



# Executive compensation

**2009**

**Flash survey** – key findings

Rewards for 2008 performance  
and remuneration committee  
decisions for 2009



## 2009

### Flash survey – rewards for 2008 performance and remuneration committee decisions for 2009

---

#### Table of contents

Flash survey – key findings	2
-----------------------------	---

---

#### Featured figures

Figure 4: Annual bonus 2008 – expectations	5
Figure 6: Long-term incentives 2008 – vesting expectations	5
Figure 21: Base salary increases in 2009	11
Figure 24: Level of STI opportunity in 2009	11
Figure 25: Level of LTI award in 2009 relative to last award	11

## Flash survey – key findings

**Executive remuneration** is rapidly adjusting to the **new economic environment**. In Watson Wyatt's flash survey, carried out on 29 January, over half of the participants reported that executive base salaries would be frozen in 2009; 25 per cent reported that there would be no bonus paid in relation to 2008 performance, and nearly 40 per cent expected that long-term incentive awards made in 2006 would lapse because performance conditions were not met.

The survey also shows that pay for performance is working. Those companies whose financial performance had dropped most in 2008 relative to 2007 were more likely to be freezing salaries and paying no bonuses. Similarly, those companies whose share price had dropped more than 20 per cent were more likely to have a long-term share plan that was not expected to vest. By contrast, those companies which had experienced better financial performance in 2008 relative to 2007 were more likely to be paying bonuses above target levels and expected long-term incentive plans to vest either partially or fully.

Those companies that experienced the largest drop in financial performance were also more likely to be reviewing performance metrics for variable remuneration in 2009, and more likely to be lowering long-term incentive grants. However, there were few differences between the higher and lower performers in 2008 regarding managing bonus opportunities for 2009 – over 40 per cent of participants in the survey are either lowering overall opportunity, or making targets tougher to hit.

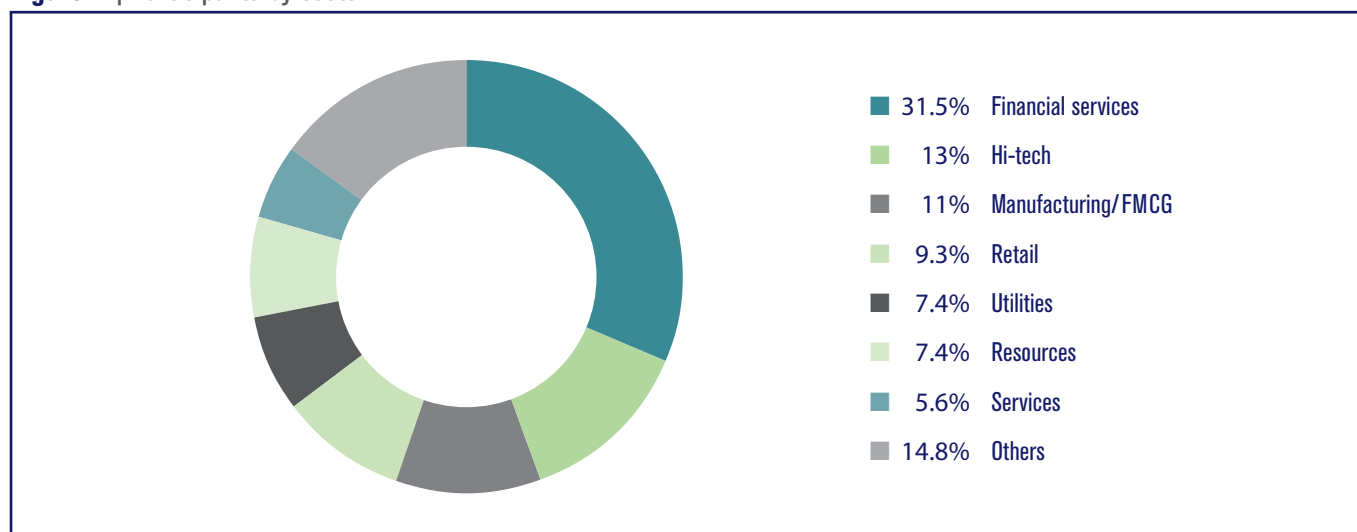
### The survey participants

The participants in this 'flash survey' attended a Watson Wyatt executive compensation seminar for remuneration directors and managers. Most represented companies in the FTSE 350 and were from the sectors shown in **Figure 1**. Watson Wyatt would like to record its sincere thanks to the participants for taking part in the flash survey.

