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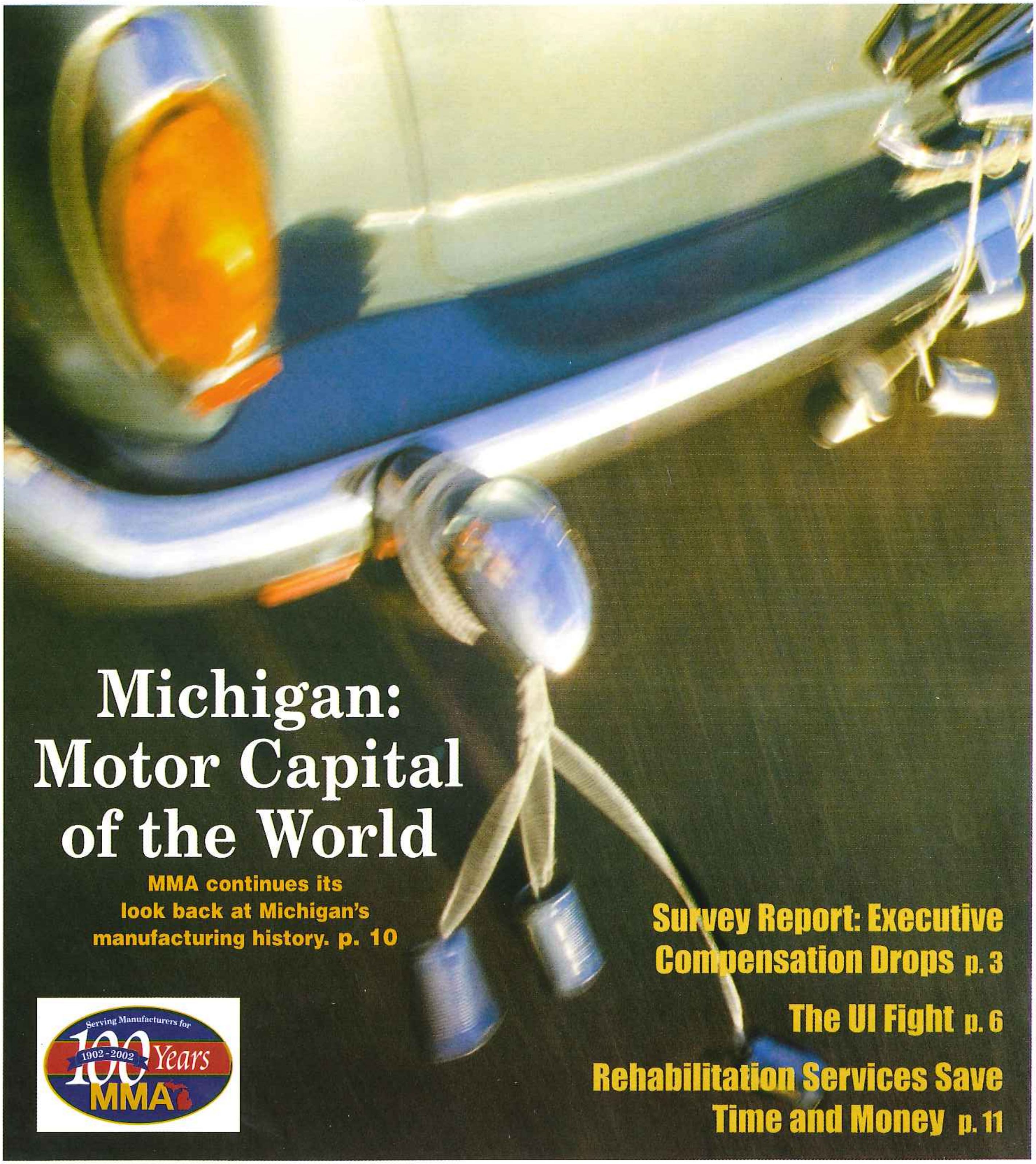

Michigan: Motor Capital of the World

MMA continues its look back at Michigan's manufacturing history. p. 10

Serving Manufacturers for 100 Years 1902-2002 MMA

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2001 Executive Bonuses Plummet in Response to Business Downturn

By Edmund B. Ura

Business was off and so were bonuses as owners paid themselves and their top executives much less for 2001 performance than the prior year. While base salaries increased for 2002, the results of the *2002 MMA Executive Compensation Survey*, conducted by Management Resource Center, Inc. (MRC), indicated clearly that executive pay in Michigan manufacturing — particularly incentive compensation — responds to company performance.

