THE CONFERENCE BOARD

CEO and Executive Compensation Practices

2019 Edition

KEY FINDINGS

BASED ON DISCLOSURE
BY RUSSELL 3000 AND
S&P 500 COMPANIES

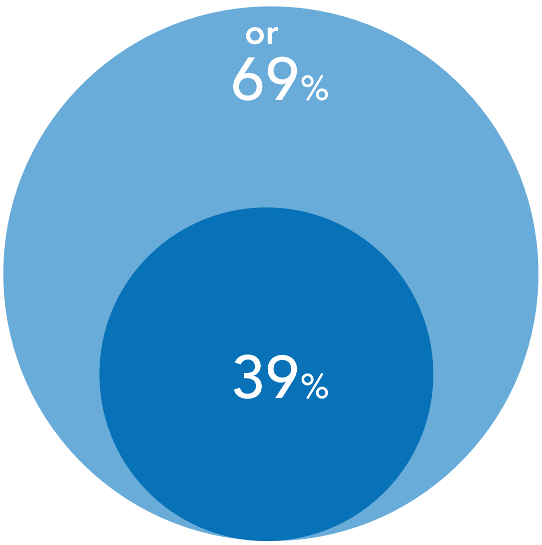
KEY FINDINGS

Part 1: CEO Compensation

Total CEO Compensation

In 2018, for the second year in a row, total CEO compensation grew in the Russell 3000 at a markedly higher rate than in the S&P 500. In fact, rises were even higher than in 2017, contrasting the decline in the rate of CEO pay growth observed over the last few years in the S&P 500. The increase in median total compensation for Russell 3000 CEOs was 12.5 percent in 2018, compared to 9.9 percent in 2017. For S&P 500 CEOs, the increase in median total compensation was 4.1 percent in 2018, compared to 4.5 percent in 2017. Cumulatively, this yearly differential is having a significant effect. Median growth in pay since 2010 for Russell 3000 CEOs is almost double that of their peers in the S&P 500, or 69.9 percent and 39 percent, respectively. However, actual median total compensation for S&P 500 CEOs ($12,350,650) continues to far exceed that of their Russell 3000 counterparts ($4,351,945). Including or excluding change in pension value from increase calculations did not markedly affect increases for either of the two groups. Excluding it made increases higher, by 13.9 percent in the Russell 3000 and 7.1 percent in the S&P 500. As discussed below, the overall growth shown across the board is primarily driven by the rise of stock awards and performance-based compensation observed in both indexes. See Figures 1.7 and 1.1.

Since 2010, **median growth** in pay for **Russell 3000 CEOs** is almost double that of their peers in the **S&P 500**,



However, actual **median total compensation** for

S&P 500 CEOs $12.3 Million continues to far exceed that of the **Russell 3000 counterparts** $4.3 Million

Source: The Conference Board, 2019.

Within the Russell 3000, CEOs in Communications Services (a newly introduced GICS sector that includes consumer product and telecommunication firms, such as Walt Disney (NASDAQ: DIS), Discovery Communications (NASDAQ: DISCA), Alphabet (NASDAQ: GOOGL), eBay (NASDAQ: EBAY), Comcast (NASDAQ: CMCSA), and Omnicom (NYSE: OMC), saw the most substantial increases in pay, according to an industry analysis. Though not the only double-digit rises, the increase in median total compensation at 32.9 percent exceeded the next highest, at 24 percent, of Health Care CEOs. Other double-digit increases went to the CEOs in the Information Technology sector, which retains software, hardware and semiconductor companies (11.7 percent), and the Industrials sector (14.1 percent). In contrast, the median total compensation of the CEOs of Consumer Staples companies dropped by 13.3 percent from the prior-year level. CEOs in two other industries experienced decreases: Energy (down 5.8 percent, after a substantial increase reported in 2017) and Materials (down 8 percent). See Figure 1.8.

