



# Pay-for-Performance Alignment: Tools and Techniques

Compensation Series

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May 10, 2011

Pearl Meyer & Partners  
*Comprehensive Compensation*<sup>®</sup>



ADVANCING EXEMPLARY BOARD LEADERSHIP



## Meet the Presenters



**Richard Goeglein** (moderator), Lead Director, Pinnacle Entertainment; Member, Advisory Board of The Board of Veteran CEOs; Trustee, Board of Volunteers in Medicine of Southern Nevada



**Todd Krauser** is a vice president in the Atlanta office of Pearl Meyer & Partners, where he advises compensation committees and executives on all aspects of executive and outside director compensation.



**Gregory Stoeckel**, a managing director in the Atlanta office of Pearl Meyer & Partners, has consulted for nearly 15 years on executive compensation programs, with a focus on peer group development, pay and performance alignment, new share requests and proxy disclosure issues.





## Discussion Agenda

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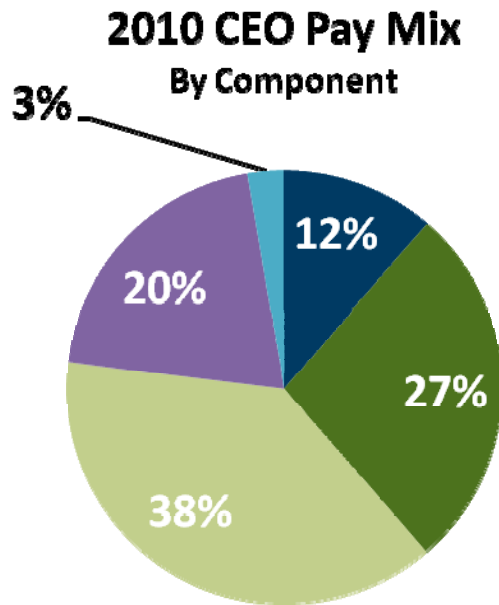
- The Business Case for “Pay-for-Performance”
- Selecting Performance Measures
- Setting Performance Goals
- Testing Pay-for-Performance Relationships



