real long-term performance data. For the rest of the companies, there is no attempt to explain or justify what are very, very substantial stock option profits and other long-term incentive awards indeed.

**Notes:** Three of the 10 CEOs have been or currently are compensated almost entirely using stock options. These are John Chambers, Richard Fairbank, and William Ford. The CEO of Caremark Rx had also relinquished his annual bonus for four years in exchange for a one-time stock option grant. Stock price appreciation has been adjusted for stock splits.

So, in the absence of any supporting evidence from the companies themselves, let us first look at the profits per share demonstrated by these option exercises. The lowest is \$3.78 per share at Ford. This demonstrates that if enough options are awarded, it is still easy to make a large profit even with a stock price that has barely gained at all. CEO William Ford exercised

**Table 6: Long-term Compensation and Long-term Performance (Source: Board Analyst/Executive Comp Analyst)**

Company	CEO	Increase (%)	Main source of increase	5-year stock price appreciation (Under/Outperformed Peers)	5-year average ROIC	Company's record of long-term achievements
Cisco Systems, Inc.	John T. Chambers	4,017,770,900.00	\$38,277,709 stock option profits	(77.86%) (Underperformed)	8.9	None given. Profit per share \$19.14
Capital One Financial Corp.	Richard D. Fairbank	83,785.43	\$56,484,609 stock option profits	55.97% (Underperformed)	7.8	None given. Profit per share \$54.56
Caremark Rx, Inc.	Edwin M. Crawford	4,380.08	\$69,798,238 stock option profits	849.97% (Outperformed)	16.8	None given. Profit per share \$30.35
Micron Technology, Inc.	Steven R. Appleton	3,091.64	\$1,547,181 total compensation	(83.59%) (Underperformed)	(3.3)	Return to profitability
Boston Scientific Corp.	James R. Tobin	1,782.55	\$36,001,500 stock option profits	174.86% (Outperformed)	12.4	None given. Profit per share \$34.29
National Semiconductor Corp.	Brian L. Halla	1,287.05	\$12,316,041 stock option profits and \$5,000,000 bonus	(32.15%) (Underperformed)	11.5	3-year TSR 17.79%, ROIC from c.-7% to 21% 2002/2004, revenue from c.\$1,500MM to \$1,983MM 2002/2004. Profit per share \$9.85
Fisher Scientific International, Inc.	Paul M. Montrone	1,279.54	\$28,685,270 stock option profits	27.91% (Underperformed)	3.5	None given. Profit per share \$47.81
FedEx Corporation	Frederick W. Smith	1,263.00	\$30,963,480 stock option profits	142.06% (Marginally underperformed)	8.6	None given. Profit per share \$51.61
Merck & Co., Inc.	Raymond Gilmartin	1,173.43	\$34,802,748 stock option profits	(47.9%) (Underperformed)	32.3	None given. Profit per share \$32.98
Ford Motor Company	William Clay Ford	943.79	\$11,919,523 restricted stock award and \$5,326,527 stock option profits	(74.33%) (Underperformed)	0.3	Restricted stock grant based on corporate pre-tax income, cost performance, market share and customer satisfaction performance. Profit per share \$3.78.

just over 1.4 million options to make the \$5.3 million profit. And, while Mr. Ford is not, and has not been, receiving any compensation barring equity since he took over the company, with profits this easy in the making, this does not look too much like altruism. Most of the other option exercises are based on far higher profits per share, but what is important here is not the absolute profit per share, but how much better stock price growth at these companies was than at their peers.

### Share price growth vs. peers

Firstly, we should note that six of the ten companies underperformed their peers in the area of stock price growth over five years, and one other company marginally underperformed its peers (Micron Technology has been excluded from this analysis, as the rise in compensation did not result from a stock option exercise). Had these CEOs received indexed stock options – stock options whose exercise price rises up or down in line with the price performance of a chosen peer group – then they would have made nothing from these stock options. This situation strikes me – and would no doubt strike stockholders were they given access to this information – as patently unfair. For stockholders in particular, who would have been better served had they invested in those peer companies, the situation is particularly galling. A better case for the adoption of indexed stock options could hardly be made. Even more surprisingly, four of the companies (again excluding Micron) had a stock price at the end of 2004 that was lower than it was five years ago. However, this is likely to be the outcome of the options being held over a longer period than five years. It is unfortunate, then, that companies do not disclose either when the options that were exercised were granted, or how long they were held. Of course, this is not currently an SEC requirement, but this information – along with how much of the stock was retained – would seem likely to go a long way towards mitigating any pejorative comments that might be made on some of the most profitable exercises.

### Mostly positive returns

The five-year average return on capital figures for the ten

*Table 7: Non S&P 500 Compensation Levels 2004 (Source: Board Analyst/Executive Comp Analyst)*

	Base salary	Annual bonus	Total annual compensation	LTIP payout	Option value realized	Restricted stock	Total compensation
Number	1,389	1,373	1,389	126	590	455	1,389
Maximum	\$4,980,000	\$30,402,451	\$55,007,300	\$6,864,200	\$88,449,741	\$26,788,762	\$88,584,941
Upper Quartile	\$750,000	\$860,000	\$1,661,946	\$1,412,493	\$3,946,968	\$1,611,200	\$3,853,264
Average	\$613,737	\$720,682	\$1,423,177	\$1,155,721	\$3,705,281	\$1,580,269	\$3,790,401
Median	\$575,000	\$425,000	\$1,037,905	\$609,705	\$1,454,735	\$795,926	\$1,879,256
Lower Quartile	\$414,615	\$102,392	\$647,764	\$246,566	\$394,867	\$340,200	\$932,932
Minimum	\$0	\$0	\$0	\$690	\$4,250	\$2,994	\$0

companies show a more positive correlation with compensation increases, though still far from perfect. Most of the figures were, at least, positive rather than negative, and several were quite substantial. The highest return figure, ironically, was at Merck which experienced an almost 50 percent drop in stock price over the same period. This does nothing more than demonstrate what a weak indicator of performance stock price actually is, calling into serious question the effectiveness of stock price as a performance metric.

### Performance and practice in detail

At Cisco and Capital One, while there was a positive return on capital at both companies in neither case was this figure particularly high. More significantly, the decisions made by the CEOs to be paid solely in stock options would appear to have paid off handsomely. At Capital One, the average annual stock price increase of around 11.2 percent over the last five years led to very substantial profits on some very substantial stock option grants, but the company underperformed its peers. At Cisco, the return to normal compensation payments contributed to the overall total compensation increase on top of the large option profits, but apart from some achievements in the immediate short-term, there is little else that would provide the justification for the size of the increase. At Micron Technology, the company makes it clear that the increase is based on the return to profitability. National Semiconductor's excellent disclosure allows us to see that its claims about its ROIC are true, and that while five-year TSR is poor, this has recovered in the last three years. Neither Fisher Scientific's stock price performance nor its ROIC over the last five years would seem to justify the level of stock option profits made by the CEO in 2004, while at FedEx, stockholders should generally be happy. At Merck, with its impressive ROIC figure, while the stock price rose considerably in the five years to 2000, it then commenced its descent, which continues to this day. More significantly, perhaps, in order to achieve the level of profit per share demonstrated by the exercise, CEO Gilmartin must have exercised the options prior to the stock's plunge from around \$45 to its current level of around \$30; in other words, prior

**Table 8: All CEO Option Grant Values and Total Target Compensation (Source: Board Analyst/Executive Comp Analyst)**

	Company-provided Black-Scholes Valuation	TCL Black-Scholes Valuation	Total Target Compensation
Number	390	1,833	1,843
	\$	\$	\$
Maximum	\$37,929,600	\$59,913,087	\$62,141,981
Upper quartile	\$3,051,671	\$1,790,543	\$3,768,598
Average	\$2,840,864	\$1,566,869	\$3,439,444
Median	\$1,391,500	\$540,751	\$1,795,529
Lower quartile	\$663,250	\$0	\$917,447
Minimum	\$1,464	\$0	\$0

to the company's voluntary withdrawal of the drug VIOXX. At Ford, although two thirds of the increase was caused by the restricted stock grant which was based on corporate pre-tax income, cost performance, market share and customer satisfaction, stockholders must really be wondering exactly what they are getting for their money.