As the company size analysis illustrates, the smallest companies in the Russell 3000 have been driving the larger increases recorded at the median level across the index. The reported shortage of highly skilled labor and innovative thinkers across business industries is a possible explanation for this finding, as smaller companies traditionally find it harder to compete for leadership talent.[7] In particular, companies with revenue of less than $100 million reported CEO total compensation increases of 30.1 percent. In comparison, just the next bracket up ($100 million to $999 million in annual revenue) showed a more modest CEO compensation growth rate of 8.7 percent. The growth rate continues to soften as companies get larger, eventually dropping to minus 4.9 percent for companies with revenue between $25 billion and $49.9 billion. This linear, inverse correlation is countered only by the largest company size group ($50 billion plus in revenue), for which the 2018 increase in total CEO compensation equaled 8.8 percent. By asset value, a benchmarking measure used by financial, insurance, and real estate businesses, the largest increases are reported in the middle ranks (8.7 percent for companies in the $1 billion to $9.9 billion group, 16.3 percent in the $10 billion to $24.9 billion group, and 4.3 percent in the $25 billion to $49.9 billion group), while the smallest and largest company CEOs experienced either a median total compensation decline or, at best, stagnation. See Figure 1.9.

By sector, median total compensation figures cluster around $5 million, with only Financials CEOs and Health Care CEOs falling outside this tight bracket. CEOs in six of the examined 11 GICS industries received total compensation between $4.7 million and $4.9 million. The highest-paid CEOs are those of Utilities companies, with median total compensation for 2018 of $5,535,733. The only other two sectors where median total compensation broke the $5 million barrier were Information Technology ($5,109,290) and Consumer Staples ($5,146,692). At the other end of the scale, CEOs of Financials earned median total compensation of $2,430,116 and Health Care CEOs were just over the $4 million mark. See Figure 1.2.

The 25 Highest-Compensation CEOs in the Russell 3000

The estimated value of granted stock options was responsible for the top entries in the list of highest earners in the Russell 3000 in 2018, a list led by the compensation packages of the Tesla and Axon Enterprise CEOs. Some companies on the list were subject to significant shareholder scrutiny by shareholders, which prompted corrections in the following year. The list of the 25 highest-paid CEOs of 2018 (see Exhibit 6) is dominated by two performance-based stock option awards for the CEOs of Tesla and Taser manufacturer Axon Enterprise, Inc. They share similarities but also considerable differences. Both comprise the vast majority of total compensation for each CEO and both measure performance over 10 years against market capitalization, revenue, and EBITDA targets. However, unlike Tesla's plan, not only is the CEO eligible for Axon's eXponential Stock Performance Plan (XSPP) but also the company's other employees.

7 *The State of Innovative Leaders Report 2018,* Harvard Business Review Analytics Service, 2018.

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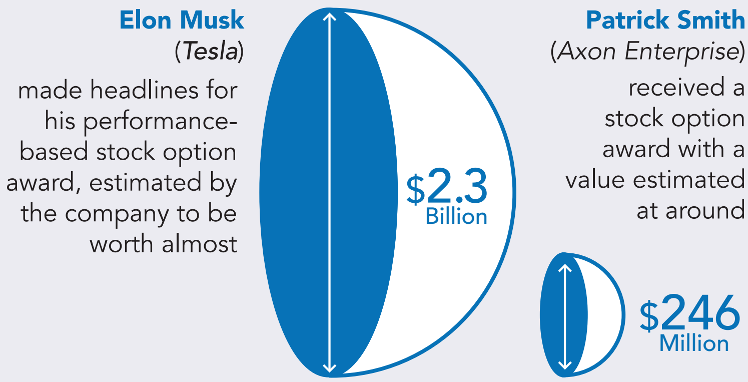


Source: The Conference Board, 2019.

Elon Musk, CEO of automaker Tesla, Inc. (NASDAQ: TSLA) made headlines for his performance-based stock option award, estimated by the company to be worth almost $2.3 billion. The award is conditioned upon a series of 12 market capitalization milestones, each adding $50 billion to Tesla's value, and 16 other performance milestones (eight based on revenue targets and eight based on adjusted EBITDA over 10 years). Smith, CEO of Taser manufacturer Axon Enterprise, received a stock option award with a value estimated at around $246 million that is based on 12 market capitalization, revenue, and EBITDA milestones. Both awards are likely to be worth significantly more if all performance targets are met.

