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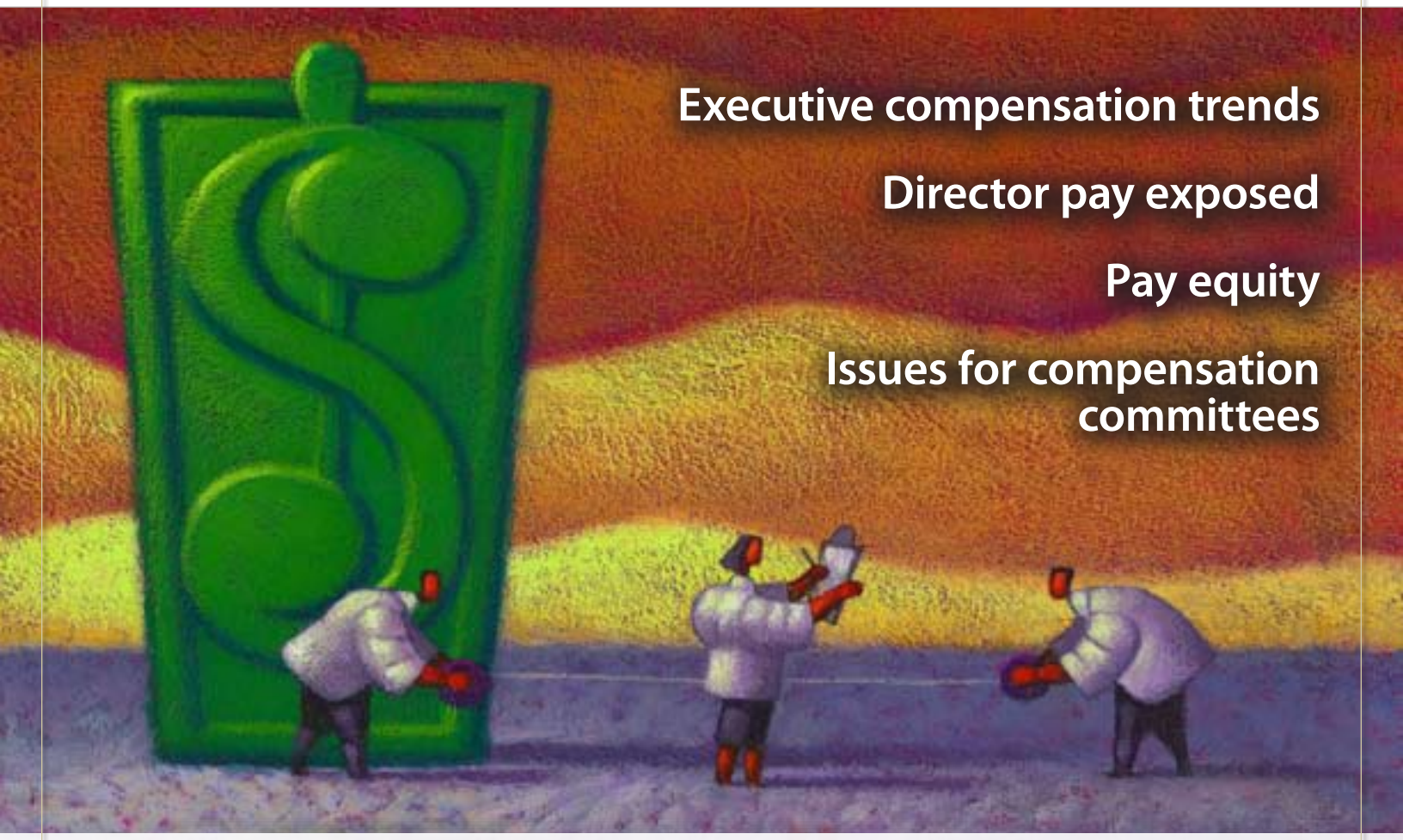
Executive and Director Compensation



Executive compensation trends

Director pay exposed

Pay equity

Issues for compensation committees

Exclusive new research on director and executive compensation

High Technology Board Compensation

By Ed Speidel and Rob Surdel

Trends and practices in an evolving boards landscape.

Ed Speidel

Rob Surdel

Board membership and participation has grown increasingly demanding, a shift that is making its presence known in both how boards conduct their responsibilities and how members are compensated. Directors sit on an average 2.5 boards, continuing a downward trend seen over recent years and reinforcing the reality that board membership is simply a more demanding job today than it was five years ago. In 2005, directors spent more than 200 hours fulfilling board-related duties, up from between 100 to 150 hours pre-Sarbanes-Oxley, according to the National Association of Corporate Directors. Multiplied by the 2.5 boards that directors typically serve, the typical director is spending about three months a year working on board-related issues.