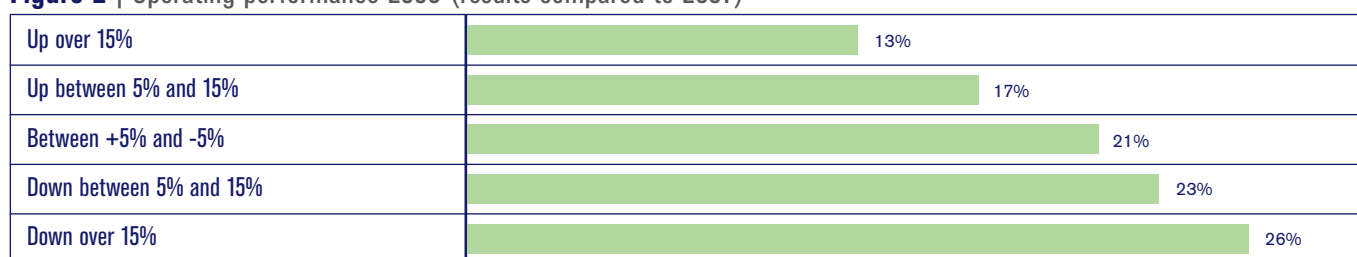
This paper first provides the aggregate information on all responses and then examines the differences between those with high and low performance relative to 2007.

To put the responses into appropriate context, we started by asking participants about their operating profit performance in 2008 and also their share price performance (share price at 31 December 2008 relative to 31 December 2007). The results are shown in **Figure 2**, opposite. 49 per cent of participants have suffered a drop in operating performance of over 5 per cent and 73 per cent of participants have seen share price falls of more than 20 per cent, as shown in **Figure 3**, opposite.

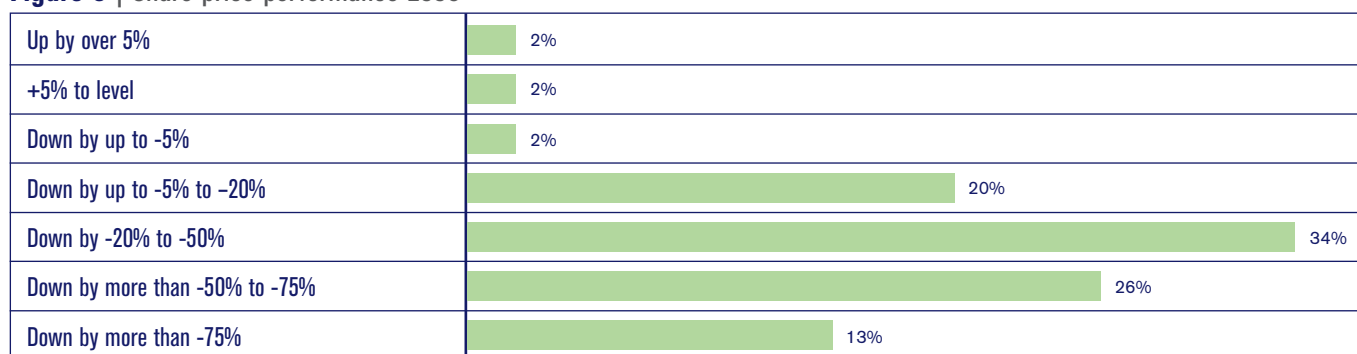
**Figure 1 | Participants by sector**



**Figure 2 | Operating performance 2008 (results compared to 2007)**



**Figure 3 | Share price performance 2008**





## Annual bonuses and long-term incentives 2008

The series of responses concerning annual bonus expectations for executive directors in relation to 2008 performance (Figure 4), show expected bonus outcomes are lower than 2007 when most bonuses paid out between target and maximum. However, corporate performance was not universally low and 35 per cent of participants still expected above-target bonuses.

