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CEO compensation: Creating a strategic package to benefit your organization

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Good governance and well-established policies that align closely with the corporation's overall goals and objectives lay the groundwork for a sound executive and CEO compensation program. Though **73% of people** say CEO compensation is too high, the reality is that determining a CEO's pay can be complex and may even require an **executive compensation solution**.

CEOs usually get an annual salary, but they can also earn performance rewards based on other parameters, such as company performance, company growth and shareholder value. As a result, the bulk of a CEO's pay is contingent on how well they do their job. This also means that a CEO's true compensation comes down to the total package and not just their reported salary. Here's how to make strategic decisions about what that package should include.

What Is CEO Compensation and V

CEO compensation is the total amount **the CEO** earns. While some CEOs receive an annual salary, their total compensation

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of

a fixed salary, performance-based bonuses and other benefits like group insurance and paid vacation. The board of directors assembles an executive [compensation committee](#) that determines fair compensation for the CEO's responsibilities.

Creating a fair CEO compensation package is especially important for publicly-traded companies because they have to report how much the CEO earns. Boards have to walk a fine line between offering competitive compensation that will either retain or attract an effective CEO while also building a package that their shareholders will approve. Getting it right can make the difference between having a compelling CEO at the helm or losing out on hard-hitting candidates that could drive the business forward.

How To Find CEO Compensation

Executive pay is public information. The [Securities and Exchange Commission](#) (SEC) requires that all publicly-traded companies disclose how much they [pay their executives](#), how they determine the total compensation and who helped determine the compensation. To find CEO compensation, review the following documents:

1. Public filings with the SEC
2. The company's annual proxy statement
3. Form 10-K, specifically the company's annual report
4. Registration statements

Components of a CEO Compensation Package

There are six primary components of a CEO compensation package:

- Base salary
- Short-term incentives
- Long-term incentives
- Employee benefits
- Perquisites
- Severance

Here's a brief description of each of them:

Base Salary

Base salaries for CEOs vary substantially, depending on the type of industry, the CEO's years of experience and other factors. Typically, boards of directors will form an executive compensation committee that sets a base annual salary, paid monthly or biweekly.

The 1993 federal tax law limits the amount that companies can deduct for cash compensation for tax purposes to \$1 million. The law holds an exception for certain performance-based compensation, which was repealed under the 2017 Tax Cuts and Jobs Act. Currently, companies must cap compensation for base salaries to \$1 million for the CEO, the CFO and the three other highest-paid executives, whether it's performance-based or not. The cap also applies to payments that executives receive after they retire or terminate their employment.

Short-Term Incentives (STIs)

As part of strategic planning, board directors set a number of short-term goals for CEOs to achieve. The intent of the base salary is to offer CEO compensation for achieving their business goals over one year. Boards set their goals based on many factors, depending on the type of business and other conditions.

Boards may set revenue-based or operations-based goals. Some examples of short-term goals for CEOs include:

- Increasing revenue or profit margins
- Increasing market share
- Expanding to new markets
- Implementing a new corporate strategy
- Developing new products
- Furthering the company's [sustainability](#)
- Meeting critical project deadlines

Most boards pay their CEOs the base salary in cash. The base compensation may have a two-tier structure with a certain payout for the normal expected performance. As an incentive for CEOs to achieve extraordinary results, boards may add a 'stretch component' that rewards CEOs for superior results. The bar for stretch rewards is typically relatively high, so it's usually challenging for CEOs to meet the threshold.

Long-Term Incentives (LTIs)

Long-term incentives comprise the most significant part of CEO compensation plans. As indicated by the name, long-term incentives are rewards for CEO performance over more than one year; many of these incentives focus on a three-to-five-year period. Like short-term incentives, compensation committees often set up long-term incentives with both target and stretch incentives.

Long-term incentives provide the most shareholder value, which is why companies are increasingly compensating their executives according to their performance. In 2021, long-term incentives and payouts accounted for **72% of total CEO pay**. Boards usually structure long-term incentives as some form of stock-based compensation, such as:

- Stocks
- Stock options
- Restricted stock
- Performance-vested stock

Most boards structure their long-term incentives based on projected **future events**, total returns to shareholders, earnings per share, return on assets or similar benchmarks. CEOs usually receive compensation for long-term incentives at the end of their stated performance periods.