The similarities between the two plans are not coincidental. According to press reports, Musk's award was a direct inspiration for Smith's. Both had to, and did, receive shareholder approval; though, in Tesla's case, not without some opposition. In addition, Axon's 2019 proxy outlines an extensive shareholder outreach program prior to the vote. "Shareholders tended to favor broad-based employee-wide plans over highly concentrated plans among senior management, and favor using performance-based share-based compensation, rather than cash, in delivering market-competitive total pay," says the proxy. The company also addressed dilution concerns by adopting "a dilution guardrail of 3% annual share count growth, calculated on a daily basis…."

Finally, while both companies have already met some of the operational targets, Musk's stock options are currently deep underwater: That means that the exercise price is above the current value of the stock, or a $350 exercise price compared to the market price of around $250 registered in July 2019.

Stock options are also the driving force of the next four highest-paid CEOs on the list: David Zaslav at Discovery Communications, Nikesh Arora at Palo Alto Networks, and Mark Hurd and Safra Katz at Oracle, though Akora's total compensation also includes a substantial stock award. Thereafter on the list, and with the only exceptions of NVR and Netflix, it is the value stock awards (or bonuses in some cases) that outweighs other compensation components.

Among the individuals who made the list, the case of Richard Handler, CEO of Jefferies Financial Group, illustrates quite well the role that the shareholder outreach and engagement program can play in today's executive compensation design process. Handler earned his rank on the list because he was awarded, in 2018 alone, three years of performance-restricted stock units (RSUs). This decision, and a number of others, resulted in a reduction in the company's say-on-pay vote support, from 90 percent in 2017 to only just over 50 percent in 2018, as shown in corporate disclosure. In response, the board embarked on a significant program of shareholder engagement; as the 2019 proxy says: "Between May and October, we conferred both with holders of a majority of our shares who voted against our plan and with the proxy advisory firms."

Some major changes were made to Jefferies's executive compensation policy as a result of this engagement. First, the company eliminated "banking," whereby executives could earn banked but unvested RSUs even though performance conditions were not met in subsequent years. Second, it replaced an absolute total shareholder return (TSR) target with a relative TSR target and increased the performance ranges for that and the return on tangible deployable equity (ROTDE) targets. It also reduced targeted cash compensation by 28 percent and overall target compensation by 10 percent, confirmed that no additional equity would be awarded on top of the three years of awards granted to Jefferies in 2018 and that no positive discretion is allowed. Finally, a more detailed explanation of the company's chosen peer group was provided. All of these changes came about as a result of the shareholder and proxy advisory firm engagement; to explain the revisions, the company issued an additional proxy filing that included the following commentary: "One final note. It bears repeating that, although our Summary Compensation Table is fully compliant with SEC rules and displays the total grant date fair value of the target shares awarded in the year 2018 as part of a program that applies to three compensation years (2018, 2019 and 2020), the Compensation Committee's intent and the underlying fact of the matter is that our executives most definitely did not receive $38.7 million worth of Jefferies equity as compensation for fiscal year 2018." The changes and additional disclosures had the desired effect, and say-on-pay support was back up to more than 85 percent this year.

Another large one-time equity award accounted for most of the total compensation of Avaya CEO, James Chirico. Following the company's emergence from bankruptcy, Chirico was awarded an "emergence equity award" that made up most of the total $22.1 million reported in stock awards. These emergence equity awards were made because all existing unvested equity awards from before the bankruptcy were cancelled.

Joseph Hogan, CEO of Align Technology, also received a large one-off equity grant, as the proxy says, with "the intent of retaining and incentivizing" him. The reported value of the stock award in 2018 was $36.8 million, which included a regular performance stock award and a special equity award. While the regular award is based on relative TSR, the special award is based on a combination of relative TSR and absolute stock price targets. The regular award has a maximum of 250 percent of target (up from 200 percent in 2017 and 150 percent in 2015), compared to a maximum of 300 percent for the special award.