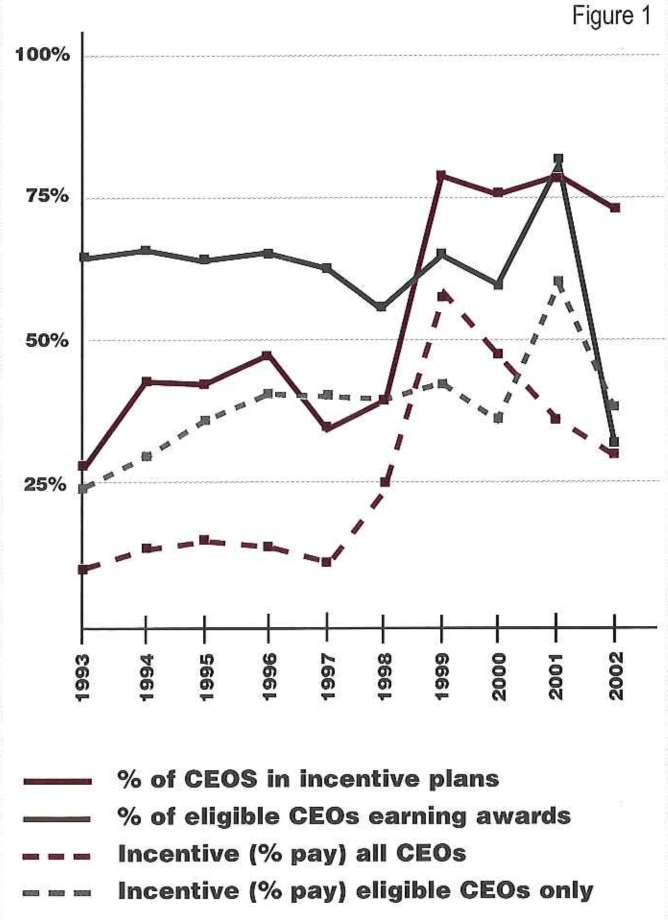
The Executive Compensation Survey, in its eleventh annual edition, is the most comprehensive state survey of pay for 17 different executive jobs, examining the practices of more than 100 Michigan manufacturers that reflect the nature of the "typical" company. It serves as a barometer of pay, company performance and the nature of the manufacturing organization, identifying the presence of owners and non-owners in key company roles.

When reviewing published reports of executive compensation, it is crucial to understand the data presented. Large, publicly traded companies, which are almost the exclusive source of data for the media, are not the typical business form. Ninety-five percent of employers are significantly smaller, and these smaller organizations are much more reflective of the true nature of both business in general and of executive compensation. Surveys such as the *MMA Executive Compensation Survey* provide a much more realistic look at how manufacturing companies pay their employees, especially at the executive level.

Media reports often miss an important factor in reporting on executive compensation — the resources of the company. The size of the company and its financial resources are the most accurate "predictor" of pay at the executive level. In the case of incentives, the connection is obvious — bonuses cannot be paid if funds are not available, regardless of an individual's performance. The large companies that provide seven-figure salaries and bonuses can cover costs of an incentive program even when they are not profitable; the typical company, however, cannot. Therefore, making the assumption that if large companies are paying huge bonuses, all companies must be, is both inaccurate and misleading.

CEO Incentive Pay — 10-Year Trend

Figure 1



Bonus Rates the Lowest in 10 Years

The percentage of "bonus-eligible" executives earning a bonus for 2001 performance was off by 60 percent. (See Figure 1.) While about threequarters of CEOs participated in a bonus program, only 32 percent actually earned an award. This means that fewer than one quarter of all CEOs received a bonus for 2001 performance compared with 60 percent in 2000. The average award paid to bonus-eligible CEOs dropped significantly, from 60 percent to 37 percent of base salary. The percent of total compensation derived from bonuses for the entire CEO population also dropped again to 28 percent, the third year of a downward trend from a 10-year high of 58 percent in 1999.