This leaves only two companies that solidly outperformed their peers. Boston Scientific and Caremark Rx. Compensation at Boston Scientific is very moderate in general, considerably more moderate than it is at Caremark Rx, and stock options typically make up a more substantial proportion of the total, so it is to be expected that any exercise could lead to a substantial increase in total compensation. However, it would be safe to say that stockholders should be very pleased with the performance of both CEOs. Again, at Caremark Rx, the decision to forgo cash bonuses and receive a large one-time grant of stock options certainly paid off, and it is to be hoped that the exponential rise in stock price is of genuine lasting impact and was not engineered to cash in on such a large grant. Certainly, the ROIC figure would suggest that some lasting value has been created at the company.

From this analysis, it can be construed that only five of the CEOs received their increase with any kind of justification – and this is an analysis of the ten highest increases, it should be remembered. Extrapolating these findings to the full sample would indicate a very poor correlation between long-term performance and long-term incentives.

#### **Total compensation decreases**

In contrast to receiving one of the highest increases in 2003, Steve Jobs, the CEO of Apple Computers received the largest decrease in 2004, of almost 100 percent, returning to total compensation of \$1, after his \$74.75 million restricted stock award. The other four largest decreases were all due to a large option exercise in 2003, most spectacularly that at Colgate-Palmolive, where CEO Reuben Mark made just over \$131 million. As Mr. Mark only receives a stock option grant every

**Table 9: S&P 500 Option Grant Values and Total Target Compensation (Source: Board Analyst/Executive Comp Analyst)**

	<b>Company-provided Black-Scholes Valuation</b>	<b>TCL Black-Scholes Valuation</b>	<b>Total Target Compensation</b>
Number	172	450	454
	\$	\$	\$
Maximum	\$37,929,600	\$59,913,087	\$62,141,981
Upper quartile	\$5,712,273	\$4,584,075	\$8,450,292
Average	\$4,606,742	\$3,728,461	\$6,807,774
Median	\$2,674,740	\$2,367,382	\$4,550,974
Lower quartile	\$1,446,093	\$705,594	\$2,438,941
Minimum	\$1,464	\$0	\$0

10 years, this may be a feat that will not be accomplished again for another decade.

### Individual total compensation increases and decreases – non S&P 500

The top five increases in total compensation in the non S&P 500 have been excluded from analysis. The largest rise of all went to Steven Schulman, the CEO of Magellan Health Services, whose total compensation went from a recorded \$0 in 2003 to \$9,098,743. Schulman, of course, was compensated in 2003, but this was done via a consulting agreement and was not recorded in the Summary Compensation Table. Magellan went from paying \$250,000 per month for four officers, plus a potential bonus of \$1.95 million, to the current situation. Schulman's 2004 compensation also includes \$1,669,822 in tax gross ups on stock purchases and awards. In a similar situation, though with very different results, Robert Whitman, CEO of Franklin Covey, moved from zero compensation in 2003 to total compensation of \$786,295. Whitman did not accept either a base salary or a bonus between May 2001 and August 2003. Despite returning to a more normal compensation arrangement, and in contrast to Mr. Schulman, Mr. Whitman's pay remains extremely moderate, in addition to which, his employment agreement was cancelled at his own request in December 2004.

The next two highest increases were due to CEOs exercising options in 2004, while none had been cashed in during 2003. James Bagley of Lam Research made over \$31 million in option profits, while Michael Coppola of Advance Auto Parts made well over \$42 million. The increase for the CEO of Continental Airlines, Gordon Bethune, came at a time when the majority of Continental's compensation committee report was given over to describing compensation reductions, and that is not the limit to the irony of this case. Some of the increase was due to a change of control payment that was owed to Bethune from a previous employment contract: "the amount he would have been entitled to receive under a previous employment agreement if he had left our employ following the purchase in 1998 by Northwest and its affiliates of a majority of our

**Table 10: Non S&P 500 Option Grant Values and Total Target Compensation** (Source: Board Analyst/Executive Comp Analyst)

	Company-provided Black-Scholes Valuation	TCL Black-Scholes Valuation	Total Target Compensation
Number	218	1,383	1,388
	\$	\$	\$
Maximum	\$12,633,290	\$16,606,243	\$55,007,300
Upper quartile	\$1,647,438	\$1,042,297	\$2,539,183
Average	\$1,447,603	\$863,530	\$2,337,699
Median	\$820,798	\$367,000	\$1,369,869
Lower quartile	\$379,290	\$0	\$779,478
Minimum	\$5,354	\$0	\$0

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voting power.” That’s a payment of around \$5.1 million from a so-called ‘single trigger payment’ with absolutely no justification. But, yet more ironical, the majority of the increase was caused by a lump sum payment of around \$22 million from his supplemental executive retirement plan (SERP) made at around the same time that Continental was announcing that its employees’ pension plan was underfunded by about \$1.58 billion.

The next highest increase was based on a base salary rise for Gregory Daily, the CEO of iPayment, which has already been discussed above. The final four highest increases were all due to option exercises – at Barr Pharmaceuticals, Sepracor, Perini and Martek Biosciences. Henry Linsert, CEO of Martek, had exercised some options in 2003, but the \$1,220,248 profit he made then paled in comparison with the almost \$28.5 million he made in 2004.

In contrast to increases, the largest decreases in total compensation were due to the disappearance, rather than appearance, of one element of compensation from the total package. The majority were caused by stock option exercises in 2003 but none in 2004. That was the case at Activision, Central Freight Lines and Health Net. At Epicor Software, however, a 96.47 percent decrease was due to the award of a \$38.25 million restricted stock grant in 2003.

#### **Total annual compensation increases and decreases – S&P 500**

As with the highest increases in total compensation, some of the largest rises in total annual compensation have been excluded from the aggregate analysis. Again, John Chambers at Cisco Systems heads this list and, again, the 190 million percent increase in his total annual compensation was excluded. Total annual compensation went from \$1 in 2003 to \$1,900,001 in 2004 due to a \$1.9 million annual bonus being paid out. While disclosure leaves something to be desired, the payment is explained thus: “Mr. Chambers’ success in achieving greater profits and higher returns on equity; his actions to improve Cisco’s cash flows; his critical role in achieving positive financial results in an extremely competitive national and global economic environment; and his overall personal example and actions in enhancing customer relations.”

A return to regular salary payments, and the award of significant bonuses were the reasons for large increases at Oracle and at Apartment Investment and Management. Lawrence Ellison’s salary from Oracle went from \$1 to \$675,000, and he also received a \$3,179,000 bonus. At Apartment Investment and Management, Terry Considine’s salary is as subject to

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performance as are his regular incentive payments. Down from \$200,000 in 2002 to \$29,171 in 2003, it increased to \$300,000 in 2004. The compensation committee indicated that total compensation levels were still well below the market median. All the other highest increases were due to bonus payments or increases. Indeed, the growth in annual bonuses has been very substantial. For the same matched sample that has been used to evaluate all compensation increases, annual bonuses for CEOs in the S&P 500 went up by a median 15.63 percent, even after screening out 53 infinite increases that resulted from a zero bonus in 2003, followed by a payment in 2004.

### **Are total annual compensation increases linked to performance?**

Since annual bonuses are generally more closely linked to particular performance metrics than are total compensation levels, it might be thought an easier analysis to test whether some of the highest increases can be justified by a firm's improved performance; easier than the analysis which had to be conducted for total compensation increases.