We anticipated that, in line with hardening attitudes amongst shareholders and non-executive directors during the year, remuneration committees would leave annual incentive plan outcomes unchanged rather than exercising discretion (either up or down). This is confirmed by the results shown in Figure 5 – but 31 per cent for upwards discretion is surprisingly high, and could potentially herald trouble from institutional shareholders.

We then asked participants whether they expected their long-term incentive awards would vest in relation to performance in the performance period to the end of 2008. The results are shown in Figure 6 – this illustrates that appreciable vesting should take place but that nearly 40 per cent of all LTI awards may lapse.

We repeated the question of the exercise of remuneration committee discretion, but this time in respect of the vesting of long-term incentive awards due to vest in relation to 2008 (2008/2009) performance. The results are shown in Figure 7 and although the figure for upwards discretion being exercised is comparatively low (13 per cent), we are a bit surprised that any upwards discretion will be exercised. Interestingly, a small number of participants were expecting remuneration committees to override measures and require LTIs to lapse.

**Figure 4 | Annual bonus 2008 – expectations**

At or near maximum opportunity	10%
Between target (or 50% of max) and maximum	25%
Between threshold and target (or 50% of maximum)	25%
At threshold	15%
No payment	25%

**Figure 5 | Annual bonus 2008 – exercise of remuneration committee discretion**

Upwards by disregarding targets overtaken by events	13%
Upwards by taking into consideration additional targets agreed during the year	18%
Downwards (or to zero) as a result of poor financial performance	20%
No discretion exercised (including no provision to exercise discretion)	49%

**Figure 6 | Long-term incentives 2008 – vesting expectations**

Yes, will probably vest in full	16%
Yes, will probably partially vest	46%
No, will probably lapse	38%

**Figure 7 | Long-term incentives 2008 – exercise of remuneration committee discretion**

Yes, upwards	13%
Yes, downwards (or zero)	7%
No	80%

We then focused on 2009 and asked a series of questions in relation to base salary, annual bonus and long-term incentive awards, respectively.

In relation to base salaries there is a clear move towards moderation, with over three-quarters of participants expecting increases of less than 3 per cent.

Figure 9 shows changes in annual bonus opportunity. It is clear the overwhelming majority view is that reward opportunity will be unchanged, but in this case there is a split between where the targets are likely to be of equal difficulty (47 per cent) and those where the targets are likely to be more difficult to hit (37 per cent).

On annual bonuses, we asked participants whether they were changing the performance metrics for 2009. As shown in Figure 10, 54 per cent of participants are planning to change or have done so already. This reflects new performance priorities in a changed economic climate.





We also asked what changes, if any, people were making to long-term incentive awards in 2009. We started by looking at the performance metrics people were planning to use. Figure 11, opposite, shows that most people were not planning to change performance metrics. However the figure for change (31 per cent) does not surprise us, being a continuation of the trend away from the 'classic' UK LTIP that uses comparative total shareholder return as the sole performance measure.

We then asked participants which of the performance metrics shown in Figure 12 will apply to 2009 long-term incentive awards. This shows that over 52 per cent will still use relative TSR as a measure, either alone or in combination with a financial metric. Interestingly, 30 per cent of respondents were proposing to use economic profit.





We also asked participants whether a financial underpin would be used for 2009 long-term incentive awards, see Figure 13, overleaf.