The article examines governance best practices, and current trends in outside director compensation, based on our analysis of publicly filed data from approximately 520 High-technology companies, representing a broad cross-section of the industry subsectors and company size.

Emerging best practices

At the median, high-tech companies have an average of eight directors, six of which are independent, compared to nearly 11 members on an average S&P 500 board (Spencer Stuart, SSBI, 2007). Further, there are typically three members in each of three committees: audit, compensation and nominating/governance, meaning directors typically serve on two or more committees.

Lead director vs. presiding directors

One of the ways boards have responded to increased demands for tighter governance standards is to more clearly define and articulate leadership responsibilities. In previous years, we've seen an increased importance of the independent, non-executive chair role. Although the use of a non-executive chairman is an important aspect of board composition, the increased use of lead directors and presiding directors is the relevant trend. Most S&P companies, for example, now have either a Lead Director (30%) or Presiding Director (64%). Technology company boards have been notably slower in creating such a role; however, greater than 50% currently have either a Lead or Presiding Director, and we expect that trend will continue as more companies move to increase the independence of the Board. The advantages of such a role have become clear. Both Lead and Presiding Directors:

- Serve as an ongoing point of contact for directors, thereby enhancing the board's independence from management
- Drive agendas and evaluate results of the board
- Convene and chair executive sessions for Independent Directors
- Fill in gaps during organizational transitions, such as a CEO departure.

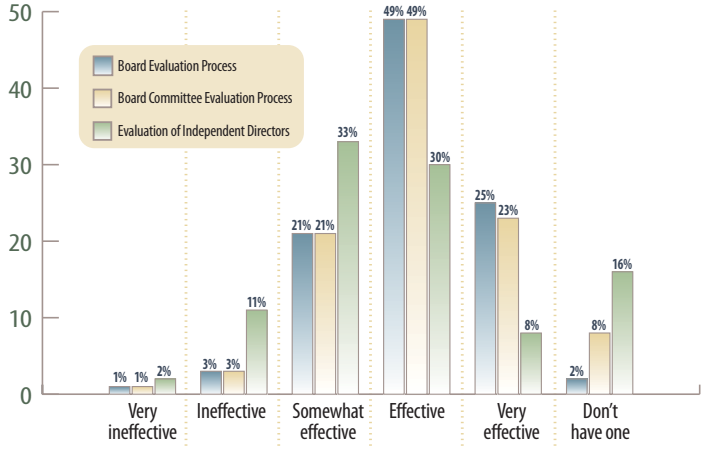
A minority of high-tech companies, 23%, have ownership guidelines in place, with the practice being more prevalent at larger companies than at smaller ones. The picture is similarly mixed with vesting practices. Most companies align director vesting schedules to those of the company's executives.

Boards are growing more disciplined and sophisticated in how they monitor, evaluate and communicate director performance. Whereas at the turn of the century performance management was virtually unheard of at the board level, today boards are increasingly evaluating directors both at the overall and committee levels.

Heidrick & Struggles, in its 2006-2007 Corporate Board Effectiveness Study, polled directors for their perspectives on evaluation effectiveness. Interestingly, about 75% of directors believed that the evaluation processes for the board as a whole and for committees was effective or very effective, while fewer than half (48%) viewed the processes for individual

director evaluation as similarly effective. Moreover, the overall "somewhat effective" to "very ineffective" figures were surprisingly high. We believe this reflects the relative novelty of the practice; directors have had to learn how to evaluate one another, and how to communicate productive feedback. Further, we expect that boards will increasingly look to outside parties to conduct the performance evaluation and feedback process in order to obtain more candid feedback.

Board Self-Rating of Their Company's Evaluations

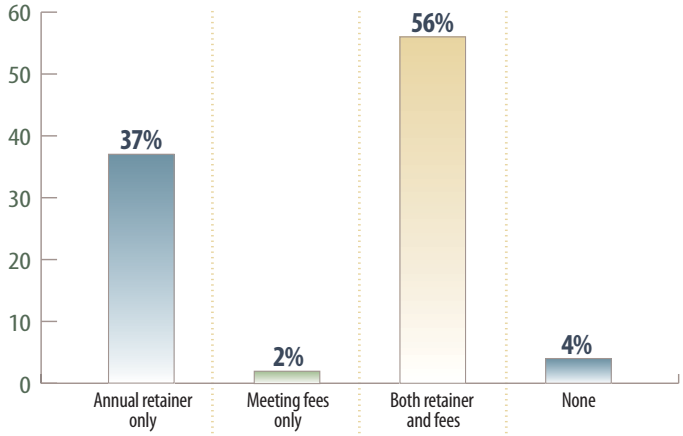


Source: Heidrick & Struggles, 2006-2007 Corporate Board Effectiveness Study

Board compensation trends

Our board compensation trend study analyzed board member compensation, board leadership compensation premiums, committee member compensation, committee leadership compensation premiums, initial appointment mandatory equity awards, ongoing annual equity awards, total retainers and fees, total direct compensation, and aggregate compensation.

