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## Introduction and Summary

The stories about CEO pay we read in the press are all about excess, greed, outrageous perks, and pay for failure. But that doesn't mean that all CEOs get bonuses for nothing and commute between their four homes on the corporate jet. There are CEOs out there who get paid for success and who have compensation committees that actually do what most boards claim they are doing – set pay responsibly, set challenging performance targets, and provide the CEO with the same benefits that the whole workforce is getting.

To give credit where it is due, as we did in both 2006 and 2007, The Corporate Library has constructed a list of Pay for Success companies. This special study identifies those companies where the creation of long-term value and the moderate compensation of the CEOs responsible are clearly linked. Using criteria that generally echo those adopted for the earlier studies, The Corporate Library has identified a group of a dozen companies where the link between CEO pay and company performance appears both strong and justifiable. The criteria used to identify these companies were:

- The Corporate Library governance rating of moderate to low risk
- The Corporate Library CEO compensation rating showing moderate or low concern
- TSR (total stockholder return) over five years over 50 percent
- Performance vs. industry peers: Outperformed
- Performance vs. S&P 500: Outperformed
- CEO total compensation <\$30,000,000 over last two years
- Index: S&P 500
- Fortune rank: 1-500

Data was collected on October 20, 2009, from The Corporate Library's proprietary database, and reflects each company's most recent proxy statement. The companies identified are shown in *Table 1*, in alphabetical order. Interestingly, five of the companies identified – those highlighted in addition to two others (see full report) – have featured in prior Pay for Success reports (Pay for Success: The Compensation Committees Responsible, published in June 2006 and Pay for Success II, published in January 2008). This is the largest number of companies that has ever appeared more than once.

**Table 1: 2009 Pay for Success Companies**  
**(Source: The Corporate Library)**

AAPL	Apple Inc.
AZO	AutoZone, Inc.
DRI	Darden Restaurants, Inc.
HUM	Humana Inc.
NUE	Nucor Corporation

One of the companies making a repeat appearance, Nucor, was not only featured in our first Pay for Success report in 2006, but was written up in 2002 in the report: *A Compensation Policy Comparison – Nucor and Consecor*. Nucor was selected because it had the best compensation policy in the S&P 500 and was contrasted with the company that had the worst policy. As if the usefulness of an effective compensation policy needed any support, Consecor is now long since bankrupt, while Nucor has made a profit every single year since 1966, an extraordinary feat for a steel

company. Such continued effectiveness is a real tribute to both the company's management performance and the board's ability to reward it.

Another of the five companies that have appeared in prior Pay for Success reports – AutoZone – was in the 2006 report and only narrowly missed being included in 2007 because it had underperformed its peers by a marginal amount during the requisite five-year period. Had it not done so, it would have received the accolade of appearing in all three of our Pay for Success reports. Lists of all the companies that have appeared in the two earlier reports are given in *Tables 2* and *3*. Those that appear in the current report or have appeared in more than one report, such as Nordstrom, are highlighted.

**Table 2: 2007 Pay for Success Companies**  
**(Source: The Corporate Library)**

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AOC	Aon Corporation
AV	Avaya Inc.
JCP	J.C. Penney Company, Inc.
JWN	Nordstrom, Inc.
PCG	PG&E Corporation
RAI	Reynolds American Inc.
ROK	Rockwell Automation, Inc.
SEE	Sealed Air Corporation
SBUX	Starbucks Corporation
TIN	Temple-Inland Inc.
WHR	Whirlpool Corporation
WMB	Williams Companies, Inc. (The)
XEL	Xcel Energy Inc.
XRX	Xerox Corporation

**Table 3: 2006 Pay for Success Companies**  
**(Source: The Corporate Library)**

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AN	AutoNation, Inc.
AZO	AutoZone, Inc.
ESRX	Express Scripts, Inc.
BEN	Franklin Resources, Inc.
HUM	Humana Inc.
NCR	NCR Corporation
JWN	Nordstrom, Inc.
NUE	Nucor Corporation
PGR	Progressive Corporation (The)
WFMI	Whole Foods Market, Inc.

