BVR
What It's Worth

Free Download

Insights Into Recent Data on Small Private Company Executive Comp

Originally published in the January 2014 issue of the *Business Valuation Update*. Authored by Stuart Weiss, CPA/ABV

Business Valuation Resources, LLC
1000 SW Broadway, Suite 1200 | Portland, OR 97205
(503) 291-7963 | info@bvresources.com
www.BVResources.com

BVR
What It's Worth

BUSINESS VALUATION UPDATE

TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

Vol. 20, No. 1, January 2014

Insights Into Recent Data on Small Private Company Executive Comp

By Stuart Weiss, CPA/ABV

As BV people, we're always trying to find good compensation data so that we can properly normalize financial statements. However, most of the good data focus on companies that are too large. And even if we wanted to purchase such data, we'd spend thousands of dollars to get it. That's why **Wayne Cooper,** chairman of Chief Executive Group, developed a product for our marketplace that includes salary, bonus, equity, benefits, and perk data for CEOs, presidents, COOs, CFOs, and other categories of management.

For **Dan Gilbert**, a valuation expert in Portland, Ore., getting good compensation data such as what's contained in this report is critical to his analysis of companies, most of which have revenues under $10 million. "It's really good material and fills a need for those of us who appraise small businesses," Gilbert says.

Cooper has been in the business information industry for 20 years, and as a management consultant he saw a tremendous need for good business data. His company has published *Chief Executive Magazine* for the past 34 years (www.chiefexecutive.net). I sat down with him to get his insights on the compensation data source he provides.

Q. How did you get the idea for a CEO compensation report for private companies?

A. About three years ago, we created a research group on behalf of our clients. This report came about from our subscribers asking us for good information on private companies. There are about 5,000 public companies in the U.S., and there's a lot of information on them. But there are about 3 million private companies, and there wasn't reliable data on compensation trends and best practices for those firms. Their boards and the CEOs wanted that information to benchmark themselves and their companies. We went out and surveyed our audience and got a tremendous response. Over 1,200 CEOs filled out the survey that included very detailed information about their own compensation as well as that of their senior executive team.

Q. Why were they willing to do that?

A. There's a trust factor. Unlike many journalists, we're not out to get them, to make a sensational story. We're on the side of CEOs, trying to help them make better decisions, so I think they trust us—and they want that benchmarking data for themselves.

Q. Do you screen the data for accuracy?

A. We do some screens and look for outliers, and we have a few tests to make sure the data are consistent. If there are outliers, they're flagged for someone to take a look at to make sure it's reasonable and legitimate. If it's out of whack with the size of the company, then we'll dig in to see whether there's a reason for the outlier. And if it's a questionable data point, we'll just throw it out. We'll throw out about 1% of the survey responses because we deem them unreliable.

Business Valuation Update™ (ISSN 1088-4882) is published monthly by Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035. Periodicals Postage Paid at Portland, OR, and at additional mailing offices. Postmaster: Send address changes to *Business Valuation Update*™, Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035.

The annual subscription price for the *Business Valuation Update*™ is $419. Low-cost site licenses are available for those wishing to distribute the *BVU* to their colleagues at the same firm. Contact our sales department for details. Please feel free to contact us via email at customerservice@BVResources.com, via phone at 503-291-7963, via fax at 503-291-7955 or visit our web site at BVResources.com. Editorial and subscription requests may be made via email, mail, fax or phone.

Q. Tell us about the version of your product dealing with smaller companies.

A. For Business Valuation Resources, we created a version of this compensation product for businesses of $10 million in sales and below, which is the market for most business valuation professionals. In the larger report, which has been around for three years, we break out the data by company revenue: $2 million and under, $2 million to $5 million, $5 million to $10 million, $10 million to $25 million—all the way up to $10 billion. Given that some of our customers were small companies and didn't need the data on the bigger companies, we did a version that just focuses on under $2 million, $2 million to $5 million, and $5 million to $10 million in revenue. This version came out this past September.

Q. Can you point out any interesting trends in the report?

A. Yes, one thing to note is the variation in total CEO compensation between top quartile and bottom quartile. While the median was $225,000, the top quartile was $586,000 and the bottom quartile was $112,000. Another interesting point is how much difference the average (mean) is from the median. In this case, the top 10% skew the overall average. Some of them had very lucrative packages and may have sold the company that year and got big equity gains that one year.

Q. I notice from the data in the report that most compensation above $400,000 is in new equity and equity gains.

A. Yes, you'll notice that the median base salary is $170,000, whereas the mean base salary is $187,280. The bonus is a bigger gap: a median of $30,000 and a mean of $94,000.

Q. It looks like salaries are significantly different for companies with revenues under $2 million versus companies with revenues between $2 million and $5 million.

A. Yes, there's a huge step-up in compensation, with median total compensation jumping from

$175,500 to $280,000. However, the step-up to $5 million to $10 million is almost nonexistent.