**“ Where future long-term incentive plans used financial metrics, we asked participants what they expected to do regarding targets for 2009 awards. ”**




**Figure 8 | Base salary 2009 – expectations**

Nil	 52%
Under 3%	 25%
Between 3% and 5%	 17%
Above 5%	 6%



**Figure 9 | Annual bonus 2009 – reward bonus opportunity**

Overall bonus opportunity reduced	 6%
Overall bonus opportunity increased	 10%
Opportunity unchanged, targets likely to be of equal difficulty when calibrated against 2008 starting expectations	 47%
Opportunity unchanged, targets likely to be more difficult to hit when calibrated against 2008 starting expectations	 37%









**Figure 10 | Annual bonus 2009 – changing performance metrics**

Planning to	 41%
Have done already	 13%
No	 46%

**Figure 11 | Long-term incentives 2009 – changing performance metrics**

Yes	 35%
No	 65%

**Figure 12 | Long-term incentives 2009 – performance metrics**

Relative TSR	 12%
Relative TSR + EPS	 33%
Relative TSR + economic profit	 5%
Relative TSR + other financial	 2%
EPS growth	 10%
Economic profit	 8%
Economic profit + other financial	 22%
Other financial	 8%

Where future long-term incentive plans used financial metrics, we asked participants what they expected to do regarding targets for 2009 awards. The results are shown in **Figure 14** – with 34 per cent in favour of lower targets.

Next, we asked participants whether they were making a change to the value of 2009 long-term incentive awards to their executive population, see **Figure 15**. We are a bit surprised that as many as 68 per cent of participants will retain the award value, despite the strong shareholder pressure to reduce awards when there has been a significant drop in share prices.

Finally, we asked participants whether they propose to seek formal shareholder approval for any changes to their long-term incentives in 2009. The results are shown in **Figure 16** – 17 per cent will be seeking shareholder approval and this is likely to be considerably higher in 2010 as companies struggle to make their long-term incentive plans more effective for motivation and retention in a recessionary environment.

### **The impact of company performance on executive remuneration**

The survey shows that all companies in the sample group are taking a more conservative approach to base salary increases; bonuses for 2008 performance are generally going to be lower, more companies are paying no bonus at all, and a significant proportion of long-term incentive awards are going to lapse in 2009. This is a general picture applying to all companies. However, are companies who experienced low financial performance in 2008 relative to 2007 making different decisions regarding executive remuneration to those who experienced stronger performance in 2008?

Below is an examination of the differences between the top performing 28 per cent of participants (who had all experienced higher profit performance in 2008 than 2007) and the bottom 20 per cent (who had experienced a drop in profits of 15 per cent or more). The drop in share price for these companies shows that the first group had companies with a typical share price fall of 20 per cent and 50 per cent, and for the latter group the share price fall was typically more than 50 per cent.

**Figure 17** shows that the bonuses of the low performers were significantly lower and there were more zero bonuses. **Figure 18** shows that low performers were also less likely to have long-term incentive plans vesting. While shareholders have been concerned about the possibility of remuneration committees exercising discretion in favour of executives in low performing companies, our survey shows that this is not the case. **Figure 19** shows that for annual bonuses both low and high performing companies were almost equally likely to have remuneration committees exercising discretion both up and down in determining the bonus payment. However, **Figure 20** (overleaf) shows that for long-term incentives discretion is less frequently exercised, but it is in the higher performing companies that discretion is most likely to be exercised in favour of the executives.

**Figure 13** | Long-term incentives 2009 – financial underpin

Yes	57%
No	43%

**Figure 14** | Long-term incentives 2009 – financial metrics targets

Absolute financial targets lower than previous grant	34%
Absolute financial targets higher than previous grant	6%
Absolute financial targets same as previous grant	42%
No financial targets	18%

**Figure 15** | Long-term incentives 2009 – award value

Lower	27%
Same	68%
Higher	5%

**Figure 16** | Long-term incentives 2009 – shareholder approval

Yes	17%
No	83%

**Figure 17** | Expected annual bonus for 2008

At or near maximum	High performers: 31%	Low performers: 0%
Target to maximum	High performers: 25%	Low performers: 9%
Threshold to target	High performers: 32%	Low performers: 18%
At threshold	High performers: 6%	Low performers: 18%
No payment	High performers: 6%	Low performers: 55%

