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# Compensating Your Executives and Other Employees in Uncertain Times

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# Today's Agenda

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- ▶ Current Environment
- ▶ Market Data
- ▶ Base Salaries
- ▶ Short-Term Cash Incentives
- ▶ Equity Compensation
- ▶ Disclosure Considerations
- ▶ Questions

# Assessing the Current Environment

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- ▶ The ongoing global economic crisis has exposed long-festering criticisms of executive and equity compensation
- ▶ The stock market decline has eroded significant equity value, undermining effectiveness of many long-term incentive plans
- ▶ Compensation “excesses” are back in the spotlight
- ▶ Government intervention has created a climate of uncertainty
- ▶ Risk aversion predominates

# Challenges in the Current Environment

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- ▶ Ensuring equitable treatment of executives and employees
- ▶ Designing incentive compensation arrangements with little to no visibility into the future
- ▶ Dealing with equity compensation – past awards and going forward
- ▶ Meeting investor expectations to “hold the line”
- ▶ Responding to the wave of corporate governance and executive compensation reforms

## Using Market Data

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- ▶ Traditionally, survey data has been the source of core market information
- ▶ In recent years, self-constructed peer groups have taken a more prominent role
- ▶ The ongoing global economic crisis has altered the utility of historical market data
  - Compensation surveys are out-of-date
  - Peer group comparisons will be less useful because data unlikely to reflect impact of economic downturn
  - Stock market fluctuations have significantly eroded equity compensation values
- ▶ Consequently, using market data to drive and explain compensation decisions will be more problematic this year

# Using Market Data

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- ▶ Challenges in 2009 (and beyond)
  - The balance between survey data and self-constructed peer groups
  - Developing a “defensible” peer group
  - Considering other data
    - Base salary
    - Short-term (annual) incentive
    - Equity awards
  - Using other compensation tools
    - Tally sheets
    - Internal pay equity analyses
    - Wealth accumulation analyses

