

## Executive Compensation: Being Prepared For Today's Lightning Rod

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May 2007

**Companies would be well advised, if they have not done so already, to have an integrated communications plan to deal with the questions that may arise from the compensation disclosures in their 2007 proxies.**

The SEC's new rules, calling for full disclosure and transparency of the compensation for the company's top executives, may result in tough questions from investors, the media and employees. The rules come at a time when public scrutiny of executive compensation is the subject of critical coverage in newspapers, magazines and on network business news programs.

The Commission's intent was to provide companies an opportunity to communicate in plain English the governance climate at their companies by describing in the Compensation Discussion and Analysis (CD&A) the philosophy and practice of compensating their executives. SEC Chairman Chris Cox told a recent corporate governance summit at the USC Marshall School of Business, "...now that the proxy season is well under way, and we've reviewed the first of this year's crop, alarm bells are ringing. Already we're seeing examples of over-lawyering that are leading to 30- and 40-page long executive compensation sections in proxy statements." Chairman Cox expressed his concern that the lawyers are using "their second language of Legalese" and the CD&A could be headed the way of the MD&A.

In crafting the explanations of compensation philosophy along with the goals and targets of the top executives, the SEC gave companies significant latitude in how they did this. Analysis of some of the early filings is revealing that, particularly where targets are concerned, companies are obscuring these out of concern over communicating competitive intelligence. Some are doing the same with respect to the true drivers of their shareholder value. This is most unfortunate and does not fulfill a company's obligation to explain – in plain English – what's behind their executive compensation practices. And, when there's a miss-match between total compensation and performance, companies dig that hole even deeper.

In these instances, companies may have more explaining to do to, particularly to their investors. The media seem focused on the total compensation number and employees on the same plus the disclosure of perks. With respect to the latter, boards are already severely limiting perquisites or eliminating them completely.

Some major pension funds, particularly union funds, are creating Web sites displaying their version of total compensation for top corporate executives. (In the compensation table where the components result in total compensation, the SEC does not include all stock options and grants.) Even small-cap companies, that may fly below the radarscope of these funds and the media, may well face questions from their investors and employees. Regardless of company size, the media is fond today of computing the ratio between the CEO's total compensation and the average annual salary of employees. At Wal-Mart, for example, it was recently reported that ratio is 1,000:1.

So, what should companies do to be prepared for questions, primarily from investors, the media and employees?

1. Develop an integrated communications plan that uses messaging that addresses all audiences – not separate messages for investors, the media and employees.
  - a. Remember that the CD&A is company disclosure and reflects the views of the compensation committee as to the company's philosophy and how compensation decisions fit into the company's overall compensation objectives. Talk with the chairman of the compensation committee to get that person's views to assist in preparing your messaging and responses to queries.
  - b. Examine the compensation disclosures, particularly those pertaining to the CEO, and develop a list of the toughest questions that could be asked and draft answers to those questions. Review these with the general counsel. But insist on plain English answers. This could be the most important part of preparing your plan.
  - c. In drafting your responses, once again think of your various audiences but keep your messaging consistent across all.
  - d. Avoid getting into an apples-to-oranges comparison with those who compute their own version of total compensation. Use only the components the rule requires for total compensation.

**e.** If the compensation disclosure creates the impression that there is an inconsistency between total compensation and the company's stock price performance, you need to be prepared to respond to that. The explanation may be what the CEO accomplished under difficult company and/or industry conditions, which should be discussed in the CD&A.

**f.** You may want to bring in outside communications/IR counsel to advise you in developing your plan and provide someone to role-play a tough investor, reporter or employee so your spokesperson is better prepared to handle the real thing.

2. Remember that the board's reputation is strongly connected to how it compensates the senior executives. How you respond to compensation inquiries can have a direct impact on the board of directors. With a growing number of companies adopting majority voting for directors, along with significant proxy rule changes pending SEC approval for 2008, it may be more difficult in the future for directors to achieve a majority vote. In the meantime, it is clear that boards will be held increasingly more accountable for their executive compensation decisions.

3. If you are not a calendar-year company and will be filing your proxy later this year, you have an opportunity to learn from the lessons some companies have experienced thus far in the 2007 proxy season. And, I expect the SEC will come out with additional guidance for preparing the CD&A once the staff has reviewed the disclosures this year's calendar-year companies.

### **About Genesis**

Genesis is a business consultancy that helps clients discover their unique points of difference and leverage them to achieve measurable business results. Genesis also provides strategic investor relations and integrated communication services. Our 360-degree view of the communication disciplines is based on our belief that communication is a strategic function when it supports corporate business goals, is integrated to combine cumulative impact with the most efficient use of resources and its effectiveness can be measured.