Q. What about geographical differences?

A. For the small company report, we didn't have enough data points to do a geographical breakdown. In our bigger report, we didn't see much difference between major regions of the country, but, for specific areas such as between Silicon Valley, Calif., and Portland, Ore., there are significant differences in compensation.

Q. Your report tabulates compensation by industry. What conclusions would you draw?

A. I was a little surprised that real estate and advertising/marketing were at the high end of the range while manufacturing was at the low end. I was also surprised at the variance by type of ownership. In the report, you'll see that the base salary is higher for private equity than any other category. On top of that, the private equity owned company offers the CEO a big chunk of new equity—$150,000—versus zero for the family business. But you have to remember that

Two Tests Courts Use to Determine Reasonable Comp

Will your analysis of reasonable compensation stand up in court? Courts typically apply one of two tests to determine reasonable compensation.

1. Independent investor test. Under this test, the court presumes the owner's compensation is reasonable if the shareholders or other independent investors are receiving their expected rates of return. For example, see *Exacto Spring Corp. v. Commissioner,* 196 F.3d 833 (7th Cir. 1999) (Available at BVLaw. Subscription required). The *Exacto* case recognizes that managers who generate higher ROI can usually command higher salaries. To rebut the presumption, it's necessary to show that the high return rates had little or nothing to do with the owner/employee's activities. Alternatively, you'd have to show that the company was using the compensation to conceal a dividend.

2. Multifactor test. Under this test, the court will apply multiple factors to determine whether the compensation claim or adjustment is reasonable. The key case here is *Trucks, Inc. v. U.S.,* 588 F. Supp. 638 (D. Neb. 1987), in which the federal district court listed 15 relevant factors in the determination of reasonable compensation:

- Employee's qualifications and training;
- Nature, extent, and scope of his or her duties;
- Responsibilities and hours involved;
- Size and complexity of the business;
- Results of the employee's efforts;
- Prevailing rates for comparable employees in a comparable business;
- Ratio of compensation to growth and net income (before salaries and federal income tax) of the business;
- Absence of the usual fringe benefits, such as pension or profit-sharing plan, stock options, etc., which are available to executives of other companies of comparable size;
- Employee's responsibility for the company's inception and/or success;
- Time of year that the compensation is determined and by whom;
- Correlation between stockholder-employee's compensation and his or her stock holdings;
- Corporate dividend history;
- Prevailing economic conditions;
- Financial condition of the company after payment of compensation; and
- Whether an independent investor would be willing to compensate the owner/employee as he or she was compensated.

In practice, one good approach is to use the multifactor test to reach your conclusions about compensation. Then, apply the independent investor test to see whether the applicable rate of return makes sense.

the private equity company is a more competitive environment with a shorter half-life than a family-owned company where tenures can last a long time.

Q. Speaking of family-owned companies, how do you distinguish between C and S corporations?

A. We do ask the controlling shareholder how much of the take-home should be allocated to salary versus ownership. Let's say it's a C corp that is owned by the founder. The market rate might be $200,000, and there was another $200,000 in profit, but, because it's a C corp, it's advantageous to take $400,000 as compensation. So we would ask: Of the $400,000, how much was truly based upon what my competitive base salary should have been?

Final point: Determining the value of reasonable compensation can be a major assignment in and of itself, depending on the nature of the subject business, the duties of the owner/employee, the amount of money involved, and other nuances. It's crucial for the analysts who use data sources to understand the databases and surveys, how they are compiled, and what they truly represent. Also, it's best to use several sources to do a complete analysis. This will help if you and your analysis end up in court (see sidebar).

Both the report described here, *Small (Under $10 Million Revenues) Private Company Executive Compensation Digest 2013-2014,* and the larger report that covers companies of all sizes, *CEO and Senior Executive Compensation Report for Private Companies 2013-2014,* are available at www.bvresources.com/compensation.

Stuart Weiss, CPA/ABV, *is a business valuation practitioner in Portland, Ore. He can be reached at stu@stuartweiss.com or 503-223-3142.*

BVR
What It's Worth

Get detailed data for owner compensation — one of the most contested issues in Business Valuation

A private company owner's compensation is among the most contested issues in a business valuation, right up there with discounts and premium issues. Chief Executive Research has two new compensation digests you'll want to have in your toolbox this year to reference often.