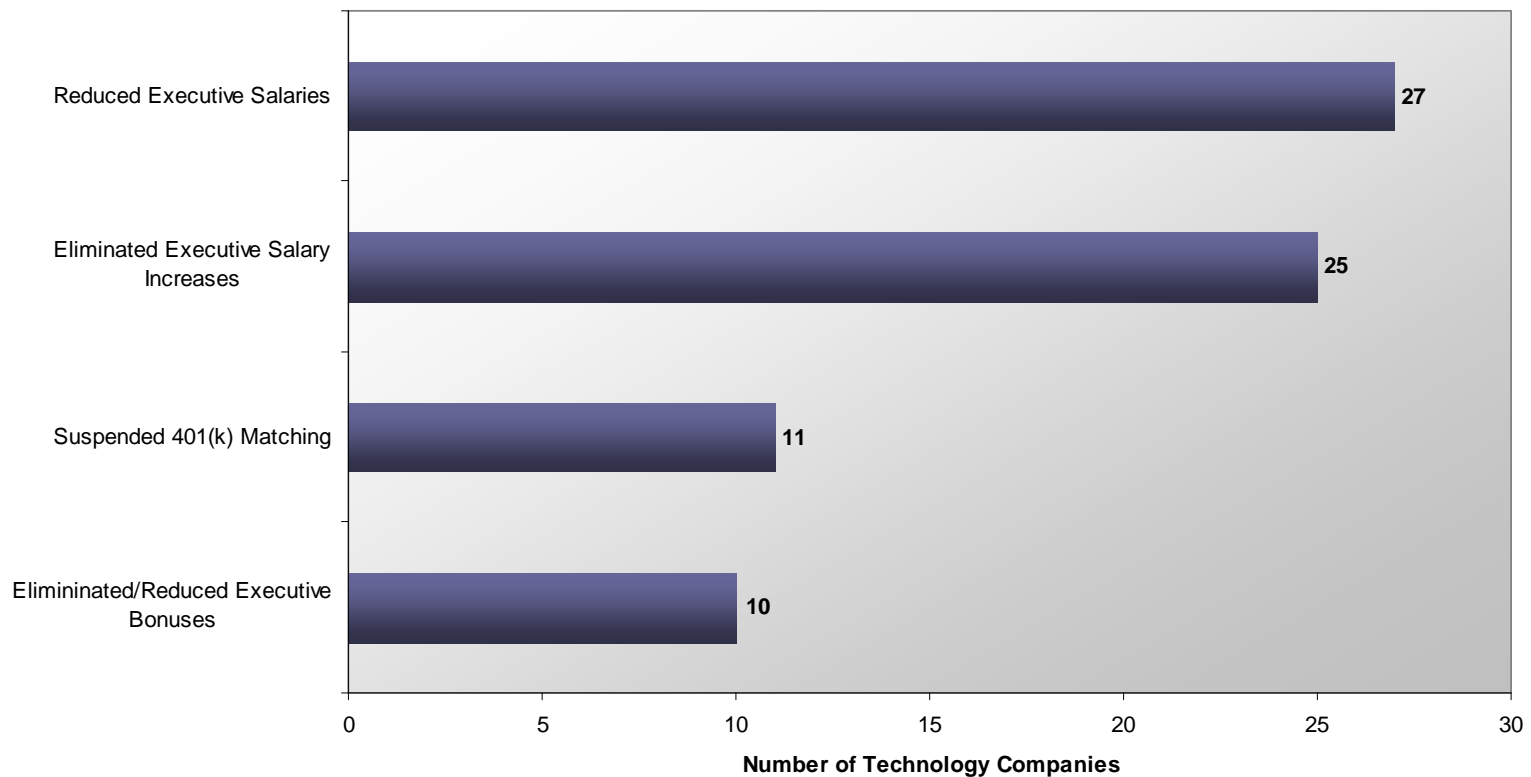
# Base Salaries

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- ▶ Traditionally, the primary “fixed” compensation component
  - Stable amount that is not at risk
- ▶ As a result of the ongoing global economic crisis, base salary levels are in flux
  - Need to conserve cash
  - Investor/public pressure
- ▶ Actions being considered and implemented
  - Salary freeze
  - Salary reduction
  - Reduced/delayed merit increases
- ▶ Scope of actions taken
  - Executive only
  - All employees
  - Directors too?

# Executive Cash Compensation Actions

**Eliminating salary increases is the most prevalent action that technology companies are making to executive cash compensation**



## Short-Term Cash Incentives

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- ▶ The primary annual “pay for performance” compensation component
- ▶ As a result of the ongoing global economic crisis, annual cash incentive arrangements are creating multiple challenges
- ▶ Addressing performance shortfalls in 2008
  - Reset performance targets
  - Lower payout thresholds
  - Extend performance period into current year
  - Increase discretionary cash component

# Short-Term Cash Incentives

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- ▶ Current trends for 2009 (and beyond)
  - Rethinking plan features
    - Selecting performance metrics and target levels
    - Calibrating metrics for an uncertain economy – relative vs. absolute performance
    - Setting performance periods
    - Planning for the possibility of performance shortfalls
  - Grappling with the \$1 million deduction cap – Section 162(m)
    - The stakes
    - The “performance-based compensation” exception
  - Discretionary plans - a viable alternative?
    - Using objective criteria within a subjective framework

# Equity Compensation

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- ▶ The primary long-term “pay for performance” compensation component
- ▶ In spite of the ongoing global economic crisis, equity compensation is still driving executive compensation packages
  - The “value creation” equation hasn’t changed
  - But the challenge in effectively aligning the interests of management and stakeholders has never been greater
- ▶ Potential pitfalls abound
  - Setting (or adjusting) the award mix
  - Rethinking stock options
  - Setting target levels in a volatile economy
  - Rewarding individual performance in a down market

