



Don Delves, The Delves Group
Warren Batts, University of Chicago Booth School of Business

It's Time to Hit the Re-Set Button on Executive Stock Compensation

Many companies have lost half or more of their market capitalization. The stock market has hit the proverbial “re-set” button, establishing new baseline values that capitalize a new market reality. Since the vast bulk of compensation for CEOs and other top executives is paid in the form of stock and options, it is also time to hit the re-set button on executive pay.

A little history: Back in 1993, stock options represented over 90% of stock compensation and accounted for about 5% of the outstanding stock of the typical company. Then, from 1994 to 2002, stock option grants to CEOs increased by 400% to 600%. By 2000, stock compensation – still over 90% options – accounted for 12% - 15% of the outstanding shares of the typical company. While some of this dramatic increase was market driven, some was the result of an irrational exuberance in executive pay that mimicked the irrational exuberance of the stock market.

When the bubble burst in the stock market, there was no equivalent drop in executive pay levels. While executive pay leveled off and returned to normal growth rates, stock compensation never went down in terms of the value granted to executives. The full 1990s run-up in executive pay became permanent, even though the stock market rise was not. While the stock bubble burst, no air has seeped from the pay balloon.

How does this work? Competitive long-term incentive grant values come from compensation surveys, which value the options and shares that are granted to executives. Those values are based on stock prices before the most recent market crash. In order to make new grants with equivalent values, it could easily take twice as many shares as it did a year ago. This calculation means twice the percentage of outstanding stock and twice the dilution to shareholders. We have to ask every independent board member seriously whether this mindless calculation is the right thing to do. If shareholders have taken a major hit in the value of their holdings, shouldn't executives also receive stock compensation that has a similarly reduced value?

We are not advocating that companies grant fewer shares and options, only that they not increase the number of shares and options granted because the stock price has fallen. To be clear, we are advocating that companies maintain recent grant levels, in terms of the number of

shares granted. This approach will result in much lower prospective grant values, which will look like executives are being paid below market levels. But since the market data will be based on pre-crash stock prices, even the prospective values have to be taken with a large grain of salt, a dash of good reason, and some seasoned wisdom.

These grants will return senior executives to the lofty compensation values they knew just last year – once they restore the market capitalization of their companies. This combination of values is the only way incentives ever have worked – exceptional rewards for almost impossible outcomes. Shareholders deserve no less.

Don Delves is the founder and president of The Delves Group in Chicago. Warren Batts is the former CEO of Premark, current and past member of many corporate boards and adjunct professor of corporate governance at the University of Chicago Booth School of Business.

Copyright © 2009 Directors & Boards, P.O. Box 41966
Philadelphia, PA 19101-1966. All rights reserved. Contact the [webmaster](#).
< [Privacy Notice](#) >