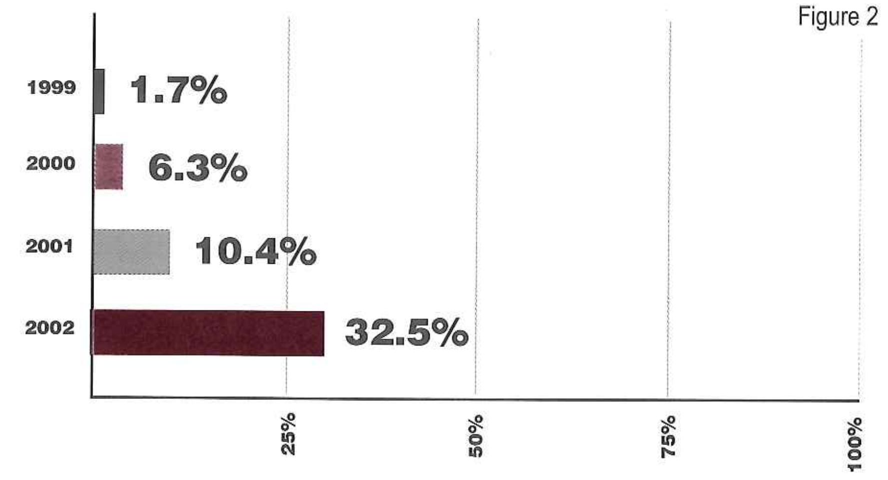
The reduced bonus payout trend was felt throughout the typical organization as fewer than half of the executives who received bonuses in the prior year earned them in 2001, and the actual amounts of the bonuses were also off dramatically. While the percentage of executives receiving bonuses was down across the organization, those hardest hit were executives with jobs closely tied to operations, such as production and operating executives. Bonuses paid to staff positions such as financial and human resource executives decreased at a slightly lesser rate.

The drop-off in bonuses reflects a key component of the nature of incentive programs in small- and mid-sized manufacturing firms. While plans are becoming increasingly more formal, and tied to goals rather than discretion, the goals and objectives that are being used are very much "bottom-line" in nature.

Few bonus programs weigh individual or departmental performance significantly, and most appear to be focused much more closely on measures such as earnings and profitability. Unsurprisingly, with profits down, lower bonuses followed.

CEO Compensation — Percent by which Nonowners Earn More Than Owners

Figure 2



Base Salary Increases, Takes Up Some Slack in Total Compensation

Base salary rates, which are more closely tied to the labor market than incentive payments, increased at a higher rate than in recent years, particularly for staff positions. Despite some media reports indicating that pay increases have been lower than in previous years, this is the second consecutive MMA survey that indicates that pay rates have actually been increasing at a greater rate than in prior years.

Why would executive base pay rates be increasing? The reason is found very clearly in the data. The typical Michigan manufacturer is relying much more on "non-owner" talent, and, as noted every year at this time, non-owner executives are paid more, from a base salary perspective, than their counterparts who own their company. As the market for such individuals increases, and the supply remains reasonably constant, the cost of this kind of talent increases. Realistically, a higher level of unemployment in some segments of the economy simply has had little to no effect on the ability of a business owner to find a talented executive who can actually get results in a small- to medium-sized company. (See Figure 2.)

The sharp rise in base pay in 2002 (from 10 to more than 30 percent) also illustrates that owner CEOs took less in salary in 2001; something a company cannot expect a non-owner to do, without risking loss of talent.

The top executives in staff roles saw a significant increase in base pay. Base salaries for the top finance, information systems and human resources positions increased more than 10 percent. Again, this reflects both a change in the market and in companies' philosophies. Each year, fewer owners are reported in key staff roles, and companies are requiring that employees in these roles have a strategic, rather than a simply administrative, focus. Once again, the greater demand coupled with little change in the supply, calls for increases.

So What's With Unemployment?

The effect of higher unemployment rates on base pay levels is not as simple as a straightforward supply and demand curve. As is often pointed out from our survey research, the effect of unemployment on individual companies is situational and depends on the industry and location of the employer. The collapse of the "dot-com" economy has not increased the availability of engineers in Traverse City, nor has the shut-down of auto plants throughout the U.S. provided the kinds of individuals needed to run a machine shop in Kalamazoo.

Each executive position and each job anywhere in an organization has its own labor market, which can be defined by geography, industry and the size of the organization. To determine whether unemployment levels can be used as a justification for holding down base pay adjustments, it is necessary to determine if there has actually been an increase in the supply of labor for that specific job, in that specific labor market. Otherwise, reliance on general labor market and unemployment statistics will only result in the loss of talented, and previously loyal, executives.

First Report for the Season

Now available, and already sent to subscribers to the H.R. InfoSeries™ (package of three survey reports), the *MMA Executive Compensation Survey* can be ordered directly from Management Resource Center, Inc. by calling 734-454-2500 or by using the form below. In early May, MMA members were sent the *MMA Employee Benefits Survey* form, the most popular study in the series with participation averaging around 400 companies. The benefits survey is the most expansive of its kind and provides information not found in any other source. Participation in the survey takes less than 30 minutes and further improves this best source of data in the state.

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