Board Member Compensation Delivery (n=519)



Source: Radford analysis of proxy data.

Continuing a trend we saw in a similar study a year ago, high-technology boards are changing the way they think about director cash compensation, shifting from a traditional activity-based pay (meeting fees) toward role-based pay (retainers). As the days when director responsibilities are executed within the confines of a meeting rapidly fade, role-base pay is rising in prevalence.

A majority (56%) of high-tech companies provides a mix of retainer and fees; however, most of the total compensation is delivered through retainers. At the median, board members receive $30,000 in retainers and $1,500 in meeting fees.

Moreover, there is significant variation in high-tech board pay based on company size, and in some cases, based on industry sub-sector (e.g., telecommunications, networking/storage, semiconductor).

Method of Compensation	All High-Technology			
	25th Percentile	50th Percentile	75th Percentile	n=
Retainer	$20,000	$30,000	$40,000	484
Meeting Fees	$1,000	$1,500	$2,000	303

Source: Radford analysis of proxy data.

Board leadership compensation

As discussed above, board leadership has been undergoing transition over the past couple of years. Almost three-quarters of technology company boards are now headed by either a Lead Director or non-employee Chair.

Compensation at this level is notably different, depending on whether the board leadership is an Independent Chairman or an Independent Director. For example, high-tech company Independent Chairs receive a 2.0x premium on the board member retainer, at the median, in recognition of their role. ($60,000 vs $30,000) By contrast Lead Directors receive, at the median, a 1.4x premium, or $42,000, although it is much less prevalent practice (40% of companies). In either case, companies are more likely to provide a premium in the form of a retainer, rather than a meeting fee.

Committee member compensation

The majority (85-90%) of technology companies pay some form of additional compensation for committee membership. Most typically, if there is additional compensation for membership in one committee, there is additional compensation for all committees; however, audit committee members are the more likely to receive additional compensation.

Retainer Premiums

	Technology		Life Science	
Percent of companies with an Independent Chairman that provide member retainers	70%	n=178	78%	n=124
Median Independent Chairman Premium as a multiple of member retainer	2.0x	n=124	2.0x	n=97
Percent of companies with a Lead Independent Director that provide member retainers	40%	n=189	39%	n=62
Median Lead Independent Director Premium as a multiple of member retainer	1.4x	n=76	1.5x	n=24

Meeting Fee Premiums

	Technology		Life Science	
Percent of companies with an Independent Chairman that provide member fees	8%	n=113	11%	n=87
Median Independent Chairman premium as a multiple of member fees	1.7x	n=9	1.8x	n=10
Percent of companies with a Lead Independent Director that provide member fees	0%	n=113	0%	n=40
Median Lead Independent Director premium as a multiple of member fees	NA	n=0	NA	n=0

Source: Radford analysis of proxy data.

	All High-Technology (Median)		
	Audit	Compensation	Nominating/Governance
Retainer	$7,000	$5,000	$5,000
Retainer n=	432	389	340
Meeting fees	$1,000	$1,000	$1,000
Meeting fees n=	278	263	253

Source: Radford analysis of proxy data.

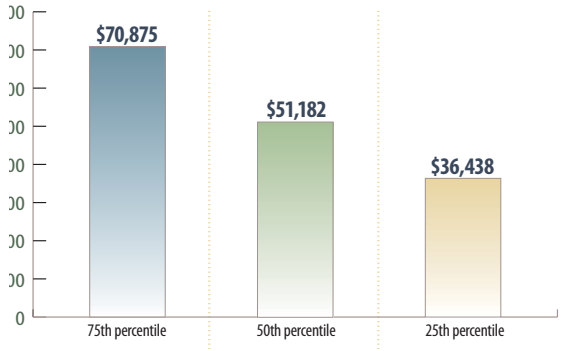
Similar pay differentiation is seen in committee chair compensation, with audit committee chairs receiving the highest pay. While nominating/governance and compensation committee members are paid roughly the same, there is more differentiation for the committee chairs, with compensation committee chairs receiving about 25% more than their nominating/governance counterparts.

Total cash compensation

Total cash compensation is a measure of all cash compensation delivered via retainers and/or fees during the year for both general board service and committee service. In high-tech firms last year, the median total cash compensation was $51,200 per director. However, the range from high to low, about 2.0x, was significant.