## Summary

Our findings include the following:

- Unlike many companies in 2008, Pay for Success companies that did not meet target performance either drastically reduced bonuses or eliminated them altogether, like Darden Restaurants.
- All of the Pay for Success companies set targets – both annual and long-term – that were truly stretch targets, requiring significant outperformance of prior year results; in addition, maximum bonuses are paid out only if performance significantly exceeds targets.
- While most of the companies in the report used pay surveys, only a few used compensation consultants, with many relying solely on the common sense of the compensation committee to design effective pay policies.
- Many companies approached executive pay much as they approach the pay of other managers and professionals at the company, setting salary ranges, using company-wide bonus plans, etc. (including Humana).
- For many of the same reasons that they use company-wide pay plans, many companies have a “no executive perk” policy, such as Apple and Nucor.
- Many of the group have introduced clawback provisions – Humana and Darden Restaurants, for example – while such companies are still in a minority even in the S&P 500.
- Few companies employ executive employment agreements (Apple and AutoZone, for example, have none).
- The vast majority of the CEOs and other named executive officers have significant tenures with the companies (Nucor).

## The Criteria

The criteria for the Pay for Success companies in the current report were chosen to identify those companies that had enjoyed substantial long-term success, both in absolute and relative terms, and yet had retained moderate compensation policies. The sample was restricted to the largest companies in the country. It was also important that The Corporate Library had identified the overall governance of the companies as presenting either moderate or low risk. Furthermore, a compensation policy review of these companies must have led to their being assessed as either of low or moderate concern in CEO pay. Details of the companies' ratings and of their CEO pay and performance are provided in *Tables 4 and 5*.

**Table 4: Company Ratings (Source: *The Corporate Library*)**

	Governance Rating	Compensation Rating
Apple Inc.	See Full Report	See Full Report
AutoZone, Inc.	See Full Report	See Full Report
Darden Restaurants, Inc.	See Full Report	See Full Report
Humana Inc.	See Full Report	See Full Report
Nucor Corporation	See Full Report	See Full Report

**Table 5: CEO Pay and Company Performance (Source: *The Corporate Library*)**

	CEO Name	5-yr TSR (%)	2008 Total Realized Compensation	2007 Total Realized Compensation	Total 2-yr Realized Compensation
Apple Inc.	Steven P. Jobs	See Full Report	See Full Report	See Full Report	See Full Report
AutoZone, Inc.	William C. Rhodes	See Full Report	See Full Report	See Full Report	See Full Report
Darden Restaurants, Inc.	Clarence Otis	See Full Report	See Full Report	See Full Report	See Full Report
Humana Inc.	Michael B. McCallister	See Full Report	See Full Report	See Full Report	See Full Report
Nucor Corporation	Daniel R. DiMicco	See Full Report	See Full Report	See Full Report	See Full Report

## *Criteria Modified*

Given the extraordinary circumstances of the last 24 months, the criteria for selecting Pay for Success companies were modified slightly from prior surveys. The TSR requirement was reduced to “greater than 50 percent” over five years, though two companies – AutoZone and one other (see full report) – would have qualified under the “greater than 100 percent” required previously. In addition, for most of these companies the measurement period we have used in the past – the five most recent fiscal years – would have been the period ending December 31, 2008, when many companies’ stocks were languishing under the cloud of the financial crisis. For example, at the end of fiscal 2008, Apple and Nucor both had negative five-year returns. However, since then each has rebounded into growth, surely one of the marks of a Pay for Success company. For this reason, a uniform measurement period of the 60 months ending June 30, 2009 was used regardless of fiscal year ends. Fiscal year ends for the group varied from December 31 to September 30.

This is not the first time we have made small adaptations to the criteria. In 2007, when we used the criteria that had been applied in 2006, 60 companies originally qualified. In order to bring that group of companies to a more manageable size, one criterion was added and another made more stringent. The new criterion was that companies also had to outperform the S&P 500. This has been retained for the current survey. The criterion that was made more stringent was the two-year compensation amount. This was lowered to \$15,000,000, compared to the \$30,000,000 limit in place in 2006. For the current survey, an initial screen based on the 2007 limit of \$15,000,000 identified only two companies – Apple and Nucor. In order to increase the size of the group, the two-year compensation maximum was increased back to \$30,000,000 and this produced the current 12 company list. These changes are made merely to ensure that we end up with a manageable group of companies for analysis.