For a start, it should be said that this survey will not be resorting to the kind of generalized references to increases in earnings for most companies providing a basis for "recovering" CEO compensation levels that form the basis of most apologists for CEO pay. CEO compensation movements and incentive plans are far too complicated for such a facile analysis. Any such justification ignores the range of performance metrics used by companies. It also ignores the fact that even if a company uses earnings as its short-term performance metric, and an increase has occurred – thereby triggering an annual bonus, there still may not be sufficient justification for a significant increase; the earnings increase may have been caused by a general industry recovery rather than any specific management actions, yet management would still have been rewarded highly.

To initiate a properly complex analysis, we will first examine the annual performance targets used, comparing them with reported performance improvements and actual performance, both absolute and against peers. *Table 11* gives the details of the awards and the performance metrics.

There are, really, three steps to be taken for each company to test accurately whether increases in incentive payments, significant or otherwise, are justified.

1. Identify what performance metrics were set by the compensation committee to assess annual performance;

**Table 11: Annual Compensation and Annual Performance (Source: Board Analyst/Executive Comp Analyst and CFRA)**

Company	CEO	Increase (%)	2004 Annual Bonus	Performance metrics	Company's record of achievements	Actual achievements
Cisco Systems, Inc.	John T. Chambers	190,000,000.00	\$1,900,000	Financial goals (probably profit and revenue), customer satisfaction, individual contribution	Greater profits, higher ROE, improved cash flow, enhanced customer relations	Net income increased by 40.53%, gross profit by 23.29% and operating income by 49.58%. ROE increased from 3.5% to 5.34%. Cash flow from operations increased from \$5,240 million for FY03 to \$7,121 million.
Oracle Corporation	Lawrence J. Ellison	10,891.64	\$3,179,000	Operating profit	Improved operating profit 2003-2004	Operating income increased by 16.07%
Apartment Investment and Management Company	Terry Considine	4,356.48	\$1,000,000	Generally TSR	TSR 20.3%, underperformed REITs but outperformed S&P 500 (0.2% in 2003), sales improved but underperformed peers, stable net operating income, pruned non-core assets, reduced cost of capital, construction services improved asset quality, but redevelopment group missed results. Funds from operations \$2.79, significant increase on 2003 figures.	From 31 Dec 03 to 31 Dec 04, the common stock price rose from \$30.5 to \$37.3 per share, with a TSR of over 20%. Sales grew by 5.32% during the same period.
Applied Materials, Inc.	Michael R. Splinter	555.56 (annualized)	\$5,000,000	Growth in revenue, net income as percentage of sales	Revenue increased 79% and net income was 16.9% of sales	Revenue increased 78.97%. Net income margin was 16.86% up from (3.33%) for FY03.
National Semiconductor Corporation	Brian L. Halla	360.76	\$5,000,000	Revenue growth and ROIC	Revenue for FY04 grew 18.57% over 2003 to \$1,983MM and ROIC improved from 1.5% in 2003 to 21% in 2004.	Revenue growth was 18.57%. ROIC did improve but CFRA's ROIC calculation (Net Income/Equity + Long Term Debt) showed an increase from (1.93%) to 16.83%
Navistar International Corporation	Daniel C. Ustian	295.51	\$2,000,000	ROE, 'cost, quality and growth initiatives'	ROE target met	There was a significant increase in ROE from (6.16%) for FY03 to 46.52%
Dillard's, Inc.	William T. Dillard	257.75	\$1,830,000	Pre-tax income and increase in pre-tax income. Bonuses paid from pool of 1.5% of income and 3.5% of increase in income.	Pre-tax income of \$184,551,000 and an increase in pre-tax income of \$168,557,000. Actual bonus amount adjusted downwards by c.\$2.5MM.	Pre-tax income was \$184,551,000, up \$168,557,000 over FY03
Caremark Rx, Inc.	Edwin M. Crawford	252.04	\$4,000,000	"Certain performance targets"	None given.	
Andrew Corporation	Ralph E. Faison	246.19	\$1,266,200	EPS	Significantly exceeded target.	EPS was 21c/share, up from 14c/share for FY03 and (30)c/share for FY02. Mean expectation for FY04 was 38c/share.
Northern Trust Corporation	William A. Osborn	208.01	\$2,000,000	Consolidated net income (0.6% for CEO)	Record net income of \$505.6MM (up 25% over 2003); record net income per common share of \$2.27 (up 26% over 2003); record assets under administration of \$2.6 trillion (up 23% over 2003); and record assets under management of \$572 billion (up 19% over 2003)	Net income was \$507.0MM, up 25.19%. Net income/share was \$2.31, up 25.79%. Total assets rose by 9% to \$45.276 billion

**Note:** In March 2000, Mr. Crawford, CEO of Caremark Rx, agreed to forego his cash bonus for the years 2000, 2001, 2002, and 2003 in exchange for a one-time grant of an option to purchase 3,875,000 shares of the Company's common stock.

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2. Establish what the compensation committee considered were the particular achievements that led to the payment of an annual bonus;
  3. Confirm that these achievements were legitimate and exceeded similar achievements by peers.

The complexity of this exercise would indicate that analyses which attempt to justify substantial aggregate increases in total annual compensation by saying that overall earnings were up in 2004 compared to 2003, therefore annual bonuses were higher, are too simplistic. It also explains why studies such as the present one limit their analysis to only the highest increases. Furthermore, there are individual CEO/company situations that also have a marked effect on increases which are also not analysable in the aggregate, such as those at Cisco and Oracle, where much of the increases were driven by the return to normal compensation arrangements.

### **Disclosure exists, at most companies**

In contrast to the disclosure surrounding long-term achievements, *Table 11* demonstrates that compensation committee reports are much better at disclosing annual achievements, despite the fact that, in general, much smaller amounts of compensation are involved. This is true for all the companies except CaremarkRx, whose compensation committee appears to think that saying that performance was measured against “certain performance targets” is sufficient. It is not, of course. While returns have been considerable at the company, and much of the increase can be explained by the return to paying annual bonuses following a four year hiatus, shareholders must still be left wondering what they are paying for. This level of disclosure is simply unacceptable.

### **Performance appears to justify pay**

At other companies, more information was provided, although it is still difficult to see, for example, why Cisco could not provide the level of detail that the Center for Financial Research & Analysis (CFRA) was easily able to provide. On the other hand, Cisco’s short-term achievements would seem to justify the bonus payment. Similarly at Oracle, though meeting a single target is always easier than meeting multiple measures. Dillard’s, Andrew Corporation, Navistar and Northern Trust also had single targets in place, though at least Dillard’s and Northern Trust pointed to achievements in other areas. Nevertheless, the choice of a single target always raises suspicions that great effort was put into meeting that target, regardless of the cost to other financials, particularly long-term value creation. Apartment Investment and Management’s record of its own achievements is probably the most comprehensive, and it is, at least, honest in pointing out that, among its achievements, performance

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sometimes fell short of either expectations or peers. But again, the bonus seems justified. Likewise at National Semiconductor and Applied Materials, bonuses seem justified by the short term achievements called for and met.

The conclusion that may be drawn from this is that the relationship between movements in annual compensation and changes in performance, or actual achievements, would seem, in the main, to have some basis in fact. This sets aside the question as to whether CEOs of multi-million dollar corporations should be rewarded for short-term achievements at all, or whether rewards should be focused almost entirely on the long-term (see my book *Building Value Through Compensation* for a complete discussion of this issue). What is certain, however, is that annual incentive plans, in contrast to long-term incentives, do appear to be working in the main. Or, at the very least, CEOs appear to be effective at ensuring that the targets that will result in a payout are met.

