Trends in CEO and CFO Compensation at Small- and Mid-Sized Public Companies

Introduction

In the fall of 2015, Pearl Meyer studied compensation of Chief Executive and Chief Financial Officers at small- and medium-sized public companies. The study was conducted to highlight recent trends in pay practices and examine the relative size and mix of pay packages. Main Data Group, a leading provider of executive compensation benchmarking and corporate governance analytics, provided CEO and CFO data from public proxy filings for fiscal years 2013 and 2014.

Findings for Small-Sized Public Companies

296 companies with revenue between $500 million and $1 billion were included in the study. Median revenue in the study group was $742 million, and median market capitalization in the group on July 31, 2015 was $1.3 billion.

CEO Results

Out of 296 companies in the group, 277 employed the same CEO for both 2013 and 2014. Year-over-year compensation to these CEOs grew from $2.42 million to $2.85 million at median, and from $3.06 million to $3.36 million on average. This represents an 18% median increase, compared to gains of 4% in total shareholder return (TSR) over the same period.

The largest contributions to this increase came in the form of long-term incentive (LTI) awards, with median total cash compensation (defined as salary, annual discretionary bonus, and annual incentive) growing by 6% while LTI grew 21% at median. Meanwhile, average total cash fell slightly (-2%), driven by a 6% slump in average short-term incentive (STI) payouts. The prevalence of equity awards offered to CEOs also increased for each
award type, with the strongest gains made in time-vesting restricted stock (RS) and restricted stock units (RSUs). The median value of RS/RSU grants to CEOs in the group increased by 48% in 2014 compared to 2013, easily the strongest growth of any pay element studied.

The graphs below show the distribution of growth in STI and LTI value to CEOs in 2014 over 2013.

Despite very robust growth in total direct compensation (TDC) overall, gains in CEO pay in the group were not evenly distributed. 41% of CEOs in the group saw negative growth in short-term incentive value compared to 2013, with nearly a quarter seeing reductions of 25% or more. This seems to account for the downward shift in average total cash for CEOs in the group during 2014, even while 53% of CEOs actually saw STI payouts grow, and a healthy 22% of CEOs earned STI payouts at least 50% higher than in 2013.

Long-term awards, meanwhile, saw more consistent growth among the CEO population at small-sized companies, with 63% earning more in LTI than the previous year. 26% received less in LTI awards, with only 11% seeing a reduction of 25% or more. The mix of LTI elements granted to CEOs in the group also continued to evolve in 2014, with roughly two out of three companies granting at least two equity vehicles. The most common LTI mix consisted of restricted stock and performance awards, and boasted a 23% prevalence, up from 20% in 2013.

**CFO Results**

For the 258 companies in the group that retained the same CFO in 2013 and 2014, CFO total direct compensation rose by 9% during the period, from $0.98 million to $1.06 million at the median and $1.17 million to $1.30 million on average. TSR performance among these companies was 3.5% at median.

In contrast to CEOs in the group, rising CFO pay was driven by strong growth in both short- and long-term pay, with median STI and LTI values growing at 7% and 13% respectively.
CFOs saw the average value grow for every compensation element except stock options, which decreased in value by 4% on average alongside a corresponding downward slide in prevalence, from 45% in 2013 to 41% in 2014. This slight decrease in option award value was countered during the same period by a robust 28% increase in the value of performance-contingent awards, contributing to a further shift in favor of performance awards over options as a vehicle for delivering long-term value.

The distribution of growth in STI and LTI value to CFOs in 2014 over 2013 was similar to the distribution among the CEO population, with a wide disparity between growth and shrink in STI distribution, and more even-keeled growth in LTI. 40% of CFOs saw STI value decrease since 2013, with 54% receiving an increase. LTI value fell for 24% of CFOs in the group, while 67% saw an increase, and 28% saw an increase of at least 50% compared to 2013. Also consistent with CEO results, the most prevalent mix of LTI elements in the study group was restricted stock and performance-contingent grants. 28% of CFOs received this mix of award vehicles, representing a 4% increase in prevalence over 2013.

**Summary**

Total direct compensation (TDC) to both CEOs and CFOs increased in 2014 over 2013 levels. Long-term incentive compensation continued to grow on both a real and a relative basis, making up well over half of 2014 CEO total direct compensation in the group. The fixed-to-variable pay ratio for CFOs remained steady for 2014, while the ratio for CEOs shifted slightly in favor of fixed compensation. While average CEO and CFO salary levels grew steadily in 2014, salary as a share of total compensation fell slightly, with relative gains in time-vesting restricted stock contributing to the increased role of fixed pay in CEO pay packages.

While both top executive positions saw larger pay packages in 2014, growth in CEO pay continues to outpace growth in CFO pay, driven primarily by larger LTI awards and a more variable pay package generally. While variable pay makes up a very significant portion of TDC for both CEOs and CFOs, this share is larger for CEOs, representing 54% of total compared to 48% for CFOs. The larger pay mix disparity between these officers is between short-term and long-term awards. The average CEO's pay package is 58% long-term, compared to 50% for CFOs.

