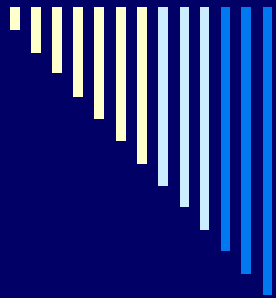


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ICD/Venture Group  
BC Directors Breakfast Club

CEO & Director Compensation  
- Governance & Trends

Thursday December 14, 2006  
Presentation by **ROGER GURR**  
([roger@rogergurr.com](mailto:roger@rogergurr.com))



# Contents

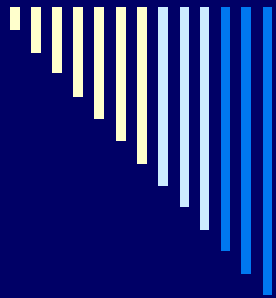
1. Governance of Executive Compensation
2. Compensation Strategy – Challenges
3. The CEO
4. CEO Compensation
5. Compensation - Other Executives
6. Director Compensation – Latest Trends/Updates



# Governance of Executive Compensation

## Sweeping Changes

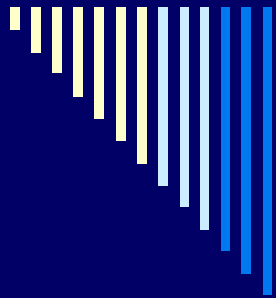
- Ongoing concern by public (and press)
  - CEOs and executives (large companies) overpaid
  - Pay levels not linked to performance
  - Compensation information – incomplete/confusing
- July 2006, in USA, SEC made significant changes
  - Disclosure of executive (and director) compensation
  - A very detailed regulatory approach
  - Challenges to smaller companies – *“over governed”*
- Indications are that, in Canada, a more principles-based approach (emphasizing process) will be taken



# Governance of Executive Compensation

## ICD Blue Ribbon Commission On Governance of Executive Compensation in Canada

- Research being conducted by a team at the Richard Ivey School of Business, University of Western Ontario
- Green Paper published and available on ICD website ([www.icd.ca](http://www.icd.ca)) – your comments are solicited
- General approach:
  - Canadian regulations will be consistent in spirit & approach to SEC
  - Canada should emphasize the compensation process (not outcomes)
  - Good news (?) for smaller companies – *“over governed!”*

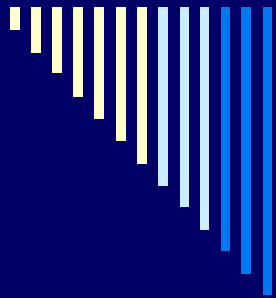


# Governance of Executive Compensation

## ICD Blue Ribbon Commission Governance of Executive Compensation in Canada

- However, the research approach focussed upon obtaining input and opinion from
  - Large cap mature companies
  - Large institutional investors
  - Suppliers (legal, accounting, consultants) to larger firms
- But smaller companies were recognized

*"... many organizations that may be influenced by our recommendations are not large sized, thus regulations may prove to be onerous. By establishing principles-based guidelines, as we have done, it is possible for all sizes to address the concerns raised in this paper"*

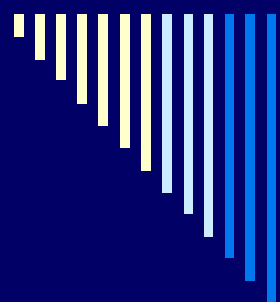


# Governance of Executive Compensation

## Green Paper Recommendations

Recognition that determining executive compensation – both level and mix of compensation

- Is complex
- Not a one-size-fits-all
- Combination of both
  - Art (judgement-based discretion)
  - Science (actual data)

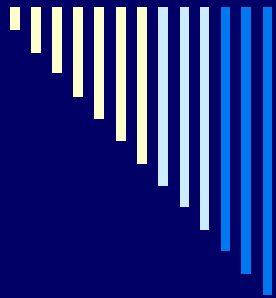


# Governance of Executive Compensation

## Green Paper Recommendations

### CEO pay **supports business objectives**

- Board & CEO **define business model**, strategy & goals
- HR Committee uses internal and external (independent) **advisors**
- **All information** regarding this process is disclosed in plain English
- HR Committee designs compensation package that **aligns CEO incentives & investor interests**



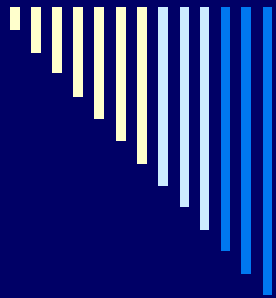
# Governance of Executive Compensation

## Green Paper Recommendations

### Alignment of CEO's compensation with investors' interests

- **Pay for performance** measures be adopted as the basis for executive compensation arrangements
- When options or RSUs are employed, these grants should be **performance based**
- Encouraged to retain **real shares** *"skin in the game"*
- **"Claw back" provision** on bonuses and LTIP payments on basis of malfeasance or significant accounting adjustments