# Equity Compensation

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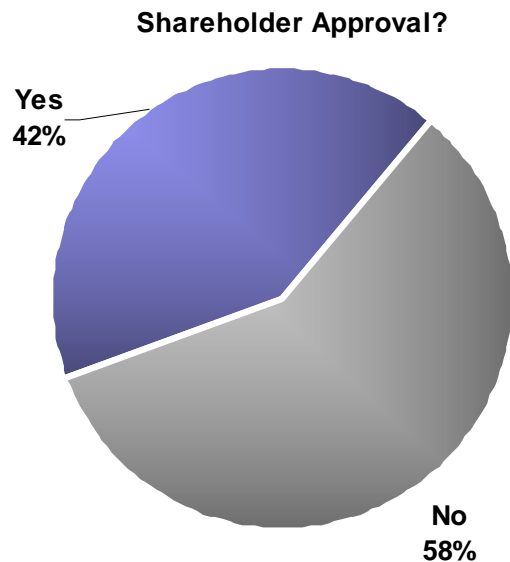
- ▶ Current trends for 2009 (and beyond)
  - Determining the “right” equity award value
  - Dealing with constraints
  - Determining the “right” equity award mix and specific award types
    - Are stock options the problem or the solution?
    - Are PSUs now a non-starter?
    - Will the use of RSUs begin to slow?
  - Grappling with the \$1 million deduction cap – Section 162(m)

# Equity Compensation

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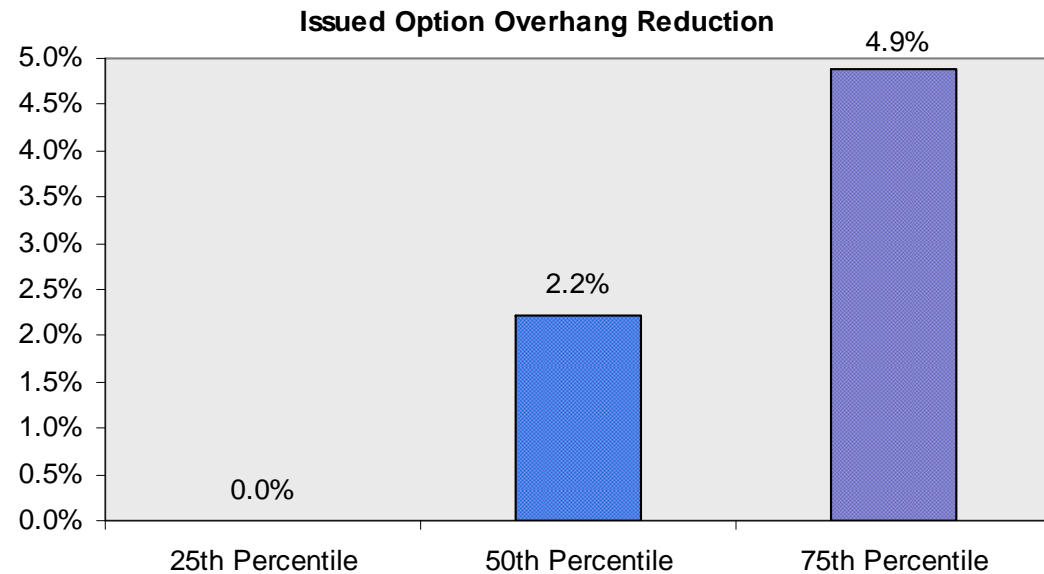
- ▶ Burn rate and dilution considerations
  - Increased pressure to manage burn rates in 2009
  - Challenges in meeting RiskMetrics' SVT model
  - Shortfalls in share reserve may make it difficult to meet award level objectives
  - Improving your “overhang” profile
    - The return of stock option repricings
    - The tolerable alternative – the option “exchange”

# Equity Compensation



## Summary of option exchanges since June 2008

- Shareholder approval more prevalent
- Issued overhang reduction has increased



# Disclosure Considerations

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- ▶ 2009 disclosure will differ significantly from previous years
- ▶ Impact of ongoing global economic crisis on prior year's compensation decisions
  - Base salary reductions or freezes
  - Short-term incentive compensation arrangements
    - Adjustment to performance metrics
    - Discretionary awards
  - Long-term incentive compensation arrangements
    - Adjustment to equity award practices
    - Adjustment to award form/size
    - Explaining option exchanges
- ▶ Impact of ongoing global economic crisis on current year's compensation practices

# Questions

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Questions

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