While there are a number of highly paid CEOs in receipt of one-off awards, the majority of the top 25 highest paid are not much more highly paid than a substantial number of their peers and should not be considered outliers. For example, another five are paid between $30 million and $35 million, 18 between $25 million and $30 million, 50 between $20 million and $25 million, and 113 between $15 million and $20 million. See Exhibit 6, Exhibit 6-bis, and Exhibit 6-ter.

CEO Compensation Mix

In the S&P 500, the portion of CEO pay represented by stock awards exceeded 50 percent for the first time in 2018, while stock options, perks, and change in pension value continued their decline. For CEOs in the Russell 3000, stock awards now represent almost two-fifths of pay. Stock awards, which include restricted stock and performance share units and only vest upon the expiration of a certain time period or the accomplishment of measurable performance metrics, continue their rise to prominence in the median CEO compensation package.

In the S&P 500, stock awards*

*including restricted stock and performance-based shares

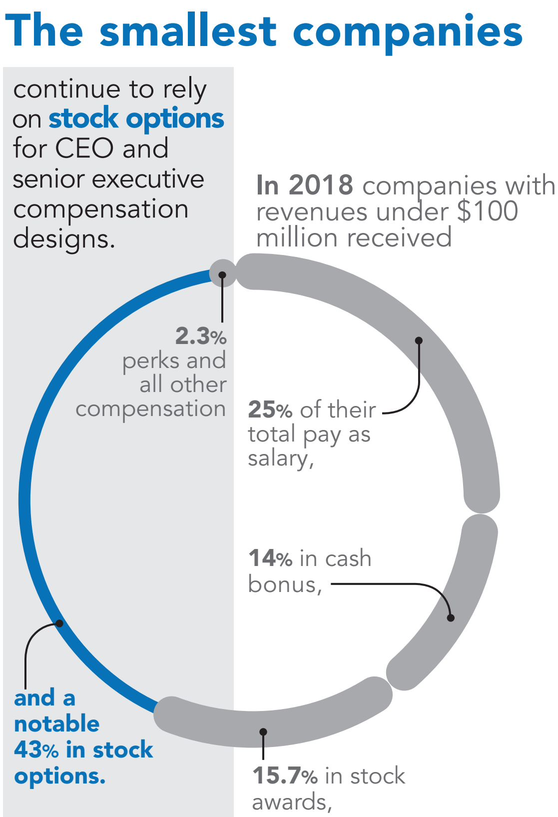
Source: The Conference Board, 2019.

As the compensation mix analysis shows, for CEOs in the S&P 500, stock awards represent 50.6 percent of pay in 2018, up from 48 percent in 2017 and from around a third in 2010. At 39.7 percent of pay for Russell 3000 CEOs, the proportion of pay as stock awards is also rising, up from 36.4 percent in 2017 and from 22.9 percent in 2010. In addition, for both groups, the weight of perks and change in pension value was reduced. While "perquisites and all other compensation" fell below 3 percent of pay for S&P 500 CEOs for the first time in 2018, they still constitute 3.2 percent for CEOs in the Russell 3000 (a slightly lower figure than what was recorded for that index in 2017). See Figures 1.3 and 1.4.

Stock options, although down from the 2010 figures, have stayed at or around 13 percent for the last three years in both the S&P 500 and the Russell 3000. Base salary and bonus have also remained relatively constant proportions of pay, with salary down by less than a percentage point from 2017 and 2018. Annual bonuses were down, again by less than a percentage point, for Russell 3000 CEOs, but showed a very slight uptick in the S&P 500. Compared to 2010, however, salary in 2018 was about 10 percentage points lower in the Russell 3000 and around five percentage points lower in the S&P 500, at 22.2 percent and 10.6 percent, respectively. See Figure 1.4.