#### **Total annual compensation increases and decreases – non S&P 500**

The highest increase in total annual compensation outside the S&P 500 was 2,400 percent; caused entirely by a base salary increase. This increase was excluded from the aggregate analysis. iPayment, Inc CEO, Gregory Daily, received the rise. The compensation committee report wrote:

“Mr. Daily is a substantial stockholder and he elected to draw a modest annual salary of \$12,000 during 2003. In reaching this arrangement, the Compensation Committee recognized that Mr. Daily’s equity position served as sufficient incentive to align his interests with the long-term performance of the Company. Commencing in 2004, the Compensation Committee approved an increase in Mr. Daily’s base salary to \$300,000 based on the criteria described above in the section captioned “Base Salary” and may approve other changes in Mr. Daily’s compensation during 2005 in a manner consistent with the factors discussed above for other executive officers. In light of Mr. Daily’s significant stockholdings in the Company, the Compensation Committee, with agreement with Mr. Daily, did not believe it necessary in 2004 to provide further equity incentives in the form of stock options or restricted stock. The Compensation Committee intends to review this determination annually.”

One other of the top ten increases was caused by a base salary rise – at Kronos Worldwide – and this will be discussed below. All the other CEOs in the top 10 had total annual compensation

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increases due to increased bonus payments, six of which increased ten-fold or more, including Kinetic Concepts, Houston Exploration Company and Smithfield Foods. At the other end of the scale, most of the significant decreases were due to a drop in the level of bonus. The exceptions were Google's CEO, who, with two other officers, requested that their salaries be reduced to \$1 in the first quarter of 2004. Also, the CEO of Universal Health saw a dramatic fall in annual compensation because, in 2003, he received loan forgiveness of just over \$7.4 million. Loans were made to pay the income tax liabilities incurred on the exercise of stock options and then forgiven after three years.

#### **Base salary increases and decreases – S&P 500**

Of the ten highest base salary rises, Terry Considine's increase at Apartment Investment and Management has already been discussed above. The second highest increase went to Andrew McKelvey, the CEO of Monster Worldwide, who received a year on year salary increase of 300 percent. In reality, the increase was even higher, as McKelvey's salary went from \$200,000 to \$1,000,000 on 1 April 2004, three months into the fiscal year, an increase of 500 percent. The increase for the CEO of Nabors Industries, from \$325,000 to \$825,000 was, like many others, the result of the board of directors' consultation of a compensation consultancy, this time Mercer Consulting. The 40 percent increase in salary for the CEO of Merrill Lynch is given no explanation, but, as the proxy reminds us, it still represents only 2.2 percent of his total annual compensation. This, of course, is not so much due to the size of the salary, than to the size of the stock award, which, at more than \$31 million, would dwarf most salary payments. A similarly-sized increase to the CEO of Carnival came alongside his decision to donate his bonus "to the American Red Cross International Relief Fund, the U.S. Fund for UNICEF and Save the Children Asia Earthquake/Tsunami Relief Fund to aid in the tsunami relief efforts in Asia and Africa."

The desire to be "at the median" led to the 37.5 percent increase for the CEO of Devon Energy; and similar increases were awarded to other officers. This is the compensation committee report description:

"In December 2003, the Committee conducted a review of executive compensation levels, based on public filings of six peer group oil and gas companies. However, due to the significant changes in the Devon management structure that occurred near year-end 2003 (i.e., the retirements of two senior officers, the promotion of one senior officer to the position of President and the restructuring of the position of Chief

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Financial Officer), and due to the fact that the base salaries of the CEO and at least some of the senior officers appeared to be substantially below the median for the peer group analysis reviewed in December 2003, the Committee engaged an independent consulting firm to review the cash compensation and long-term incentive awards for all of the senior officers. They requested that the independent consultants delay their review until year-end 2003 data became available. The independent consultant's analysis was largely based on data from a peer group comprised of eight oil and gas companies that were similar to Devon in terms of revenues, balance sheet ratios, oil and gas revenues, and overall oil and gas operations. The companies in the peer group are included in the industry group index found in the Performance Graph included in this Proxy Statement. The independent consultant's analysis, which was delivered to and discussed with the Committee in June of 2004, revealed that the base compensation of the CEO was significantly below the median of year-end 2003 base salaries for the eight companies in the independent consultant's group. As a result of this finding, and reflecting on the performance of the Company, the Committee decided to increase the base salary of the Chief Executive Officer to a level slightly above the market median, consistent with the Company's compensation philosophy. This increase was made retroactive to January 1, 2004."

Alignment with the market also led to the increases for the CEO and other officers of Power-One, as the compensation committee announced its decision to reduce the proportion of stock compensation and increase cash pay levels. Again, an explanation was offered:

"The Committee's belief historically has been that the Company's performance generally is reflected in its stock price.

"Therefore, the Company has historically generally paid base salaries and cash bonuses that have been in the lower half for executive officers at similar companies. This cash compensation has been supplemented with equity awards that are tied to the performance of the Company's stock.

"However, over the last several years, based on the hiring of certain officers and other senior employees, the Company has recognized that the market realities of attracting and retaining experienced executives require

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more competitive base salaries. In October 2003, the Committee approved certain base salary increases for selected executive officers, including the Chief Executive Officer, to become effective April 1, 2004. This action represented a continuation of efforts begun in 2003 to bring base salaries of selected executive officers in line with current market amounts. The approved increases were authorized following continued analysis performed with the assistance of independent compensation consultants. The Committee believes that the current base salary amounts now being paid to all executive officers are consistent and in keeping with current market rates.”

While the explanation is welcome, there is no recognition that paying below the market might actually represent best practice, and relinquishing it may not be in the best interests of stockholders.

At Maxim Integrated Products, the CEO’s salary is beginning to move closer to former levels. Says the compensation committee report: “Officer salaries for the first quarter of fiscal 2004 were reduced by 30% from fiscal 2002 levels to support Company-wide cost reduction goals. Beginning with the second quarter of fiscal 2004, officers received 85% of their fiscal 2002 salary levels, except for the Chief Executive Officer who received 50% of his 2002 salary level.”

At the other end of the scale, the only real decrease in base salary was due to “cost saving” reductions. Peter Karmanos, the CEO of Compuware volunteered for a 69 percent cut in salary in October 2003, with reinstatement only occurring in September 2004.

#### **Non S&P 500 base salary movements**

The largest increase, for the CEO of iPayment, has already been discussed. Other CEOs received substantial rises, for a variety of reasons, though new employment agreements appear to be the most common culprit. The 155.22 percent increase for William Walton, the CEO of Allied Capital, for example, appears to have been as a result of his signing of an employment agreement. In contrast, the 150 percent increase for Kevin Reilly, CEO of Lamar Advertising, appears to be entirely on his own recommendation. The compensation committee report says:

“For 2004, the Chief Executive Officer made recommendations to the Committee as to base salary amounts for each executive officer (including himself) based on his assessment of each officer’s individual

performance and current level of compensation. This recommendation also took into account the total compensation paid in 2003, which included a one-time bonus adjustment to achieve total cash compensation that was comparable to a media industry peer group, and the intention to realign total compensation so that base salary represents approximately 60 to 70% of total compensation. The Committee evaluated the Chief Executive Officer's recommendations, taking into account the officer's tenure in his position, the Committee's subjective assessment of individual performance and our overall performance during the prior year. The Committee did not apply a strict formula but instead considered these factors together without giving any specific weight to any individual factor. The Committee gauged our overall performance based on several key indicators. These indicators included the number of acquisitions completed and the aggregate purchase price thereof, the market performance of our Class A Common Stock and the growth in net revenues and cash flows. The Committee also considered the current financial and economic environment in making its assessment. The Chief Executive Officer recommended that for fiscal 2004 his base salary be set at \$550,000 and that the 2004 base salary for each of the Chief Operating Officer and the Chief Financial Officer be set at \$425,000. The Committee approved these recommendations."

