

Association of Executive Search Consultants

Executive Compensation: What Lies Ahead?

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What Lies Ahead?

- Continued and ongoing criticism of executive pay
- Impact of data availability on expectations
- Cost-of-living differences
- Regulations, disclosure, and accounting
- Compensation elements
- Executive search implications

Executive Pay – Endless Follow the Leader?

- Modern fables: executive compensation increases because every company wants to be above the median
 - Lake Wobegon effect. Boards made up of cronies...
 - Little relation between what companies say they do and reality
 - Public boards take their jobs seriously
- Religious debates of executive pay rarely helpful
 - Market levels dominate
 - Clients (and candidates) have to face the market
- Growing criticism and focus makes it more difficult to close contracts/agreements
 - Recognize excessive/silly agreements out in the marketplace
 - Arrangements becoming more rational

Impact of Data on Candidate Expectations

- Online resources for cash compensation
- Company compensation philosophy
- Management equity awards
- Executive contracts and severance
- Management perquisites
- Stock price history
- Bonus payouts and terms
- Retirement and benefit plans
- Compensation peer groups

Cost-of-Living Differences

- National market for executive pay beginning to crumble due to big differences in cost-of-living
 - Growing issue for first time in many years
 - Housing, taxes, private schools, entertainment, etc.
- Dallas → Boston
 - Almost impossible on economics unless major promotion
 - Dallas – no income tax – 4 BR – 3,000 SF - \$500k
 - Boston – home of John Kerry
- New York → Atlanta
 - Flat lateral can produce much higher living standard

Regulations, Disclosure, and Accounting

- 409(A) deferred compensation regulation
 - Limits flexibility in structuring deferred compensation and severance provisions
 - Excites consultants and lawyers – thankfully little real impact
- Upcoming proxy disclosure (draft)
 - SEC finally updating compensation disclosure
 - More inclusive to include equity awards and retirement to arrive at single larger figure
 - Probable 2007 sticker shock
- FAS 123(R) – Accounting charge for stock options
 - Significant charge for stock options – no more “free lunch”
 - Buyouts of existing awards more expensive and alters dynamic
 - Much greater use of restricted stock vis-à-vis stock options

Compensation Elements

- Base salary ↑
- Bonus ↑
- Restricted Stock ↑
- Agreements/Normal Severance ↑
- Stock Options ↓
- Pensions ↓
- Perquisites ↓
- Formal Contracts/High Severance ↓

∴ Environment in flux responding to different pressures

Executive Search Implications

- Boards more skeptical of executive compensation
 - May not accept or understand market situation
 - Contract/agreements more protracted
- Cost-of-Living differences becoming major issue
- Stock option charge impacts buyouts and awards
- New disclosure rules will create one-time sticker shock
- Search firms underinvested in managing compensation equation
 - Often don't understand likely full offer from client or candidates realistic expectations
 - Contrast commercial real estate, financial models part of standard offering
 - Over complicated executive compensation requires attention