■ High performers ■ Low performers

**Figure 18** | Expected LTI vesting

Will probably vest in the full	High performers: 15%	Low performers: 0%
Will probably partially vest	High performers: 70%	Low performers: 33%
Will probably lapse	High performers: 15%	Low performers: 67%

■ High performers ■ Low performers

**Figure 19** | Exercise of remuneration committee discretion on annual bonus outcome

Upwards with change in targets	High performers: 8%	Low performers: 10%
Upwards taking into account of additional targets	High performers: 25%	Low performers: 20%
Downwards	High performers: 17%	Low performers: 20%
No discretion	High performers: 50%	Low performers: 50%

■ High performers ■ Low performers

Figure 21 shows that there was also a significant difference in expected base salary increases in the two groups; 82 per cent of the low performers were freezing executive salaries, while only 38 per cent of the high performers were awarding no increases.

Companies experiencing significant profit falls are also facing more challenges about how their annual bonus and long-term incentive plans will operate in 2009.

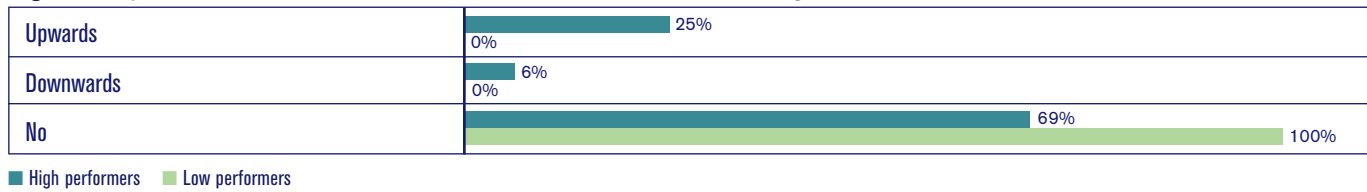
Figures 22 and 23 show that the lower performers are more likely to be changing their performance metrics in 2009.

Figure 24 shows that there is no significant difference between the low and high performers in relation to changes in short-term incentive opportunity in 2009, but Figure 25 shows that low performers are more likely to be reducing their long-term incentive levels.

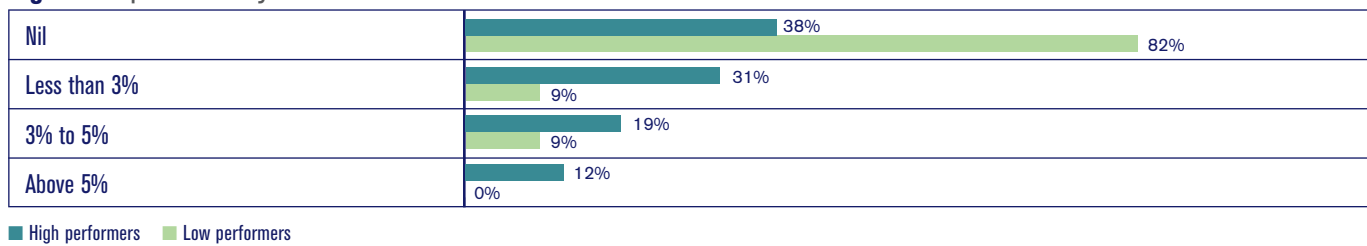
Although this is not a large survey, and care needs to be exercised in generalising its findings across all the FTSE 350, given a bias in the sample to larger companies, the survey indicates that remuneration committees are generally behaving responsibly in the present environment and the performance-related pay systems for executive directors are working.