The same recommendations, and acceptance of same, are repeated in every section of the report. Exactly what role the compensation committee thinks it is playing here is something of a mystery, though it appears that it is the perfect embodiment of the rubber stamp. Such behavior may not be against the letter of the NYSE listing rules, but it is surely against the spirit. At Flextronics, CEO Michael Marks received a 130.06 percent increase. According to the compensation committee report:

**Table 12: Top 10 S&P 500 Total Compensation 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Total Compensation
Yahoo! Inc.	YHOO	Terry S. Semel	\$230,553,721
United Health Group Incorporated	UNH	William W. McGuire	\$124,773,691
Waters Corporation	WAT	Douglas A. Berthiaume	\$109,681,899
Forest Laboratories, Inc.	FRX	Howard Solomon	\$92,115,725
Coach, Inc.	COH	Lew Frankfort	\$89,367,093
United Technologies Corporation	UTX	George A.L. David	\$88,711,570
Exxon Mobil Corporation	XOM	Lee R. Raymond	\$81,726,307
Caremark Rx, Inc.	CMX	Edwin M. Crawford	\$78,838,782
J.C. Penney Company, Inc.	JCP	Allen I. Questrom	\$74,800,113
Countrywide Financial Corporation	CFC	Angelo R. Mozilo	\$71,779,133

“Mr. Marks’s [sic] base salary is based on our expectation of his personal performance and comparisons to the base salaries of other Flextronics’s [sic] executive officers and in the industry. With respect to Mr. Marks’s base salary, the Compensation Committee intended to provide him with a level of stability and certainty each year and not have this particular component of compensation affected to any significant degree by short-term company performance factors. For fiscal year 2005, Mr. Marks received a base salary of \$985,000.” I can think of no other position where an increase is based on the expectation of someone’s performance. Merit increases, by their definition, reward merit that has already been demonstrated, rather than the expectation of it. A new employment contract was also the reason behind Christopher Pappas’ increase at Luby’s. In fiscal 2004, Pappas was paid an annual base salary rate of \$100,000 until March 31, 2004. It was then increased to \$400,000, but his salary is then set to go down again. The employment contract fixes Pappas’ base salary at \$400,000 for the first year and then reduces it to \$300,000 for the second year.

At the Mills Corporation, Laurence Siegel, CEO, signed a new contract in 2004 that appears to have simply added \$1,000,000 to his existing \$700,000 salary. Not only that, but the contract also guarantees \$50,000 annual increases on top of this. Another example of the tyranny of the market can be seen in the doubling of Thomas Bell’s salary at Cousins Properties, which was due to the most recent “benchmarking study.” The same reason led to a virtual doubling of George Perlegos’ salary at Atmel. Further details on this decision from the compensation committee do not tend to improve its reputation. The compensation report says: “Such group is subject to change from year to year based on the Compensation Committee’s assessment of comparability.” Since the committee decided that Perlegos’ salary was below the market average, the new comparator group must have contained CEOs who were more highly paid than the prior group. Leaving aside any discussion of whether compensation committees should slavishly follow the market every time the

**Table 13: Top 10 S&P 500 Stock Option Profits 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Option Value Realized
Yahoo! Inc.	YHOO	Terry S. Semel	\$229,951,741
United Health Group, Inc.	UNH	William W. McGuire	\$114,552,832
Waters Corporation	WAT	Douglas A. Berthiaume	\$106,996,417
Forest Laboratories, Inc.	FRX	Howard Solomon	\$90,546,050
Coach, Inc.	COH	Lew Frankfort	\$84,119,964
United Technologies Corporation	UTX	George A. L. David	\$83,621,610
Caremark Rx, Inc.	CMX	Edwin M. Crawford	\$69,798,238
J.C. Penney Company, Inc.	JCP	Myron E. Ullman	\$64,875,809
Capital One Financial Corporation	COF	Richard D. Fairbank	\$56,484,609
Countrywide Financial Corporation	CFC	Angelo R. Mozilo	\$48,591,496

“market rate” changes, what if the group changed again, this time containing some lesser paid CEOs? Would the committee then reduce Perlegos’ salary? This is hardly likely, therefore the converse action should not be either. This simply presents a compensation committee being led by circumstances, rather than being in charge of them.

### *Pay Levels – S&P 500*

#### **Total compensation**

The highest total compensation in fiscal 2004 was earned by Terry Semel, CEO of Yahoo!. Semel earned \$230.5 million, almost entirely made up of profits on the exercise of large grants of market and premium-priced stock options he was awarded on joining the company in 2001. In furtherance of this report’s emphasis on ‘was the pay worth it?’, Yahoo!’s stock price has tripled since Semel took over, with a consequent effect on shareholder value. But, while the award of large portions of premium-priced options as part of Semel’s hiring package certainly met with approval, the award of very large amounts of market-priced options during 2004 seems very much less well thought out. All the other CEOs in the top 10 table are there because of an option exercise, except for Lee Raymond at Exxon Mobil and Angelo Mozilo of Countrywide Financial. Raymond is there partly for a stock option exercise, but while he still retains substantial option awards, the company has moved away from this form of compensation and now grants primarily time-restricted stock awards. The award of such shares ensures his placement in the top 10. On the other hand, Angelo Mozilo is present not only because of an option exercise but also a very substantial annual bonus.

#### **Stock option profits**

The enormous influence of stock option profits on total compensation is shown by the fact that of the top 10 stock option profits, nine are for CEOs who also appeared in the top 10 total compensation table. The only different company

**Table 14: Top 10 S&P 500 Restricted Stock Grants 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Restricted Stock Payout
Merrill Lynch & Co., Inc.	MER	E. Stanley O’Neal	\$31,300,038
Goldman Sachs Group, Inc. (The)	GS	Henry M. Paulson	\$29,150,028
Exxon Mobil Corporation	XOM	Lee R. Raymond	\$28,000,500
Allegheny Energy, Inc.	AYE	Paul J. Evanson	\$27,360,010
XTO Energy Inc.	XTO	Bob R. Simpson	\$24,253,500
Occidental Petroleum Corporation	OXY	Ray R. Irani	\$16,850,800
KB Home	KBH	Bruce E. Karatz	\$14,045,340
Home Depot, Inc. (The)	HD	Robert L. Nardelli	\$13,880,000
Morgan Stanley	MWD	Philip J. Purcell	\$13,775,923
Colgate-Palmolive Company	CL	Reuben Mark	\$13,105,903

is Capital One, whose CEO, Richard Fairbank, has been compensated solely with stock options for the last eight years, though, having said this, his stockholding is remarkably low. And, while it is true that stockholders have benefited also from the bank's rising stock price since the commencement of the equity only compensation policy, they have not benefited as much as if they would have done had they invested in a basket of comparator banks during the last five years.

### Restricted stock

Three investment banks make their appearance in the top 10 restricted stock awards table, all because they received either no stock option awards or cash annual bonus or both in the year, and all incentive compensation was loaded into the one grant. Again, in a continued demonstration of the dominance of stock options, even though there were two CEOs who received two of the 10 largest restricted stock awards as well as exercising stock options – Lee Raymond at Exxon Mobil and Bruce Karatz at KB Homes – their stock option profits dwarfed their restricted stock awards.

