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The Crystal Report on Executive Compensation



Bye Bye, Shareownership Guidelines

by Graef Crystal

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The way I figure it, shareownership guidelines, one of the proudest accomplishments of the corporate governance priesthood, are about to bite the dust.

For quite a few years, company after company told their shareholders that top executives were no longer going to be free to, for example, exercise a stock option, immediately sell the shares and use the proceeds to diversify their portfolios.

On the contrary, these top executives were going to be required to hold that number of shares – real shares, mind you, not unexercised option shares – equal to, say, five times their base salary.

Some of those executives took these guidelines seriously and anteed up their own money to buy enough shares to move them past the minimum ownership limit.

But more sagacious executives figured that what the company took with one hand it would give with the other. In many cases, they were not disappointed. They suddenly started receiving much larger option grants and much larger free share grants, thereby making it relatively painless to meet whatever ownership requirements were set forth in the guidelines.

That was then. This is now, where “now” is a collapsing stock market.

Alternatives

I see three alternatives here.

The first is to enforce the guidelines. But that would mean someone going to the CEO and saying: “I have bad news and worse news. The bad news is that you aren’t getting any bonus this year.” “After that, what could be the worse news?”, asks the CEO. “You’re going to have to

take your own money and buy enough additional shares to get back on top of the shareownership guideline.

Cynic that I am, I don't see that happening.

The second possibility is for the company to materially increase its grant of equity awards – particularly free shares. If the shareownership guideline can't be fully achieved right away, the infusion of free shares will close a lot of the gap.

Practical person that I am, I don't see that happening either. In the midst of all the red ink and market carnage, how is a comp committee going to justify reporting substantially-higher pay for its CEO and other top executives?

That leaves the alternative that I figure will happen: The shareownership guidelines will be quietly dropped.

Think here about a company that has, in the past, come under the glare of suspicion for backdating or, if not backdating, at least massively opportunistic option grant timing. (Since this is merely an illustration, there is no need here to mention the name of the company.) An examination of the company's option grant dates over some 14 years showed no consistent pattern, thereby adding fuel to the fire.

Not long after criticism of this company, there then appeared in the next proxy statement an innocuous declaration to the effect that the company's policy is to make grants within the ten business-day period following the release of the annual earnings. And that is what the company has done in each succeeding year.

Nowhere in this bland disclosure is there any mention that this represented a fundamental sea change for the company.

And that, friends, is how a company that wants to scuttle its shareownership guidelines can quietly do so. Simply stop mentioning that you have them – oops, had them.

2009 marks GRAEF Crystal's 50th anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay. In the Spring of 2009, he will be teaching a course in executive compensation at the University of California at Berkeley's Boat School of Law.