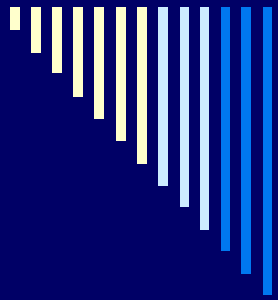


# Governance of Executive Compensation

## Green Paper Recommendations

### CEO Performance Metrics

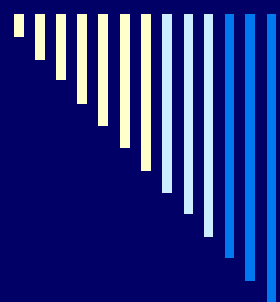
- Clear & full disclosure of metrics
  - Quantitative
  - Qualitative
- Measurement & assessment process clear
- Impact of achievement of metrics upon compensation numbers
- Comparator companies (if used)
  - Justify selection
  - Disclose any changes (year to year)



# Compensation Strategy – Challenges for Smaller Companies

## Business Model

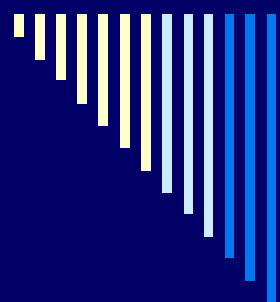
- Not easy to define for companies in “*development*”
- Cashflow negative – constraints on cash
- Model complex (more so than mature company), especially the linkage to compensation
- Reluctance to disclose



# Compensation Strategy – Challenges for Smaller Companies

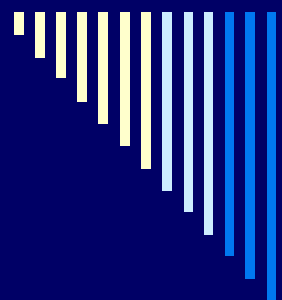
## **Alignment** of CEO interests with shareholders

- CEO usually has “*skin in game*”, especially early stage.
- Pay for performance
  - Ability to pay cash
  - Dependence on time based options
  - Defining CEO performance – changing business model



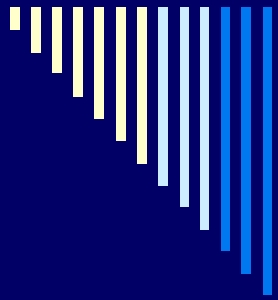
# Compensation Strategy Elements

- Marketplace for talent, impact upon attract/retain
- Comparator companies (size, sector)
- Company success measures– absolute & relative
- Elements of compensation and relative value
- Importance of pay for performance and for continuity
- Salary “stance” v. comparators (median, top quartile, other)
- Annual bonus opportunity – target, capped/open, etc.
- Mid term incentives or significant event awards
- Long term incentives- vehicle, quantum (compared to comparators)
- Any significant executive perks & benefits, including SERPs
- Total remuneration potential – checks that “reasonable/justified” based on comparators, company performance and shareholder value



# CEO Performance Metrics

- Use of comparator group ideal
- Performance overall - not all about financial results
- Emphasis upon qualitative
  - More difficult to define (with measures)
  - Not an excuse
  - More art than science

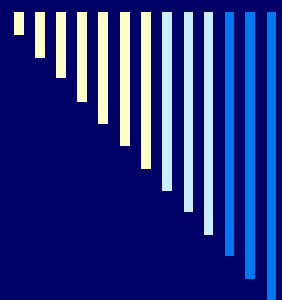


# CEO – Typical Performance Areas

## *“What”* of Achievement

- Strategy formulation/updating
- Strategy implementation
- Performance (financial, operations, development)
- Controls & IT
- Leadership
- People – succession & talent building
- External relations
- Board relations

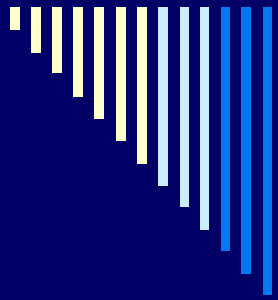
Relative importance (weighting) dependent upon stage of development/maturity,  
strategic importance



# The Perfect CEO

*"How"* of Achievement – Core Competencies

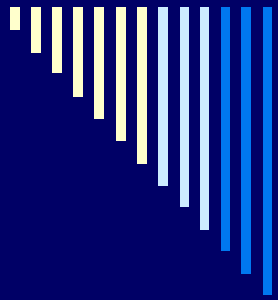
- People leadership skills
- Sound analyzer & problem solver
- Implementer/action taker
- Business acumen / business operator
- Product/service obsession
- Versatility & flexibility
- Team player
- Interpersonal sensitivity & skills
- Public ambassador