### LTIP awards

While restricted stock awards are generally far less valuable than stock option profits, the value of LTIP awards – the element of long-term incentive compensation that is supposed to be most closely related to actual performance achievements – is pitiful by comparison. First of all, only a fifth of CEOs in the S&P 500 received an LTIP award. Of these, the LTIP represented a median of only 20 percent of total compensation. For example, Ray Irani, CEO of Occidental, received an LTIP payment of \$7,681,905. This was dwarfed by the profits from an option exercise worth \$37,188,460, by a restricted stock award of \$16,850,800, even by the grant date value of his new stock option award of almost \$12 million. The only element of incentive compensation that the LTIP award did exceed, though not by much, was the annual bonus. This demonstrates

**Table 15: Top 10 S&P 500 LTIP Payouts 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	LTIP Payout
TXU Corp.	TXU	C. John Wilder	\$36,907,589
Valero Energy Corporation	VLO	William E. Greehey	\$13,694,457
Proctor & Gamble Company (The)	PG	Alan G. "A.G." Lafley	\$9,864,000
Washington Mutual, Inc.	WM	Kerry K. Kilinger	\$8,935,416
Burlington Resources, Inc.	BR	Bobby S. Shackouls	\$8,632,000
CIGNA Corporation	CI	H. Edward "Ed" Hanway	\$7,980,000
Occidental Petroleum Corporation	OXY	Ray R. Irani	\$7,681,905
Georgia-Pacific Corporation	GP	Alston D. Correll	\$7,007,485
Textron, Inc.	TXT	Lewis B. Campbell	\$6,775,531
Pfizer, Inc.	PFE	Henry A. "Hank" McKinnell	\$5,829,120

that, although LTIP awards are growing in popularity, it will be many years before they occupy center stage.

Having said that, even some of the highest LTIP payouts were not particularly closely related with performance. For example, John Wilder, CEO of TXU, received 1,000,000 performance units worth almost \$37 million, for achieving three, not very challenging, stock price targets. At Valero, where CEO William Greehey received \$13,694,457, the plan pays out 50 percent of the award even for below median performance. And the plan allows participants two attempts to earn the award, as the performance cycle can be rolled onward for an extra year. There is really no justification for paying out incentive awards for below median performance, and plan administrators, as well as stockholders, should be wary of approving plans that allow it. The third highest LTIP amount, paid to Alan Lafley at Procter & Gamble, was paid out early, due to the cycle being interrupted by the company's merger with Gillette. The award was paid out at the maximum, despite the fact that performance was measured over only one year. Although it is certain that the plan rules demand such a treatment on a 'change of control', it would seem more reasonable, and would certainly create a stronger performance-pay link, if the LTIP was held over until the merger proved its worth.

#### **Annual compensation – salary and bonus**

Nine of the top 10 annual compensation earners are there because they are also in the top 10 annual bonus table. Only one makes it into the former table, and not for the first time, for other reasons – Robert Nardelli, CEO of Home Depot. He is there in large part because of the amount paid out as other annual compensation – \$6,355,146 in loan forgiveness and tax gross up payments. This is the penultimate payment of this kind, and the final installment in December 2005 will mark the end of this sorry epoch in executive compensation whereby a completely non-performance related "retention loan" of \$10

**Table 16: Top 10 S&P 500 Total Annual Compensation 2004 (Source: Board Analyst/Executive Comp Analyst)**

<b>Company</b>	<b>Ticker</b>	<b>CEO</b>	<b>Total Annual Compensation</b>
Viacom Inc.	VIAB	Sumner M. Redstone	\$21,579,495
Countrywide Financial Corporation	CFC	Angelo R. Mozilo	\$20,012,263
Cendant Corporation	CD	Henry R. Silverman	\$18,907,351
TXU Corp.	TXU	C. John Wilder	\$17,759,754
News Corporation	NWS	Keith Rupert Murdoch	\$17,009,000
XTO Energy Inc.	XTO	Bob R. Simpson	\$16,372,693
Home Depot, Inc. (The)	HD	Robert L. Nardelli	\$14,105,146
Centex Corporation	CTX	Laurence E. Hirsch	\$12,123,761
Lehman Brothers Holdings Inc.	LEH	Richard S. Fuld	\$11,000,000
Citigroup Inc.	C	Charles O. "Chuck" Prince	\$10,796,209

million has cost stockholders more than twice that amount. Some of the CEOs in the total annual compensation table are there also because of significant salary payments. Indeed, in this list, only the CEOs of Centex, Lehman Brothers and XTO Energy have any claim to moderation in the receipt of base salary. The base salary of Sumner Redstone – now fast approaching \$5 million – is preposterous. Somewhat unsurprisingly, it is another “entertainment” industry CEO who earns the second highest base salary, Keith Murdoch, at News Corp with just over \$4.5 million.

### *Pay levels – non S&P 500*

#### **Total compensation**

As with their colleagues in the S&P 500, the main influence on the total compensation of the non S&P 500 CEOs was stock option profits. Eight exercised options, and for six of these, option profits were the main contributory factor. The CEO of the Jefferies Group also received a substantial restricted stock award. And John Antioco, CEO of Blockbuster, who has only ever made a profit on stock options over parent company Viacom stock, not in his own company’s, received not only a very substantial restricted stock award, but also a very, very large grant of stock options. Two CEOs appeared in the top 10 because of management and other fees paid to their companies – Mario Gabelli of Gabelli Asset Management and Frank Stronach of Magna International.

#### **Stock option profits**

Because of these varied payments, there is less similarity between the top 10 total compensation earners, and the top 10 option profiteers. The highest is, of course, the CEO of the Bank of Hawaii, whose option profits represented 99.8 percent of his total compensation. For two CEOs, this marks their second appearance in this table in successive years. Dwight Schar of NVR made \$54,854,278 on the exercise of stock options in

**Table 17: Top 10 S&P 500 Annual Bonuses 2004 (Source: Board Analyst/Executive Comp Analyst)**

<b>Company</b>	<b>Ticker</b>	<b>CEO</b>	<b>Annual Bonus</b>
Countrywide Financial Corporation	CFC	Angelo R. Mozilo	\$17,273,290
Viacom Inc.	VIAB	Sumner M. Redstone	\$16,500,000
TXU Corp.	TXU	C. John Wilder	\$15,915,000
XTO Energy Inc.	XTO	Bob R. Simpson	\$15,500,000
Cendant Corporation	CD	Henry R. Silverman	\$15,281,508
News Corporation	NWS	Keith Rupert Murdoch	\$12,500,000
Centex Corporation	CTX	Laurence E. Hirsch	\$11,173,761
Lehman Brothers Holdings Inc.	LEH	Richard S. Fuld	\$10,250,000
Bear Stearns Companies Inc. (The)	BSC	James E. Cayne	\$10,081,291
Citigroup Inc.	C	Charles O. “Chuck” Prince	\$9,690,000

2003, compared to \$34,823,195 in 2004. Peter Rummell of St. Joe Company made \$27,441,144 in 2003 and \$28,510,072.

### Restricted stock grants

Heading the restricted stock table is John Antioco of Blockbuster, mentioned above. Even Michael Capellas – whose pay levels were subject to a corporate monitor – appears here with the payout of his anticipated \$18 million in restricted stock. Michael Neidorff, CEO of Centene, received 1,000,000 shares of restricted stock, as a result of signing a new employment agreement, that begin to vest in 2009, but do not vest in their entirety until 2014. But then, his 10-year employment agreement runs until then also. Stuart Essig, CEO of Integra LifeSciences, appears to be the main driving force behind the company's need to increase the number of shares available for issue under its comparatively new 2003 equity plan. These had to be increased by 1,500,000 at the 2005 annual meeting because 2,000,000 of the original 4,000,000 had already been delivered to Essig, including the 750,000 stock units in 2004 as a “fully-vested equity-based signing award bonus”. It is only in the world of executive pay that employees must receive enormous non-performance-related awards in order to induce them to continue in their current position. Indicating fairly clearly that such shares are unlikely to play much of a role in aligning Essig's interests with those of stockholders, Essig has rights to require the company to file a “shelf registration” that will provide for the sale on a continuous or delayed basis of all his equity awards.