Employee Benefits

Employee benefits for CEOs are similar to those of other salaried employees within the company. CEOs can expect such benefits as:

- Social Security
- Medicare
- Workers' compensation
- Unemployment insurance
- Paid vacation and holidays
- Additional time off for sick pay or personal sabbaticals
- Health insurance
- Life insurance
- Special retirement plans: may not be subject to protective federal tax and pension rules, which places those funds at risk if the company goes bankrupt

Perquisites

The word 'perks' stems from 'perquisites,' which refers to additional CEO compensation not available to other salaried employees. Perquisites compensate executives for extra demands

on their time. Perks may include:

- Hired drivers
- The use of private planes
- Special parking privileges
- Communications systems in their home
- Security for executives at home or work

Severance Packages

Severance packages provide CEOs with payments in the event of voluntary or involuntary termination. Severance pay can be instrumental in recruiting and retaining CEOs. Nominating and governance committees may use severance packages as incentives in recruiting talented CEOs. Severance pay is a benefit that may entice a CEO candidate who's on the fence about leaving a long-time employer in fear that the move might not pan out.

CEOs have a fiduciary duty to put the company's best interests before their own. While this is a well-known concept called the Duty of Care, the notion becomes challenging when a merger or acquisition is on the horizon that might jeopardize the CEO's job as a new administration takes over.

Some benefits packages include a change-in-control agreement, also called a golden parachute. This provision compensates executives if they should lose their jobs due to a merger or acquisition in which the purchasing company replaces them with their own leaders. Golden parachutes allow CEOs to continue working for the good of the company without worrying about losing their primary source of income.

Should CEO Compensation Be Tied to Performance?

CEOs are responsible for an estimated **40% of company performance**. While this makes their job important, it also means their performance can turn the tide on whether or not the company succeeds or fails.

With CEO compensation tied to performance, the CEO's interests align with the company's interests, assuring the board of directors that the CEO will always act in the company's best interest; what's good for the company becomes good for the CEO.

Using the CEO Pay Ratio to Calculate CEO Salaries

The CEO Pay Ratio is a ratio that reflects the CEO's pay in relation to the median pay for company employees. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires that companies track and disclose this ratio, so it's an essential tool for determining CEO compensation and achieving compliance.

Companies must include all employees — full-time, part-time, seasonal, and temporary — and calculate their median pay once every three years. This data can come from a statistical sampling, a reasonable estimate or payroll. Though it might seem beneficial to calculate a high median salary so that CEO Pay Ratio appears lower, this can ruffle feathers among employees who make less than that median.

To calculate the CEO Pay Ratio:

1. **Identify the Median Employee Compensation:** The SEC mandates that companies calculate compensation using a consistent measure, which may be base, bonus, equity, or any combination of the three. Companies could also use W-2 wages.
2. **Determine the CEO Compensation:** The compensation a company uses for the CEO Pay Ratio must match what it reported in the proxy statement.
3. **Calculate the Ratio:** The ratio reflects how many times larger the CEO's compensation is in relation to the median employee compensation. The median employee income is numerically always one, meaning the ratio will be something like 1:300.

Though the media and shareholders are often most interested in the CEO Pay Ratio, it's also available to employees. Consider how the information will impact them, and even use it as a gut check to decide whether the possible CEO compensation will set up both the CEO and the company for success.

Deliver Data-Backed CEO Compensation

Executive compensation plans are complex. They have multiple components, each spanning different lengths of time, and shareholders are increasingly vocal about aligning CEO performance with pay. Public sentiment is also stacked against the compensation it often requires to attract a stand-out CEO.

Executive compensation solutions are a valuable tool for independently benchmarking and analyzing CEO compensation and ensuring that the compensation is enough to incentivize the CEO but not so much that it won't pass shareholder scrutiny.



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