Total Cash Compensation (n=519)

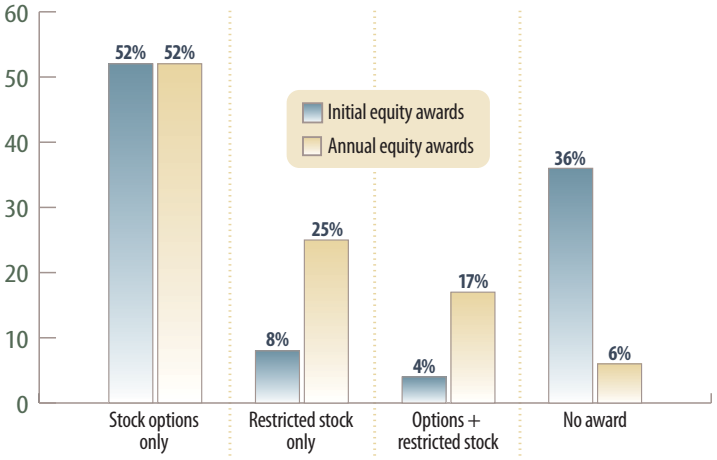
Source: Radford analysis of proxy data.



Equity, total direct compensation and aggregate cost

About two-thirds of all high-tech companies provide equity grants to new board members, and 94% provide annual grants. Stock options have long been the favored vehicle for delivering equity compensation, and that continues to be the case, particularly with respect to initial equity grants.

Equity Award Vehicle (n=519)



Source: Radford analysis of proxy data.

However, technology companies have begun to adopt the use of full-value shares for annual grants. About 40% of high-technology companies use some form of restricted stock (restricted stock only, or in combination with stock options).

The value of initial equity grants to directors last year was $140,000 at the median and was $79,000 for annual grants. Only about one-quarter of companies provide additional equity compensation for non-employee board Chairs, for a median additional value of $65,000. Fewer companies

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still (about 7%) provide additional equity compensation to Lead Directors, for a median additional value of $30,000.

Total direct compensation is a measure of all cash compensation (retainers and fees), plus all annual equity compensation for the past fiscal year. Median total direct compensation was $140,600 last year for high-tech company board members, compared to $211,200 in total direct compensation for S&P board members.

Increasingly, companies and investors are looking at the aggregate cost of director compensation relative to revenue, market cap and other key metrics. In our analysis, the range of aggregate board costs was quite high—more than 2x—and the median aggregate cost was $933,535. This represented 0.20% of last fiscal year revenue and 0.08% of last fiscal year end market cap. We expect companies to draw comparison of their aggregate board cost to their peers in the future as another benchmark to determine program reasonableness.

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executives at 500 of America's largest public corporations. This tool also permits comparisons of compensation between different companies. The information can be located and reviewed quickly with a few computer clicks rather than wading through pages of proxies. In this information age, where the availability of information spawns new movements and energizes others, some reflection may be in order over how the increased attention on executive compensation from Washington may affect public companies and their compensation packages.

The SEC's launch of this online tool is just part of the current 'open season' on executive compensation. Other events in this season are the SEC staff's extensive review and comments on disclosures made in the Compensation Discussions and Analysis segments in proxies, and Congressman Waxman's congressional inquiry on compensation consultants and their impact on executive compensation. All of these activities should be viewed as part of the movement in today's society against large compensation packages for corporate executives.

Perhaps free agency in professional sports is a simple and helpful analogy for defending large executive compensation packages in the public forum.

Decisions to center the spotlight on executive compensation are not driven by investment analysis needs. In Benjamin Graham's classic, *The Intelligent Investor*, the topic of executive compensation is not a material factor in analyzing a company for investment purposes. The SEC staff's pressure for better explanations of why and how various factors affected compensation decisions will not fill any significant void in material information desired by investors.

Washington's focus is about politics, as it almost always is. If so viewed, the Compensation Committee must be sensitive to the realities that compensation of executive officers will receive close scrutiny and may have to be persuasively defended in the public forum. Whenever a large severance package for a CEO is announced, there is an outburst of adverse publicity and criticism.

Perhaps free agency in professional sports is a simple and helpful analogy for defending large executive compensation packages in the public forum. Certain professional athletes command significant compensation for their talents because their past performances have demonstrated an ability to excel and there is competing interest for their skills. Particular executives too can command substantial compensation for the same reasons as successful athletes.

Terrence Ahern, a partner with the law firm of Stinson Morrison Hecker LLP, has more than 30 years experience advising businesses regarding the establishment, operation and termination of employee benefit plans.