**“ ...more companies are paying no bonus at all, and a significant proportion of long-term incentive awards are going to lapse in 2009. ”**

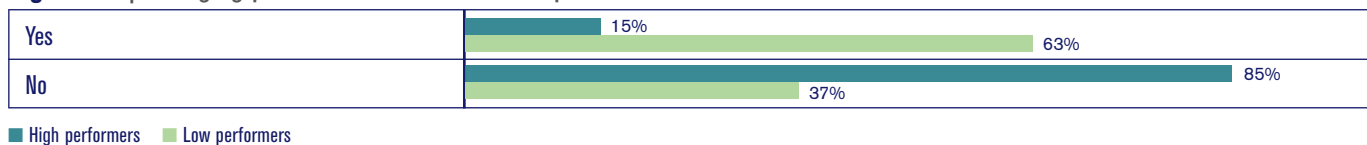
**Figure 20 | Exercise of remuneration committee discretion on LTI vesting outcome**



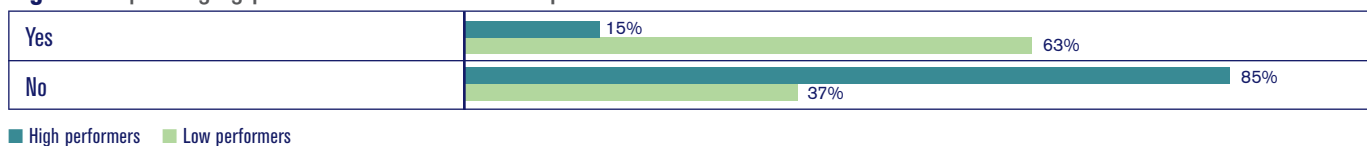
**Figure 21 | Base salary increases in 2009**



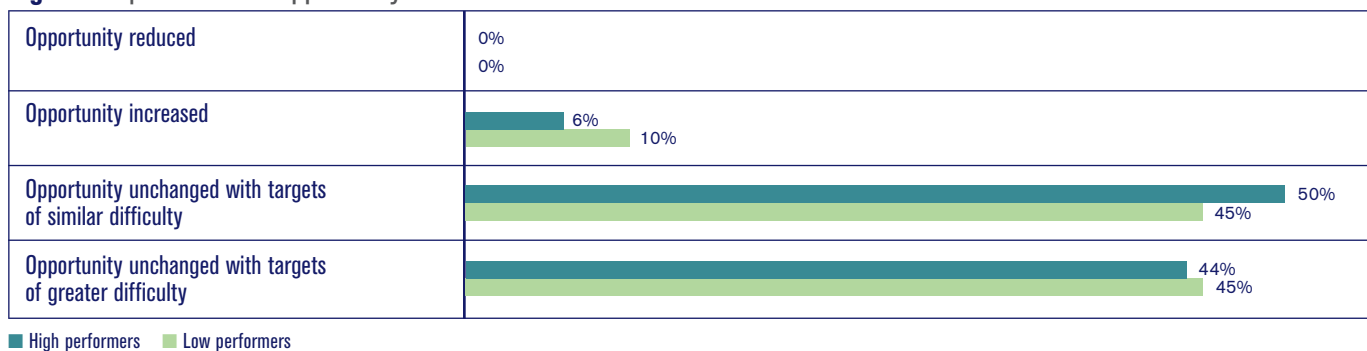
**Figure 22 | Changing performance metrics in STI plans in 2009**



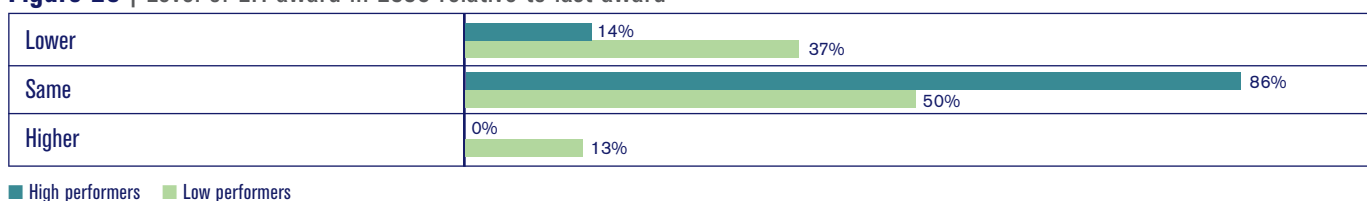
**Figure 23 | Changing performance metrics in LTI plans in 2009**



**Figure 24 | Level of STI opportunity in 2009**



**Figure 25 | Level of LTI award in 2009 relative to last award**



## Watson Wyatt worldwide

Watson Wyatt is the trusted business partner to the world's leading organisations on people and financial issues.

