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SPECIAL REPORT -- EXECUTIVE PAY

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After two years of double-digit declines, executive pay was finally supposed to bounce back in 2003. A few weeks ago, compensation consultants were predicting increases of 15% or more, as boards doled out huge profit-driven bonuses and CEOs rushed to cash in options during the market upturn. Indeed, with their shares soaring in value, some long-successful CEOs took the opportunity to cash in options that were about to expire. That resulted in some gargantuan pay packages. "I'm a little embarrassed about it," says United Technologies Corp.'s (UTX) George David, who pulled down $70.5 million last year. "But it's a direct result of greater shareholder value."

Top executive paychecks in 2003 were, as usual, off-the-charts amazing. However, overall raises for corporate leaders actually slowed considerably. The chief executives in *BusinessWeek*'s 54th annual Executive Pay Scoreboard saw their average salary, bonus, and long-term compensation increase 9.1% last year, to $8.1 million, a far cry from the double-digit gains that were common in the 1990s. And they had better get used to it. A combination of increasingly independent boards, angry shareholders, and a likely rule change that would make it easier for big investors to oust clueless directors has many boards revamping pay packages in ways that should keep a lid on massive paydays far into the future.

Many of the executives who managed to buck those downward forces to top the 2003 pay ranks are familiar names. No. 2 Steve Jobs of Apple Computer Inc. (AAPL), who last year swapped 27 million underwater options for $74.8 million in restricted stock that he'll collect in 2006, appeared in our 2001 and 2002 surveys. Apple points out that those options, along with a Gulfstream V that Jobs got in 2001, are the only pay he has received since returning to the company's helm in 1997. Cendant Corp.'s (CD) Henry R. Silverman, who took home $54.4 million last year, came in at No. 4, marking his second appearance on the list. Hot on his heels: Citigroup (C) Chairman Sanford I. Weill, who stepped down as CEO in October, had a $54.1 million payday -- placing him among the nation's highest-paid executives for the fourth time in five years.

It's hard to justify anyone making so much money. But some of the top pay packages reflected years of phenomenal performance. Take the No. 1 name on our list, Colgate-Palmolive Co.'s (CL) Reuben Mark. To cash in the options that made up most of his $141.1 million pay package, he had to clear some exceedingly high hurdles. Ten years ago, the Colgate board granted Mark 4 million split-adjusted options -- his last for seven years -- that would pay off only if Colgate stock surged as much as 80%. They would lapse long before their 10-year expiration date if the stock price did not hit specified targets. Mark was able to cash those options in last year because Colgate's stock rose 286% over 10 years, more than twice the 114% gain for the Standard & Poor's 500-stock index.

Traditional options often allow a CEO to ride a rising market to extraordinary riches without having to beat any targets. But such premium-priced options reward CEOs only after they've delivered big gains, says Patrick S. McGurn, senior vice-president at proxy adviser Institutional Shareholder Services Inc. "He has earned the right to exercise those options by creating sustained growth in shareholder value," says McGurn.

That sort of nuance is easy to miss in a survey of corporate proxy reports. That's why *BusinessWeek* decided this year to look behind the top CEO paychecks to get a more complete picture of what it takes to climb this mountain of corporate wealth. To pinpoint the characteristics of top-earning execs, we started with a list of 100 of the largest companies in the S&P 500 where the current CEOs have been on the job for the past three years. Then we gathered publicly available biographical information -- from date of birth to where they got their MBAs -- and asked them for additional info. Finally, we concentrated on the 25 CEOs with the highest pay, trying to determine what traits they share.

The portrait that emerged was illuminating. For one thing, the road to corporate power remains, for the most part, a meritocracy. Most of these execs did not attend elite universities. They began their adulthood uncertain of where life's path would take them and made at least one sharp turn to get onto the fast track. For many, that meant changing educational plans, abandoning a life in academia or government service for a career in business, or switching industries later in life.

First, the obvious: As a group, these 25 CEOs were extremely well compensated. Their average annual pay came to $32.7 million. To put that in perspective, it's more than four times the average pay for all the CEOs in *BusinessWeek*'s Executive Pay Scoreboard for the same three-year period -- and more than 900 times the annual salary of the typical U.S. worker. The bulk of executive pay today is tied to company performance, so shareholder returns were a big factor, although, as we found out, not as big as you might think.

EASTERN STARS. Granted, it can be misleading to extrapolate too much from a small sample. Still the results were provocative. It's not surprising that 44% of those CEOs were born in the East. But how to explain that 6 of the 25 CEOs -- including Oracle's Lawrence J. Ellison and Citigroup's Weill -- were New Yorkers, from a city with less than 3% of the U.S. population? One explanation may be that growing up in the home of Wall Street and the world mass-media capital prepares kids for a life at the top of the hierarchy. James M. Citrin, who recruits technology and media execs for search firm Spencer Stuart, knows this firsthand. At a Broadway show recently, his 13-year-old son spotted Jack Welch, the legendary ex-CEO of General Electric Co. (GE) -- a face not instantly recognizable by most 13-year-olds. "They're going to be business-savvy at an extraordinarily young age," says Citrin.