### LTIP payouts

The highest LTIP payout outside the S&P 500 is there by accident, Western Digital's payout date for their LTIP is so close to the fiscal year end, that two payouts were made in the latest fiscal year, rather than one, although either one or other of the payments would still have placed the company close to the top of the league. Furthermore, although placed in the LTIP column of the Summary Compensation Table, the

**Table 18: Top 10 S&P 500 Base Salaries 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Base Salary
Viacom Inc.	VIAB	Sumner M. Redstone	\$4,973,073
News Corporation	NWS	Keith Rupert Murdoch	\$4,509,000
Exxon Mobil Corporation	XOM	Lee R. Raymond	\$3,600,000
Cendant Corporation	CD	Henry R. Silverman	\$3,300,000
General Electric Company	GE	Jeffrey R. Immelt	\$3,000,000
Archer-Daniels-Midland Company	ADM	G. Allen Andreas	\$2,901,667
Jones Apparel Group, Inc.	JNY	Peter Boneparth	\$2,500,000
Countrywide Financial Corporation	CFC	Angelo R. Mozilo	\$2,466,667
MBNA Corporation	KRB	Bruce L. Hammonds	\$2,461,525
Pfizer, Inc.	PFE	Henry A. “Hank” McKinnell	\$2,224,900

awards are classified by the company as long-term retention agreements, vesting over time, and appear to have nothing to do with performance. The size of the TD Banknorth payout also has little to do with performance, as it consisted of accelerated cash payouts of awards following a change of control. Again, given the airline industry's present parlous state, it would seem strange that any payout was being made from a long-term incentive plan, but again Gordon Bethune's payment predictably has nothing to do with performance. On top of his jarring \$22 million pension lump sum, Bethune also took receipt of LTIP payments that he had waived the right to during 2003 as part of efforts to reduce compensation. While Continental executives have made some significant efforts to share in the pay reductions being applied to all other staff, the decision to pay out compensation that has been waived as part of this would surely undermine any and all of these efforts. Altruism is only altruism if it is maintained. If the thing sacrificed is later indulged in, then there is no altruism at all.

Only one of the top four LTIP payouts appears to have any real relationship to performance at all – the award at Equitable Resources. Performance stock units were paid out in 2004 at 191.7 percent of the target amount because the company's total stockholder return (TSR) ranked fifth in a peer group of 30 companies.

#### **Total annual compensation and annual bonuses**

Four of the companies in the top 10 annual compensation table were present in last year's survey; the CEOs of Ryland Group, Lennar, Friedland Billings Ramsey, and Standard Pacific earned sufficiently large bonuses in both years to join the table. The highest annual compensation was earned by Mario Gabelli, the CEO of Gabelli Asset Management. The source of this compensation is explained in a note to the summary compensation table:

**Table 19: Top 10 Non S&P 500 Total Compensation 2004 (Source: Board Analyst/Executive Comp Analyst)**

<b>Company</b>	<b>Ticker</b>	<b>CEO</b>	<b>Total Compensation</b>
Bank of Hawaii Corporation	BOH	Michael E. O'Neill (former CEO)	\$88,584,941
Gabelli Asset Management, Inc.	GBL	Mario J. Gabelli	\$55,007,300
Toll Brothers, Inc.	TOL	Robert I. Toll	\$50,239,614
Jefferies Group, Inc.	JEF	Richard B. Handler	\$43,654,846
Advance Auto Parts, Inc.	AAP	Lawrence P. Castellani (former CEO)	\$43,598,842
Genentech, Inc.	DNA	Arthur D. Levinson	\$43,486,532
Magna International, Inc.	MGA	Frank Stronach	\$40,312,700
NVR, Inc.	NVR	Dwight C. Schar	\$38,233,695
Endo Pharmaceuticals Holdings, Inc.	ENDP	Carol A. Ammon (former CEO)	\$37,745,876
Blockbuster, Inc.	BBI	John F. Antioco	\$37,540,688

“For 2004, Other Annual Compensation represents: (i) \$11,016,609 representing the incentive-based management fee (10% of our pre-tax profits); (ii) \$16,418,241 for acting as portfolio manager and/or attracting and providing client service to a large number of separate accounts; (iii) \$16,342,698 for creating and acting as portfolio manager of several open-end Gabelli Funds; (iv) \$8,078,464 for creating and acting as portfolio manager of closed-end Gabelli Funds; (v) \$3,150,793 for providing other services, including acting as portfolio manager of investment partnerships and as a broker; and (vi) \$496 representing a contribution made under our profit-sharing plan.”

Much of this could be classed as incentive compensation, and the levels are, no doubt, not unusual on Wall Street, however, it would nevertheless seem to be the case that his services might have been obtained for less.

Another CEO also received a substantial amount of money as “other annual compensation.” This was largely made up of tax reimbursements for vested restricted stock units; plainly a waste of stockholders’ money. Dreier, the CEO of Ryland Group, also received another substantial annual bonus, and his salary is set at \$1,000,000. The annual bonus was even higher for construction industry colleague Robert Toll, the CEO of Toll Brothers. Yet one more construction industry colleague – Stuart Miller, CEO of Lennar – also earned a substantial bonus, but large accommodation is allowed this company for its exemplary disclosure:

“The Compensation Committee decided that, as in past years, Mr. Miller’s bonus should be based on a percentage of the Company’s pre-tax earnings, with the percentage depending on the Company’s return on net capital (from 0.5% if return on net capital is below 13% to a high of 1% if return on net capital equals or

**Table 20: Top 10 Non S&P 500 Stock Option Profits 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Option Value Realized
Bank of Hawaii Corporation	BOH	Michael E. O'Neill (former CEO)	\$88,449,741
Advance Auto Parts, Inc.	AAP	Lawrence P. Castellani (former CEO)	\$42,612,690
Genentech, Inc.	DNA	Arthur D. Levinson	\$41,156,607
Endo Pharmaceuticals Holdings Inc.	ENDP	Carol A. Ammon (former CEO)	\$36,995,936
NVR, Inc.	NVR	Dwight C. Schar	\$34,823,195
Barr Pharmaceuticals, Inc.	BRL	Bruce L. Downey	\$32,177,098
Lam Research Corporation	LRCX	James W. Bagley	\$31,647,305
Smith International, Inc.	SII	Douglas L. Rock	\$31,153,298
St. Joe Company (The)	JOE	Peter S. Rummell	\$28,510,072
Martek Biosciences Corporation	MATK	Henry Linsert	\$28,472,600

exceeds 20%). However, in order to reach the maximum percentage of pre-tax earnings, a specified customer satisfaction rating must be achieved. Because in 2004, the Company's return on net capital exceeded 20% and the Company exceeded the customer satisfaction rating goal, the bonus percentage for 2004 was 1%, which is the maximum percentage that could have been achieved. This is the same percentage that was achieved in 2003. However, because the Company's pre-tax earnings grew from \$1.2 billion in 2003 to \$1.5 billion in 2004, Mr. Miller's bonus increased from \$12.1 million in 2003 to \$15.2 million in 2004."

Such disclosure cannot be faulted, and it throws into even sharper contrast the inadequate disclosures made by 99.9 percent of other companies.

### Base salary

The highest base salary outside the S&P 500 went to the CEO of Valhi, Harold Simmons, though the amount was made up not so much of salary, but fees. The proxy describes the payment thus:

"The amounts shown in the summary compensation table as salary for each named executive officer represent the portion of the fees Valhi and its subsidiaries paid to Contran pursuant to certain ISAs with respect to the services such officer rendered to Valhi and its subsidiaries. The amount shown in the table as salary for each of Messrs. Simmons and Watson also includes director compensation paid to each of them by Valhi's subsidiaries."