Our client relationships, many spanning decades, define who we are. They are shaped by a deep understanding of our clients needs, a collaborative working style and a firm-wide commitment to service excellence.

Our consultants bring fresh thinking to client issues, along with the experience and research to know what really works. They deliver practical, evidence-based solutions that are tailored to your organisation's culture and goals.

With 7,700 associates in 32 countries, our global services include:

- managing the cost and effectiveness of employee benefit programmes
- developing attraction, retention and reward strategies that help create competitive advantage
- advising pension plan sponsors and other institutions on optimal investment strategies
- providing strategic and financial advice to insurance and financial services companies
- delivering related technology, outsourcing and data services.

## Further information

If you require further information, please contact:

**Vicky Wright**

+44 (0) 20 7598 2898  
vicky.wright@watsonwyatt.com

---

**Calvin Jackson**

+44 (0) 20 7227 2329  
calvin.jackson@watsonwyatt.com

---



## locations

**ASIA-PACIFIC** ■ Bangkok ■ Beijing ■ Bengaluru ■ Delhi  
Guangzhou ■ Hong Kong ■ Jakarta ■ Kolkata ■ Kuala Lumpur  
Manila ■ Melbourne ■ Mumbai ■ Seoul ■ Shanghai ■ Shenzhen  
Singapore ■ Sydney ■ Taipei ■ Tokyo ■ Wuhan

**EUROPE** ■ Amsterdam ■ Apeldoorn ■ Birmingham ■ Bristol  
Brussels ■ Budapest ■ Dublin ■ Düsseldorf ■ Edinburgh  
Eindhoven ■ Frankfurt ■ Lausanne ■ Leeds ■ Lisbon ■ London  
Madrid ■ Manchester ■ Milan ■ Munich ■ Nieuwegein ■ Paris  
Purmerend ■ Redhill ■ Reigate ■ Rome ■ Rotterdam ■ Stockholm  
Vienna ■ Welwyn ■ Wiesbaden ■ Zürich

**LATIN AMERICA** ■ Bogotá ■ Buenos Aires ■ Mexico City  
Montevideo ■ San Juan ■ Santiago ■ São Paulo

**MIDDLE EAST** ■ Dubai

**NORTH AMERICA** ■ Atlanta ■ Berwyn, PA ■ Boston  
Calgary ■ Charlotte ■ Chicago ■ Cincinnati ■ Cleveland  
Columbus ■ Dallas ■ Denver ■ Detroit ■ Grand Rapids ■ Hartford, CT  
Herndon, VA ■ Honolulu ■ Houston ■ Irvine ■ Kitchener-Waterloo  
Los Angeles ■ Madison, WI ■ Memphis ■ Miami ■ Minneapolis  
Montréal ■ New York ■ Paramus, NJ ■ Philadelphia ■ Phoenix  
Portland ■ Rochelle Park, NJ ■ St Louis ■ San Diego ■ San Francisco  
Santa Clara ■ Seattle ■ Stamford ■ Tampa ■ Toronto ■ Vancouver  
Washington, DC

watsonwyatt.com

21 Tothill Street, Westminster, London, SW1H 9LL UK

Telephone +44 (0) 20 7222 8033

Fax +44 (0) 20 7222 9182

Authorised and regulated by the Financial Services Authority.

The information in this publication is for general interest. No action should be taken on the basis of any article without seeking specific advice.

To unsubscribe, email [unsubscribe@watsonwyatt.com](mailto:unsubscribe@watsonwyatt.com) with the publication name as the subject and include your name, title and company address. You can manage your Watson Wyatt subscription at [watsonwyatt.com/membership](http://watsonwyatt.com/membership)

This publication is printed on paper produced using a chlorine-free process and wood pulp originating from managed sustainable plantations.