Organizations were not excluded because there had been a change of CEO within the five-year performance time frame examined. The control of compensation levels and compensation policies is inherent to the boards of the companies, not the CEOs. Only three of the 12 companies saw a change in CEO during the last five years.

## Individual Company Compensation Analysis

### Apple

Since we have included Apple in our list, it must now be time to lay to rest the “Gulfstream Jet Bonus” and “Underwater Stock Option Replacement” skeletons in the closet of Apple’s compensation history. In 2000, the board converted Mr. Jobs’ cash bonus into a \$90,000,000 Gulfstream private jet, with almost half the cost being tax reimbursement. In 2003, the board converted Mr. Jobs’ 20 million underwater stock options into an award of restricted stock worth about \$75 million at the time of grant and around \$650 million at the time of vesting. Such amounts put the apparent altruism of Jobs’ \$1 salary into a somewhat different perspective.

On the other hand, Apple is one of the few companies in the U.S. to have accepted the opinion of a majority of its shareholders that it should hold an annual, non-binding vote on executive compensation. Apple will introduce a “Say on Pay” vote at its 2010 annual meeting. While such a proposal could only have gained majority support because there were shareholders with memories long enough to remember the skeletons, there is much that is commendable about Apple’s current executive compensation policies. The company has no employment agreements, no special severance or change of control payments, and the only perquisites and benefits available to executives are those that are available to employees generally.

The company’s use of restricted stock units (RSUs), rather than the stock options that are more typical among younger technology companies, has led to a reduction in the run rate (the rate at which shares are used annually for compensation) and in the overhang (the amount of total shares reserved for awards) to levels that are acceptable to most public shareholders. Additionally, such awards are not made annually, but every two years. Cash bonuses are set at a very modest level as a percentage of base salary (salaries are already relatively modest) and are based on double-digit growth targets in revenue and operating income.

Perhaps most unusually, if neither target is met, no bonus will be paid out. While this might seem obvious, it does not accord with the practice of 90 percent of U.S. companies whose executives receive bonuses – albeit below target ones – even if they meet around 80 percent of the target set for them. At the same time, if more than one performance target is used, most companies will still pay out a bonus if one target is missed and another is met. Apple’s structure is the logical design.

### AutoZone

Back in 2006 we wrote about the appointment of AutoZone’s new CEO William Rhodes – appointed from within the company in a seamlessly operating succession plan. On his promotion, he received an increase in base salary to a relatively modest level and an additional small grant of stock options.

Similar to our findings in 2006, simplicity and moderation remain the two key words to describe compensation policy at AutoZone. The CEO and the other named executive officers (NEOs) are employed without contracts and will receive relatively low levels of severance benefit if they ever leave the company. Defined benefit pension plans at the company are frozen – for all employees, not just for non-management or non-officer employees. The annual bonus plan is appropriately set with effective performance measures – earnings before interest and taxes (EBIT) and return on invested capital (ROIC). Stock option grants are awarded at levels that are far below the maximum limit set by the shareholder-approved plan. Finally, unlike Apple, which retains the services of Frederick Cook & Co., AutoZone does not employ compensation consultants. Neither the company itself nor the compensation committee retains the services of any consultancy on compensation matters, though reference is made to several pay surveys that are used to determine market rates. Notably, there is very little difference between the pay structures for executives and those for management generally, indicating that executives do not receive special treatment. An executive medical plan, for example, was discontinued in 2007. The only potential special treatment is perhaps airline club memberships and occasional status upgrades on flights; however, there is no corporate jet usage.

## *Darden Restaurants*

Darden demonstrated a reaction to trying economic circumstances that was all too rare this proxy season. Poor performance led to significant reductions in cash bonuses, and performance share units were forfeited as minimum targets were not met. The company did not resort to discretionary awards like so many other companies, and the only “adjustment” to incentive pay was the introduction of a peer-related set of targets – sales growth and earnings per share – for a special “outperformance” bonus. While growth targets were not met, Darden did not suffer from the downturn to the extent of its peers and outperformed them in all measures. Of course, such a provision would be more effective if it was incorporated into the bonus plan officially, but perhaps the lessons of this downturn will lead to this. Also, as a reaction to the difficult economy, salaries were frozen and no other element of compensation was increased.