Executive Compensation in Small (<$10 Million) Private Companies ($495.00)
Chief Executive Research surveyed 250 small private companies about their 2012 and 2013 senior executive incentives, and compiled the data in this 190-page small private company executive compensation digest. The digest includes small company compensation data (base salary, bonus, new equity, equity gains, benefits and perks) by:

- Title - Includes CEO, President, COO, CFO, CMO, CSO, CIO and R&D
- Revenue - Includes revenue ranges from under $2M, $2-4.9M and $5-9.9M
- Ownership Type - Includes employee owned, family owned, investor owned, partnerships, private equity owned, sole proprietorships, and venture capital owned
- Number of Employees - Includes employee size ranges from 0-10, 11-24, 25-49 and 50-99

CEO & Senior Executive Compensation Report for Private Companies, 2013-2014
Two Volumes ($1,995.00)

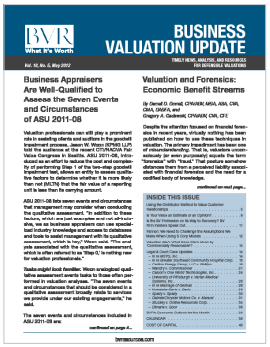
Chief Executive Research has gathered compensation and best practices data from 1,102 private companies, with more than 2,800 current CEO and executive compensation data points. Most of the data for this two-volume set came from companies with revenues between $10-$250 million. This is the most comprehensive proprietary dataset for private company CEO and executive compensation ever collected. Use this report to:

- Craft compensation practices that motivate and reward your executive team
- Attract and retain the right senior talent
- Benchmark your own compensation relative to your peers

Order your copies today!
www.BVResources.com/Publications

If you prefer, contact us at: info@bvresources.com or (503) 291-7963

BVR
What It's Worth



BVR What It's Worth

BUSINESS VALUATION UPDATE

TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

Vol. 10, No. 5, May 2012

Business Appraisers Are Well-Qualified to Assess the Seven Events and Circumstances of ASU 2011-08

Valuation professionals can still play a prominent role in the goodwill impairment testing and assessment process, Jason W. Wilson (SFMS) LLP, told the audience at the recent CITUN/NACVA Fall Value Congress in Seattle. ASU 2011-08, introduced as an effort to reduce the cost and complexity of goodwill, ASC 350-20 of the goodwill impairment test, allows an entity to assess qualitative factors to determine whether it is more likely than not (MLTN) that the fair value of a reporting unit is less than its carrying amount.

ASU 2011-08 lists seven events and circumstances that management may consider when conducting the qualitative assessment. "In addition to these factors, which are just examples and not all-inclusive, we as business appraisers can use specialized industry knowledge and access to databases to provide a more comprehensive qualitative assessment, which is key," Wilson said. "Flow and risk associated with the qualitative assessment, which is often referred to as 'Step 0,' is nothing new for valuation professionals."

Sales-might-look-familiar: Wilson analogized qualitative assessment events tasks to those often performed in valuation analyses. "The seven events and circumstances that should be considered in a qualitative assessment totally relate to sector we provide under our existing engagements," he said.

The seven events and circumstances included in ASU 2011-08 are

continued on page 4...

Valuation and Forensics: Economic Benefit Streams

by Gerald O. Dorsel, CPA/ABV, MBA, ASA, CIA, CBA, DBFA, and Gregory A. Gadawski, CPA/ABV, CVA, CFE

Despite the attention focused on financial forensics in recent years, virtually nothing has been said about the role of forensics in business valuation. The primary trade-offered has been one of misunderstanding. That is, valuators unconsciously (or even purposely) equate the term "forensics" with "fraud." That posture somehow implies that the forensic accounting is associated with financial forensics and the need for a codified body of knowledge.

continued on next page...

INSIDE THIS ISSUE

THOMSON STORE.COM

Subscribe Today!
$419.00/year

BVUpdate™

Business Valuation Update™ (BVU) keeps you at the center of the business valuation profession. You'll get the new thinking from leading appraisers, detailed reports from valuation conferences (even when you can't attend yourself), analysis of new approaches and court decisions, regulatory and standards updates, and more! Your subscription includes the monthly BVU (in PDF or print), weekly news updates (via *BVWire*) and online access to all previous issues — everything you need to stay current on your challenging and rewarding profession.

Benefit with the BVU:

- Stay current on changes at FASB, TAF, IASB, DOL, and the many other regulatory agencies and courts that influence how valuation is practiced
- Get analysis of "landmark" cases in key business valuation issues such as discounts for lack of marketability, control premia, the effect of taxes in S Corporations, and more
- Access excerpts from BVR's monthly *Economic Outlook Update* including historical economic data and forecast charts
- Quickly access all current and historical issues—so you can always find the valuation approach, case, or source you need
- Better support your valuation conclusions by incorporating the latest research and findings in your reports or expert witness testimony
- Access cost of capital highlights from Duff & Phelps, monthly economic update summaries you can use in your reports, and a calendar of the best CPE from ASA, NACVA, the AICPA, BVR and others

Subscribe Today at www.BVResources.com/BVU

If you prefer, fax this form to our secure line: (503) 291-7955 or call (503) 291-7963

❏ **Yes!** I'd like to subscribe to BVUpdate for $419.00/year **(Priority code: PRIOR1365).**

Name: _____ Firm: _____

Address: _____ City,State,Zip: _____

Phone: _____ Fax: _____ E-mail: _____

Billing Information:

❏ Visa ❏ Mastercard ❏ AMEX ❏ Check payable to: Business Valuation Resources, LLC

Credit Card #: _____ Exp. Date: _____ Sec. Code: _____

Cardholder Name & Address (if different): _____