By industry, the compensation mix tends to resemble that of the Russell 3000 index as a whole, with notable exceptions represented by the even greater rise of equity awards in Information Technology, Energy, and Real Estate and the continued use of stock options by rising biotechnology companies included in the Health Care sector. The exceptions are Energy CEOs, with 51.7 percent of pay in the form of stock awards and only 4.8 percent in stock options. As seen in the past, the practice of rewarding executives through stock awards is particularly pronounced in industries that have traditionally relied on equity-based pay. Information Technology CEOs had an ever-larger share of their compensation package (53.1 percent) composed of equity, a figure surpassed only in the Real Estate sector (54.6 percent of total pay in stock awards and less than 2 percent in stock options). For Financials CEOs, stock options are a small portion of pay (3.8 percent), but the slack is taken up with base salary, at almost 31 percent. In contrast, at Health Care companies, almost two-fifths of pay for CEOs in 2018 is represented by stock options, more than stock awards—at one-quarter of total pay. See Figure 1.5.

While perks and benefits comprise 7.6 percent of the total pay value of CEOs at the largest companies by annual revenue, they are almost absent in the CEO compensation structure of smaller businesses. Interestingly, the opposite is true in the asset-value analysis of financial services firms, where the smallest company CEOs receive almost 11 percent of their total compensation in the form of perquisites. Aside from disparities in perks and all other compensation, pay types are fairly consistent across all but the smallest company size groups: The share of stock options ranges between 3 percent (found among companies in the $1 billion to $9.9 billion and $10 billion to $24.9 billion brackets) and 14 percent (companies with annual revenue between $10 billion and $24.9 billion). Stock awards never drop below 25 percent for companies with assets valued between $1 billion and $9.9 billion and can be as high as 52 percent of the total CEO pay package (companies with revenues between $5 billion and $9.9 billion); cash bonus ranges from 19.4 percent (in the $100 million to $999 million revenue bracket) to 31 percent (in the $50 billion to $99 billion asset value group); and base salary fluctuates from 9 percent (in the $25 billion to $49.9 billion revenue group) to 38.4 percent (financial companies with asset value between $1 billion and $9.9 billion). As seen in prior years, the exceptions are the smallest companies, which continue to rely on stock options in the design of their CEOs, and senior executives' compensation design. In particular, in 2018, those with revenues under $100 million received a quarter of their total pay as salary, 14 percent in cash bonus, 15.7 percent in stock awards, and a notable 43 percent in stock options. For these smaller companies, stock options are more practical to use than performance shares as it may be difficult for organizations to conduct the type of financial result forecasting that performance shares require. See Figure 1.6.



Source: The Conference Board, 2019.

Individual CEO Compensation Components

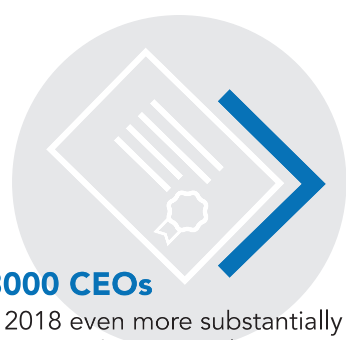
Base CEO salary grew in 2018 at a higher rate than the salary growth rate for the median US employee. Median CEO base salary in the S&P and Russell 3000 grew in 2018 by 4.5 percent and 4.3 percent, respectively—a rate that is higher than the 2.9 percent recorded for both indexes in 2017. Growth over the last eight years, however, confirms the differential reported in the past between indexes, with Russell 3000 CEOs seeing salary growth of 21.7 percent in the period, compared to 16.2 percent in the S&P 500. In contrast, for the median US employee, The Conference Board reported an actual total salary increase of 3 percent in 2018, the same percentage seen in each of the prior seven years.[8]

8 Judit Torok, *U.S. Salary Increase Budgets for 2019*, Research Report No. 1666, The Conference Board, July 2018.

By industry, salaries grew the most for CEOs in Energy (7.3 percent), Information Technology (6.8 percent), and Consumer Discretionary and Financials (both 5.5 percent). In general, salary rises were higher in 2018 for smaller companies, by both annual revenue and asset value, with exceptions: CEO salaries in midsize companies in both analyses ($10 billion to $24.9 billion in assets and $5 billion to $9.9 billion in revenue) were either frozen or declined, while for CEOs of companies with $10 billion to $24.9 billion in revenues, median base salary increased by 6.5 percent. Public and investor scrutiny on the largest pay packages and the widening spread observed over the years may help to explain why the growth rate of CEO compensation is higher among smaller firms. See Figures 1.10, 1.11 and 1.12.