**Findings for Medium-Sized Public Companies**

A total of 302 companies compose the medium-size company study group, each with revenue between $1 billion and $2.5 billion. Median 2014 revenue in the group was $1.5 billion, with median market capitalization on July 31, 2015 of $2.4 billion.
CEO Results

292 companies in the mid-sized company group retained the same CEO for both 2013 and 2014. Median total direct compensation to these CEOs grew from $3.79 million to $4.37 million in 2014, an increase of 15%, while TDC on average grew 11%, from $4.44 million to $4.93 million. Median total shareholder return for the group was 6% for the same period.

Growth in long-term pay elements outpaced growth in total cash compensation, with LTI value up 18% at median compared to 9% growth in total cash compensation over 2013. This increase in the value and relative weighting of LTI awards was driven by growth in the value and prevalence of performance-contingent grants and time-vested restricted stock and RSUs, as companies continued to move away from stock option grants in 2014. Just 45% of the 292 CEOs in the group received a stock option grant in 2014, down from 51% in 2013, while the average value of option awards declined 16% over the period. The strongest growth observed for any pay element was the 34% average increase in LTI value to CEOs in the group, corresponding to a 50% increase in median value for the same award type.

The graphs below show the distribution of growth in STI and LTI value to CEOs in 2014 over 2013.

![Change in Annual Incentive Distribution](image1)

![Change in Long-Term Incentive Distribution](image2)

Despite growth in STI value on average, the year-over-year change in STI payouts to CEOs was not evenly distributed. While 57% of CEOs saw an increase in STI value in 2014, 36% saw a decrease, with 21% receiving payouts at least 25% reduced from 2013 levels. The larger percent increase in average LTI value in 2014 was driven by more even growth among CEOs in the group, with 68% of CEOs receiving an increase. Only 26% of CEOs received a smaller LTI package than in 2013, with 8% declining by more than 25% in 2014.

Changes in LTI pay mix to CEOs in 2014 also reflect changing practices, with fewer companies granting stock options and more relying on performance-based awards to deliver long-term value to executives. While many companies still grant stock options or a combination of options and other vehicles, prevalence slid downward for all combinations of
LTI vehicles that included stock options. The most common mix of LTI elements to CEOs in the group included time-vesting RS/RSUs and performance-based grants, with 29% of CEOs receiving this combination of award vehicles. This represents a significant increase in prevalence from the 2013 level, when 21% of CEOs received the same mix of elements.

CFO Results

Out of 302 companies in the group, 259 employed the same CFO for both 2013 and 2014. Year-over-year compensation to these CFOs grew from $1.32 million to $1.51 million at median, and from $1.58 million to $1.78 million on average. This represents a 15% median increase over 2013, consistent with growth in CEO compensation during the same period.

As with CEOs in the mid-sized group, rising total direct compensation to CFOs in 2014 was driven by increases in the prevalence and value of performance-contingent long-term awards and time-vesting restricted stock grants. The percentage of CFOs receiving an RS/RSU award jumped from 72% in 2013 to 78% in 2014, alongside a jump from 61% to 68% in the prevalence of performance-contingent grants. The value of these award vehicles also increased in 2014, with median value of RS/RSU awards up 30%, and the median value of performance-contingent awards up 40%. By contrast, the average value of option awards remained essentially flat, while the percentage of CFOs receiving an option grant declined from 49% to 46%.

The distribution of growth in STI and LTI value to CFOs in 2014 over 2013 was similar to the distribution among the CEO population. 34% of CFOs in the group saw their STI payouts decrease from 2013 levels, with 59% receiving an increase. LTI value fell for 29% of CFOs, while 66% saw an increase, and 21% saw an increase of at least 50% compared to 2013. Also consistent with CEO results, the most prevalent mix of LTI elements in the study group was restricted stock and performance-contingent grants. 29% of CFOs received this mix of award vehicles, representing a 7% rise in prevalence over 2013. The prevalence of the second-most common LTI award mix grew from 22% to 24% in 2014, representing grants of restricted stock, stock options, and performance-contingent awards.

Summary

Total direct compensation to both CEOs and CFOs in the group increased in 2014 over 2013 levels. Long-term compensation continued to grow on both a real and a relative basis, making up 61% of CEO and 52% of CFO total direct compensation in 2014. The fixed-to-variable pay ratio for CEOs and CFOs remained steady for 2014, at 36% to 64% for CEOs and 44% to 56% for CFOs. While average CEO and CFO salary levels grew steadily in 2014, salary as a share of total compensation fell slightly. Options made up a smaller
portion of total compensation to both top executive positions in 2014 than in 2013, with options accounting for 14% of CEO pay, down from 19%.

Compensation to both top executive positions increased at similar rates during 2014. While variable pay makes up a very significant portion of TDC for both CEOs and CFOs, this share is larger for CEOs, representing 64% of total compared to 56% for CFOs. Compensation to CEOs also relies more heavily on long-term compensation, with the average CEO’s pay package being 61% long-term, compared to 52% for CFOs.

About Main Data Group

Main Data Group is a provider of high-resolution executive compensation benchmarking and corporate governance analytics. Their mission is to empower executive compensation professionals by providing comprehensive total rewards and corporate governance information in an affordable, easy-to-use online service.

About Pearl Meyer

Pearl Meyer is the leading advisor to Boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer’s global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.