Other very high salaries are earned by entertainment industry and financial industry CEOs. The standout is Jeffrey Steiner, CEO of Fairchild, but again this is made up of several different elements. He earns: "\$2,500,000 per year, consisting of (i)

Table 21: Top 10 Non S&P 500 Restricted Stock Grants 2004 (Source: Board Analyst/Executive Comp Analyst)

Company	Ticker	CEO	Restricted Stock
Blockbuster, Inc.	BBI	John F. Antioco	\$26,788,762
Centene Corporation	CNC	Michael F. Neidorff	\$24,600,000
Integra LifeSciences Holdings Corporation	IART	Stuart M. Essig	\$23,535,000
DIRECTV Group, Inc. (The)	DTV	Charles G. "Chase" Carey	\$19,994,000
MCI, Inc.	MCIP	Michael D. Capellas	\$18,000,000
Jefferies Group, Inc.	JEF	Richard B. Handler	\$16,000,000
SL Green Realty Corp.	SLG	Marc Holliday	\$11,116,750
Plains Exploration & Production Company	PXP	James C. Flores	\$10,863,100
DST Sytems, Inc.	DST	Thomas A. McDonnell	\$10,000,998
Coventry Healthcare, Inc.	CVH	Allen F. Wise (former CEO)	\$9,688,000

\$1,700,000 pursuant to his employment agreement with the Company, (ii) \$400,000 per year pursuant to his employment agreement with Banner Aerospace, plus (iii) \$400,000 for services in Switzerland with respect to the Company's European operations." The fact that it is from several different sources does not, however, detract from the fact that the salary is nonetheless excessive. •

**Table 22: Top 10 Non S&P 500 LTIP Payouts 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	LTIP Payout
Western Digital Corporation	WDC	Matthew E. Massengill	\$6,864,200
TD Banknorth, Inc.	BNK	William J. Ryan	\$6,260,440
Equitable Resources, Inc.	EQT	Murray S. Gerber	\$6,247,492
Continental Airlines, Inc.	CAL	Gordon M. Bethune (former CEO)	\$5,106,128
Assurant, Inc.	AIZ	J. Kerry Clayton	\$5,053,676
Joy Global, Inc.	JOYG	John Nils Hanson	\$4,703,568
Toro Company (The)	TTC	Kendrick B. Melrose (former CEO)	\$4,688,957
Timberland Company (The)	TBL	Jeffrey B. Swartz	\$4,594,140
Yellow Roadway Corporation	YELL	William D. Zollars	\$4,148,876
Cleveland-Cliffs, Inc.	CLF	John S. Brinzo	\$3,622,185

**Table 23: Top 10 Non S&P 500 Total Annual Compensation (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Total Annual Compensation
Gabelli Asset Management, Inc.	GBL	Mario J. Gabelli	\$55,007,300
Toll Brothers, Inc.	TOL	Robert I. Toll	\$31,780,668
Ryland Group, Inc. (The)	RYL	R. Chad Dreier	\$16,258,702
Lennar Corporation	LEN	Stuart A. Miller	\$16,190,700
Kinetic Concepts, Inc.	KCI	Dennert O. "Denny" Ware	\$14,110,497
Standard Pacific Corporation	SPF	Stephen J. Scarborough	\$12,499,195
Friedman, Billings, Ramsey Group, Inc.	FBR	Eric F. Billings	\$9,847,887
Polo Ralph Lauren Corporation	RL	Ralph Lauren	\$9,000,000
D.R. Horton, Inc.	DHI	Donald J. Tomnitz	\$8,620,134
Triarc Companies, Inc.	TRY	Nelson Peltz	\$7,997,263

**Table 24: Top 10 Non S&P 500 Annual Bonuses 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Annual Bonus
Toll Brothers, Inc.	TOL	Robert I. Toll	\$30,402,451
Lennar Corporation	LEN	Stuart A. Miller	\$15,190,700
Kinetic Concepts, Inc.	KCI	Dennert O. "Denny" Ware	\$13,546,648
Ryland Group, Inc. (The)	RYL	R. Chad Dreier	\$12,245,622
Standard Pacific Corporation	SPF	Stephen J. Scarborough	\$11,533,857
Friedman, Billings, Ramsey Group, Inc.	FBR	Eric F. Billings	\$9,367,887
D.R. Horton, Inc.	DHI	Donald J. Tomnitz	\$8,320,134
Polo Ralph Lauren Corporation	RL	Ralph Lauren	\$8,000,000
BlackRock, Inc.	BLK	Laurence D. Fink	\$7,210,000
Legg Mason, Inc.	LM	Raymond A. Mason	\$7,100,000

**Table 25: Top 10 Non S&P 500 Base Salaries 2004 (Source: Board Analyst/Executive Comp Analyst)**

Company	Ticker	CEO	Base Salary
Valhi, Inc.	VHI	Steven L. Watson	\$4,980,415
Greenhill & Co., Inc.	GHL	Robert F. Greenhill	\$3,961,351
Fairchild Corporation (The)	FA	Jeffrey J. Steiner	\$2,500,005
Annaly Mortgage Management, Inc.	NLY	Michael A.J. Farrell	\$2,430,000
Doral Financial Corporation	DRL	Salomon Levis	\$2,400,000
Commerce Bancorp, Inc.	CBH	Vernon W. Hill	\$2,250,000
Blockbuster, Inc.	BBI	John F. Antioco	\$2,045,192
DIRECTV Group, Inc. (The)	DTV	Charles G. "Chase" Carey	\$2,000,000
MGM Mirage	MGG	J. Terrence Lanni	\$2,000,000
Accenture Ltd.	ACN	Joe W. Forehand (former CEO)	\$1,968,000

### Survey details

The survey is based on a sample of the top 2,042 US companies as measured by market capitalization. Of these companies, 1,843 CEOs were in post for the whole of their last fiscal year. All compensation analysis has been based on full-year figures taken from the latest available proxy statement at the end of June 2005. Proxy filing dates ranged from 1 July 2004 through to 28 June 2005, with over three-quarters of proxies filed in 2005. Compensation and increase analyses were calculated for companies in the S&P 500 and then for all other companies, including Smallcaps, Midcaps and currently non-indexed companies from the sample.

### Definitions

**Base salary** – This is not necessarily the figure set at a CEO's salary review, but the amount paid during the year. It also includes any directors' fees (where paid) and any deferred compensation.

**Annual bonus** – This includes all payments made under annual incentive schemes, including the cash value of any stock payments.

**Other annual compensation** – Includes the taxable valuation of benefits provided during the year such as corporate transportation, financial planning advice, any tax reimbursements, interest or loan forgiveness.

**Total annual compensation** – Is the sum of the three items above.

**LTIP payout** – Long-term incentive plan payouts consist of the payment in shares or cash of long-term bonuses based on performance over two or more years.

**Option value realized** – This is the profit made on the exercise of stock options, calculated by multiplying the number of options exercised by the difference between the exercise price at grant and the market price for a share on the day the options were exercised. It should be remembered that, unless the CEO sold all the shares on the day, none of this "value" will necessarily have been realized in cash. Further, if shares were sold subsequent to exercise, they may not have been sold at the same market price as was in effect at the time of exercise.

**Restricted stock** – The value of the stock on the date of grant.

**All other compensation** – this is the taxable value of other long-term benefits, primarily life and other types of insurance and SERPS (supplemental executive retirement plans) contributions.

**Total Compensation** – This is the sum of total annual compensation, LTIP payout, Option value realized, restricted stock and all other compensation.

### Increases

Increases are based on a matched sample of CEOs who were in post for the full fiscal years 2003 and 2004. It is therefore based on a much smaller sample – of 1,523 CEOs – than the analysis of aggregate pay data. In order to compute a more representative figure for the year on year changes in base salary, total annual compensation and total compensation, increases were calculated for each matched CEO. Aggregate increases were calculated from these figures. Increases were not calculated by comparing average or median pay data from one year to the next.