# CEO - Challenges

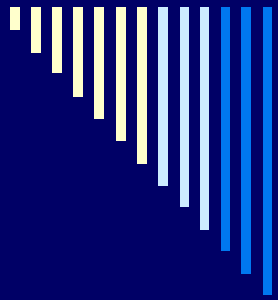
- Lifetime as a CEO is declining
  - 4 years in USA
  - 7 years in Canada
- **Pressure to perform** in short/mid term
- **Leave a legacy** during economic boom times
  - Build a business
  - Growth
  - Profitability
- Need to **build/retain an executive team**





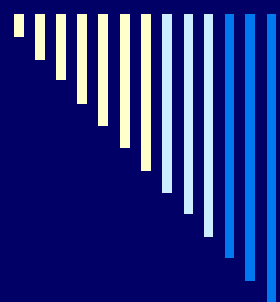
# CEO - Concerns

- Recent research/surveys of major concerns of CEOs in North America
  - Top 2 concerns
    - Organization performance
    - Executive (& key talent) retention
- Not keeping team together could seriously affect growth and legacy objectives



# CEO - Motivation

- Typically not *“shy retiring”* individuals
- Motivation – much more than compensation
  - High need for power, freedom to act
  - Recognition – leave a legacy
  - Company & work – intrinsic value
- Challenge to *“manage”*
- Role of directors
  - Normally *“nose in, fingers out”*
  - Except compensation strategy and CEO performance assessment & pay



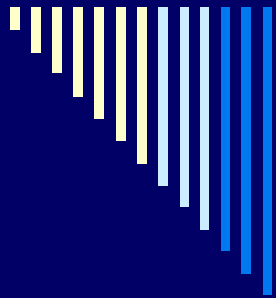
# CEO (and Executive) Compensation Requirements

- Tough economic market (shortage of top talent)
- What attracts
  - Salary
  - A *"piece of the action"*
- What retains
  - Competitive/fair salary
  - Pay (BIG) for performance
  - Wealth creation (if successful)
  - Recognition
- Need for reasonable creativity
  - The art of pay
  - Discretion of the Board of Directors



# CEO Compensation

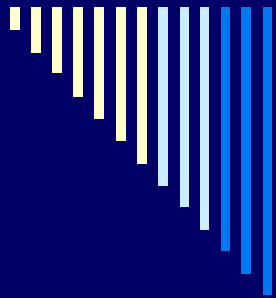
- CEO Compensation – dependent upon job value
- Job value dependent upon:
  - Organization size
  - Complexity
  - Diversity (product, geography, etc)
- Organization size – the numbers
  - Market cap
  - Annual revenues
  - Assets under administration
- High growth/development (early in life cycle)
  - Hire *“ahead”* of current size
  - Recognize maintenance & development



# CEO Compensation

**Canadian Technology Sector** – publicly traded, market cap \$20 - 100 m

- Relative value (mix) of three major elements dependent upon compensation strategy
- Typical ranges are:
  - Salary \$150,000 – 300,000
  - Bonus opportunity (% salary) 20 – 50%
  - Stock Options (Face Value)
    - Annual 1 – 2 times salary
    - Upfront one-time 2 – 6 times salary  
(2 -3 times annual)
- **Vesting** (performance or time based) should apply to issuances of equity based compensation for employees



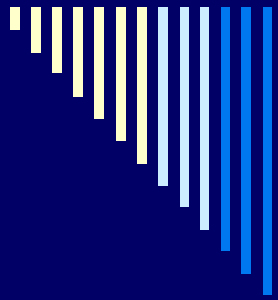
## CEO Compensation – Technology Sector

### Mid Range Value of Compensation

- Assume a stock price of \$1 and full target bonus award
- Total remuneration (mid range) would be:

Salary	\$225,000	Certain
Bonus (35%)	78,750	Short-term variable
Stock options (annual)	112,500	Long-term variable
	<hr/>	
	\$416,250	

Value of 337,500 stock options calculated using a Black Scholes value of 0.33



## CEO Compensation – Private Sector

- Tend to pay lower salaries than publicly traded
- Salaries lower by about 20%; however, some indication of “*catch up*” over past two years, due to talent shortage
- Equity based compensation emphasized, often CEO is significant shareholder
- Increasing concern about dilution, especially with private equity placement

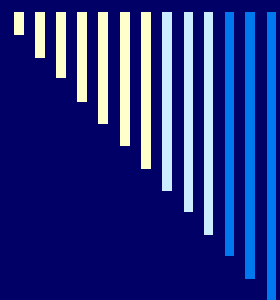


# Other Executive Compensation

- Overall typical job size (salary) relationship to CEO is approximately as follows:

•CTO	70 - 80%	higher if founder
•VP, Sales & Marketing	60 - 70%	higher emphasis on bonus
•CFO	50 - 60%	but increasing
- Relationship dependent upon number of executives
- Annual issuance of options is approximately 1.5 times salary (face value) – top execs
- *“Recruiting issuance”* can be up to 4 - 5 times salary





# Director Compensation

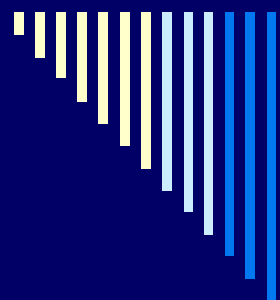
## Trends & Issues

- Continued emphasis upon governance
  - SEC regulations (July 2006)
  - ICD Blue Ribbon Commission – Executive Compensation
  - Influence of Canadian Coalition of Good Governance (CCGG)
- Increasing time commitment & accountability
- Increased specialization/focus
  - Industrial
  - Financial literacy
  - Human Resources literacy



# Director Compensation

- Rate of compensation increase (recently at very high levels) is slowing
- However, there is a bimodal distribution of director compensation – some significantly behind market trends
- Companies beginning to
  - Adopt a more strategic approach
  - Pay for specialization & literacy

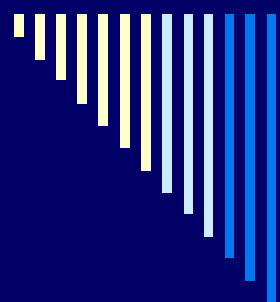


# Director Compensation

## Strategic Approach

**Best Practices** National Association of Corporate Directors (NACD) in USA

- Establish deliberate & objective process
- Define a **value** of total compensation
- Pay non-executive directors with cash and equity-based compensation
  - 0 -50% Cash
  - 50 -100% Equity
- Set a target stock ownership (including DSUs) for each director, with time period to reach target



# Director Compensation

## Cash or Equity

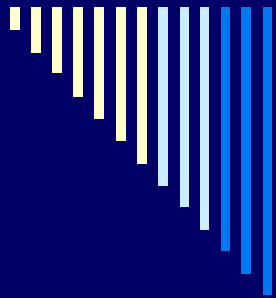
- Mix dependent upon stage of development
  - Early stage            100% equity based
  - Mature stage        50% cash, 50% equity
- Early stage (especially private) provide real shares. Options usually vest upfront, if no cash
- Mature stage – options vest over time
- Usually similar compensation strategy as used for executive compensation
- Check relationship with executive compensation



# Director Compensation

## Relationship with Executive Compensation

- Any *"Rules of Thumb"* provided for general guidance
- Director compensation will depend upon
  - Strategy
  - Mix of pay – cash/equity
  - Special roles/accountabilities
- *"Rules of Thumb"*
  1. Total compensation (all directors) approximates CEO compensation, if number of directors reasonable
  2. Stock option issuances to an independent director about half provided to CFO – higher if options are the only form of compensation or early stage company

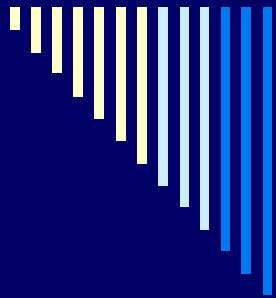


# Director Compensation

## Technology Sector – Small (Mid Range)

### Thumb Rule (1)

- Assume 5 independent directors
- Value of annual compensation \$80,000 per independent director
- Assuming Cash/Equity is 50/50 and stock price of \$1
- Compensation would be
  - Cash \$40,000
  - Options 120,000 (number with exercise price of \$1)  
Assuming Black Scholes value of 0.33 of face value



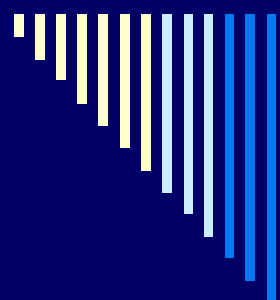
# Director Compensation

## Technology Sector – Small (Mid Range)

### Thumb Rule (2)

- CFO would have salary of approximately \$150,000
- Number of options of  $1.5 \times 150,000 = 225,000$
- Half is about 110,000
- About same as Rule (1) with 120,000 options

NB Additional roles (Chair of the Board, Chair Audit Committee) would normally receive additional compensation



# Director Compensation Information - Sources

## Early stage & small cap companies

Basil Peters

[http://www.angelblog.net/Director\\_Compensation.html](http://www.angelblog.net/Director_Compensation.html)

## Small & mid cap companies

Roger Gurr & Associates

[www.rogergurr.com](http://www.rogergurr.com) - see resource page

## Large cap companies

Patrick O'Callaghan & Associates

Annual publication – next available mid January 2007

[www.poca.net](http://www.poca.net)