For most chief execs in training, life comes to a fork at age 18, when people must decide on a college. But here, one of the cherished myths of executive development -- that top talent is drawn from the academic elite -- turns out to be just that. True, 8 of the top 25 attended Ivy League colleges -- but the rest went to the likes of Texas Tech, Iowa State, and City College of New York. Fourteen of the top 25 have an advanced degree, but only 10 of those are MBAs. Seven of those MBAs came from top-ranked B-schools. Jeffrey A. Sonnenfeld, associate dean at the Yale School of Management, says that this underscores the egalitarian nature of success in America and that the market for talent rewards groundbreaking innovators regardless of pedigree. "These are people who made huge leaps," says Sonnenfeld. "None of these are aristocrats."

While some of the 25 highest paid undoubtedly contemplated a business career early on, many others did a fair bit of experimentation before settling down to a life in senior management. Qualcomm Inc.'s (QCOM) Irwin M. Jacobs began as a professor at Massachusetts Institute of Technology and the University of California at San Diego. Kenneth I. Chenault at American Express Co. (AXP) was a consultant at Bain & Co. And James E. Cayne of Bear Stearns Cos. (BSC) started in sales and playing professional bridge, only to end up as a broker. If a certain amount of wanderlust is a prerequisite for success, then a few of our top 25 CEOs have plenty. Ellison, Morgan Stanley's (MWD) Philip J. Purcell, and Daniel J. Warmenhoven of Network Appliance Inc. (NTAP) all head companies far from their birthplace.

On the other hand, once a CEO is ensconced in the corner office, there are powerful incentives to stay put. It generally takes 10 years for options stockpiles to get big enough and valuable enough to generate regular eight-figure pay packages. That's why 18 of the 25 top-paid CEOs in the group we studied have been in that post for more than five years, more than half of those for a decade or more.

To rake in the big bucks, CEOs must also produce a surge in shareholder value. So you would expect the top-paid CEOs to outperform the rest of the field. Most did. However, 8 of the 25 failed to beat the S&P 500 for total shareholder returns over the past three years. Little surprise that, thanks to their giant pay packages, none of the other 17 aced our pay-for-performance analysis. Berkshire Hathaway Inc.'s Warren E. Buffett was the biggest bargain for shareholders in 2003.

Jozef Straus, retired CEO of JDS Uniphase Corp. (JDSU), delivered the least bang for the buck. The company notes that more than 80% of Straus's three-year pay of $151.9 million came from options exercised at the peak of the telecom boom in August, 2000 -- during the company's 2001 fiscal year but before the start of *BusinessWeek*'s survey period, based on calendar years. Following the peak, Straus's pay fell to $500,000 a year. Oracle Corp.'s (ORCL) Lawrence J. Ellison was also among the lowest performers from 2001 through 2003, producing shareholder returns of -54%, compared with -16% for the S&P 500. He was a champion when it came to his pay package, however, taking home a three-year haul of $746.7 million. Ellison, through a spokesman, declined to comment.

The huge options awards behind the top paychecks are likely to shrink further. Many boards last year began making pay more dependent on meeting tough goals, limiting massive payouts. Among the changes: shifting pay from options to restricted stock and replacing traditional options with those that pay off only after a big rise in stock prices. Gargantuan option grants haven't vanished: In 2003, American International Group's (AIG) Maurice R. "Hank" Greenberg got 750,000 options -- double his 2002 grant -- that will be worth $66.3 million in 10 years if AIG stock rises 10% a year. But companies such as GE and IBM (IBM) are leading the way on reform, and others will follow. Says Ira Kay, compensation practice leader at Watson Wyatt Worldwide (WW): "It will take even better performance to yield the same pay."

Never underestimate the ability of CEOs to find fresh sources of compensation, though. One part of the formula that doesn't seem to be changing is the generous shower of perks. The 25 highly paid CEOs in the *BusinessWeek* study received average perks valued at $938,111 in 2003. For 4 of the 25, the perk package alone topped $1 million. Bear Stearns's James Cayne took home $12.3 million in above-market earnings on company stock. Bear Stearns says that represents "investment income," not a perk, and that it is similar to discounts many Wall Street execs receive on restricted stock grants.

"BADGE OF MERIT". To some extent, perks are built into a CEO's retirement package; Company contributions to 401(k) plans and life insurance are tied to salary. But others reflect rights accorded today's corporate nobility. Not only does Coca-Cola Co.'s (KO) Douglas N. Daft get to use the company aircraft for personal travel but Coke also picks up taxes on the perk. In 2001, Wells Fargo & Co.'s (WFC) Richard M. Kovacevich got $67,044 to cover mortgage interest on the purchase of his house in San Francisco. Paul Hodgson of corporate governance watchdog The Corporate Library explains that such power perks have been increasing for some time, in what he describes as a case of keeping up with the Joneses. "There's a 'he's getting it, so why shouldn't I?' aspect to it," says Hodgson. "It's a badge of merit."

That sense of entitlement may shrink in the face of energized boards and emboldened shareholders. The CEO gravy train is slowing in response to these forces. But as this Scoreboard shows, the road to riches is still wide open.

By Louis Lavelle, with Jessi Hempel and Diane Brady, in New York