In contrast to the perquisites lavished on many CEOs, there are limited perks at Darden Restaurants, with no supplemental retirement plan, and even the company’s contributions to the executives’ non-qualified deferred compensation plan are determined based on “guest count” performance, i.e. the number of paying customers at the restaurants for which they are responsible.

Finally, there were a number of changes to compensation policy in the last 18 months that improved practices generally. These included:

- a clawback provision was introduced
- payment of dividends on unvested share awards was terminated
- performance now measured over three years rather than annually over five years for performance shares
- unvested equity awards now only vest immediately if an executive is terminated in connection with a change in control
- excise tax gross-up on excess golden parachutes was terminated

While market-priced stock options continue to comprise the majority of any long-term equity award, the company complies with best practices by having them cliff vest after three and four years, rather than begin vesting after the first year, as is most common.

## *Humana*

As we wrote three years ago, when Humana was first noted as a *Pay for Success* company, it is the simplicity of the company’s approach to compensation that keeps compensation levels down, while at the same time appearing to incentivize executives effectively. The main compensation vehicle is market-priced stock options granted at moderate levels. In addition, stock options have only a seven-year term so stock price growth must be at higher rates than those with a ten-year term for similar profits to be made.

In keeping with this simple approach, annual incentives are based on a single metric – earnings per share (EPS) – which requires outperformance over prior year results. As the target was not reached in 2008, no cash bonuses were awarded – a reaction to events that is surprisingly uncommon.

The company recently introduced a clawback policy like several other Pay for Success companies.

## *Nucor Corporation*

Nucor was originally identified as having the best compensation policy in the S&P 500 in a report we wrote in 2002, *A compensation policy comparison - Nucor and Consecor*, so it came as no surprise that Nucor qualified as being a Pay for Success company in the first Pay for Success report nor that it has qualified again in Pay for Success III. While Nucor had the best pay practices, Consecor had the worst policy at the time of that 2002 report. Nucor’s superior performance has continued over the last seven years, while Consecor descended into bankruptcy shortly after the report was published. There have been changes to Nucor’s compensation and incentive plans since then, but these changes have, in fact, cemented effective policy at the company, improving it in many different areas.

Fixed pay levels at the company are kept low, with base salaries below the market median, and even total compensation on occasions is well below peer median levels. Annual incentives will only be paid out if certain return on equity (ROE) thresholds are met and the size of the bonus is further modified by a comparison between Nucor's net sales growth and the net sales of its peer group. Such a combination of metrics ensures that only solid performance is rewarded and that the metrics are not susceptible to manipulation. The long-term incentive (LTI) awards are based on Nucor's return on average invested capital (ROAIC), both against industry peers and against a set of high-performing general industry companies, to ensure that rewards are paid out only for superior performance. In addition, the LTI awards contain further vesting restrictions that follow on from the three-year performance period. Most of the changes since 2002 have increased the potential for variable pay, and most of the increase in pay has been in equity and cash compensation that is related to performance, with time-vesting stock option grants being eliminated and time-based restricted stock units kept at moderate levels. In addition, a portion of the stock-based awards made to executives must be held until retirement.

As with many of the Pay for Success companies, perquisites are not provided to executives. This attitude is also applied to the provision of benefits such as pensions and other deferred compensation – so much so that Nucor's compensation discussion and analysis features far fewer tables of compensation than most companies.

While this is not necessarily a consequence of the company's effective compensation policy, the company does state that it has turned a profit every year since 1966 "through business cycles where peer companies showed losses." Few companies can make such a claim.

## Conclusions

Similar to our conclusions in prior Pay for Success reports, the analysis of these individual pay packages shows that there is no one-size-fits-all compensation policy here. Each of them is different. Indeed, among all the companies the only commonalities are simplicity and moderation. However, there are a few elements that are common at more than one company:

- incentives not paid for below-median performance
- challenging performance targets
- fewer stock options and restricted stock and more performance-related equity awards
- use of value growth measures (many companies use cost of capital and/or return on capital measures)
- long-term incentives that are not based on simple stock price measures
- generally low levels of perks
- moderate employee benefits
- few employment agreements and consequently little or no severance benefits

Pay for Success is more than just not paying for failure, but there is no single recipe for success here. There are, however, examples being set that can be followed or adapted by others.