Annual CEO bonuses were up again in 2018, but, unlike other elements of pay, they show wide variation across business sectors and revenue size groups. Median annual bonus grew by 11.2 percent for CEOs in the Russell 3000 and by 6.6 percent for those in the S&P 500. But annual bonuses for CEOs of Communications Services companies increased by 15.9 percent from the prior year, followed closely by bonuses for CEOs in Health Care (15.2 percent) and in both Industrials and Financials (up by just over 11.6 percent from the disclosed 2017 figures). In contrast, CEO bonuses in Consumer Staples fell by 29.6 percent and by 9.7 percent for chief executives in Utilities. Similar to last year's survey results, while bonuses grew more in the Russell 3000, CEOs of companies in the second-largest revenue bracket ($25 billion to $49.9 billion) saw a more substantial increase, at 17.4 percent. According to the asset-value analysis of financial-sector companies, bonuses for CEOs in the two smallest asset-value brackets (under $500 million and $500 million to $999 million) fell by 13.9 percent and 15.5 percent, respectively; whereas the CEOs of companies with assets between $10 billion and $24.9 billion and $25 billion and $49.9 billion went up by 18.3 percent and 10.2 percent, respectively. See Figures 1.13, 1.14 and 1.15.

Stock awards for Russell 3000 CEOs grew in value in 2018 even more substantially than annual bonuses, at a rate that is almost twice as high as in the S&P 500. This trend is driven by smaller companies and the Health Care sector. In 2018, the value of stock awards in CEO compensation packages grew at the median by 19.9 percent in the Russell 3000 and by 11.7 percent in the S&P 500, both slightly higher increases than were seen in 2017. In the Health Care business sector, in particular, stock awards enjoyed a strong growth rate in 2018 (90.1 percent), compounding the 111 percent and 155 percent seen in 2017 and 2016, respectively.



Stock awards
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19.9% and **11.7%**,
respectively—
a trend driven by smaller companies and the Health Care sector.

Source: The Conference Board, 2019.

Although partially offset by the decline of base salary as a percentage of the package value, the rise of stock awards contributed to the overall increase in total CEO compensation in the Health Care sector, as shown in Figure 1.8. Other sectors that saw significant growth were Communications Services, Consumer Discretionary, Industrials, and Information Technology—all with increases of around 30 percent. Only CEOs in Materials experienced a decline in the median value of their stock awards. Additional insights result from a company size analysis, as the lowest increases in stock award value are found in the largest size groups: 4.8 percent for CEOs of companies with revenue of $50 billion or higher and 4.3 percent for those of companies with asset valued at $100 billion and over. Instead, the smaller asset sizes (under $500 million and $500 million to $999 million) reported stock award value increases of 102 percent and 177 percent, respectively. The competition for leadership talent, which has recently intensified in certain sectors and among smaller organizations, may help to explain these findings.[9] See Figures 1.16, 1.17 and 1.18.

Contrasting a trend observed across industries and most size groups, the largest companies in the Russell 3000 continue to include generous amounts of perks and benefits in their CEO compensation packages. In five of the 11 business sectors examined for the purpose of this report, the value of perks and other benefits fell; the decline was by double digits in Utilities and Communications Services. None experienced significant growth. The company size analysis, however, shows that the largest companies by revenue ($50 billion and over) were the only group reporting a significant perk value growth (up by 33.6 percent from the disclosed 2017 value). See Figures 1.25, 1.26 and 1.27.

9 *The State of Innovative Leaders Report 2018*, Id.

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