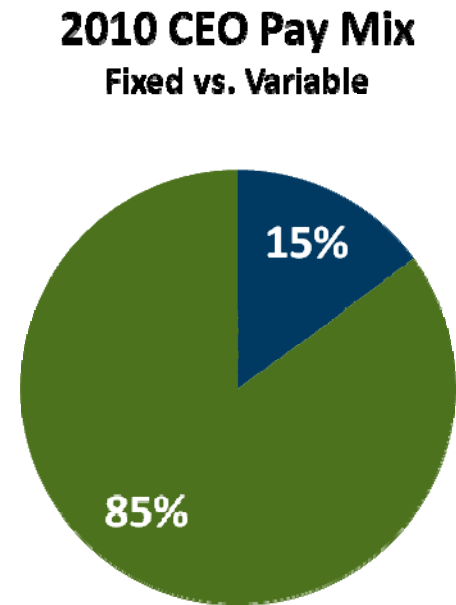


# 1. The Business Case for Pay-for-Performance

85% of CEO Pay is Variable <sup>1</sup>



■ Salary ■ Bonus ■ Stock ■ Options ■ Other



■ Fixed ■ Variable

<sup>1</sup> Average S&P 500 CEO Pay Mix as reported by Equilar



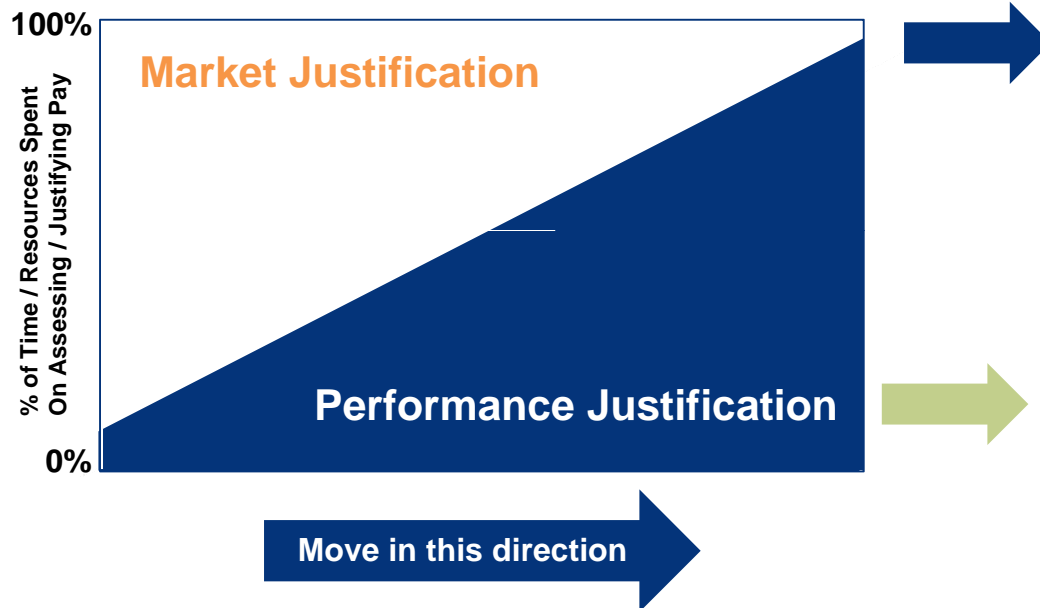


# 1. The Business Case for Pay-for-Performance

*Variable Pay Needs to be "Performance Justified"*



## WHAT IT "SOUNDS" LIKE



### ***MARKET JUSTIFICATION***

- We need to increase pay to be competitive

### ***PERFORMANCE JUSTIFICATION***

- We need to increase pay to bring pay and performance into alignment

*Which do you think resonates better with shareholders?*



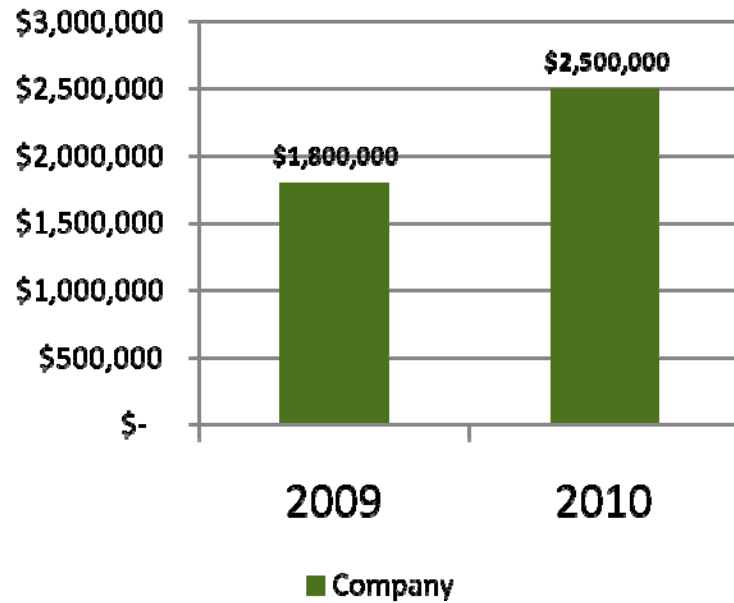


# 1. The Business Case for Pay-for-Performance

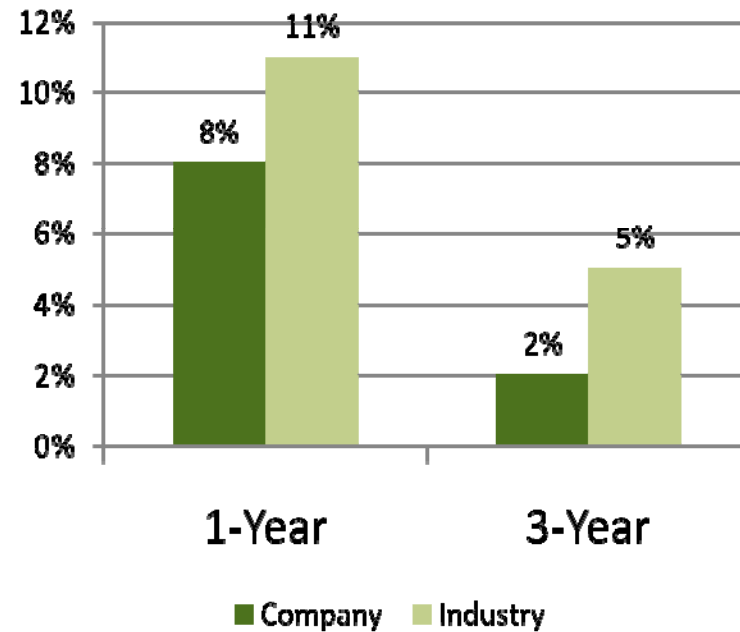
*Pay-For-Performance "Disconnects" Causing SOP Challenges*



### CEO Pay



### Company TSR



Increased CEO Pay + Below Market Returns = AGAINST SOP





# 1. The Business Case for Pay-for-Performance

*Pre-Emptive Filings Focusing on Pay and Performance Linkage*



## Pre-emptive Filings

Post Proxy Filing  
After Advisory Firm Reports  
Voluntary Supplemental Filings  
Offer an Alternative Perspective  
Intended to Improve Vote  
Outcome



## Issues Addressed

Peer Group (GICS)  
Performance Measures  
Time Periods  
Equity Valuation Methods  
Special Circumstances

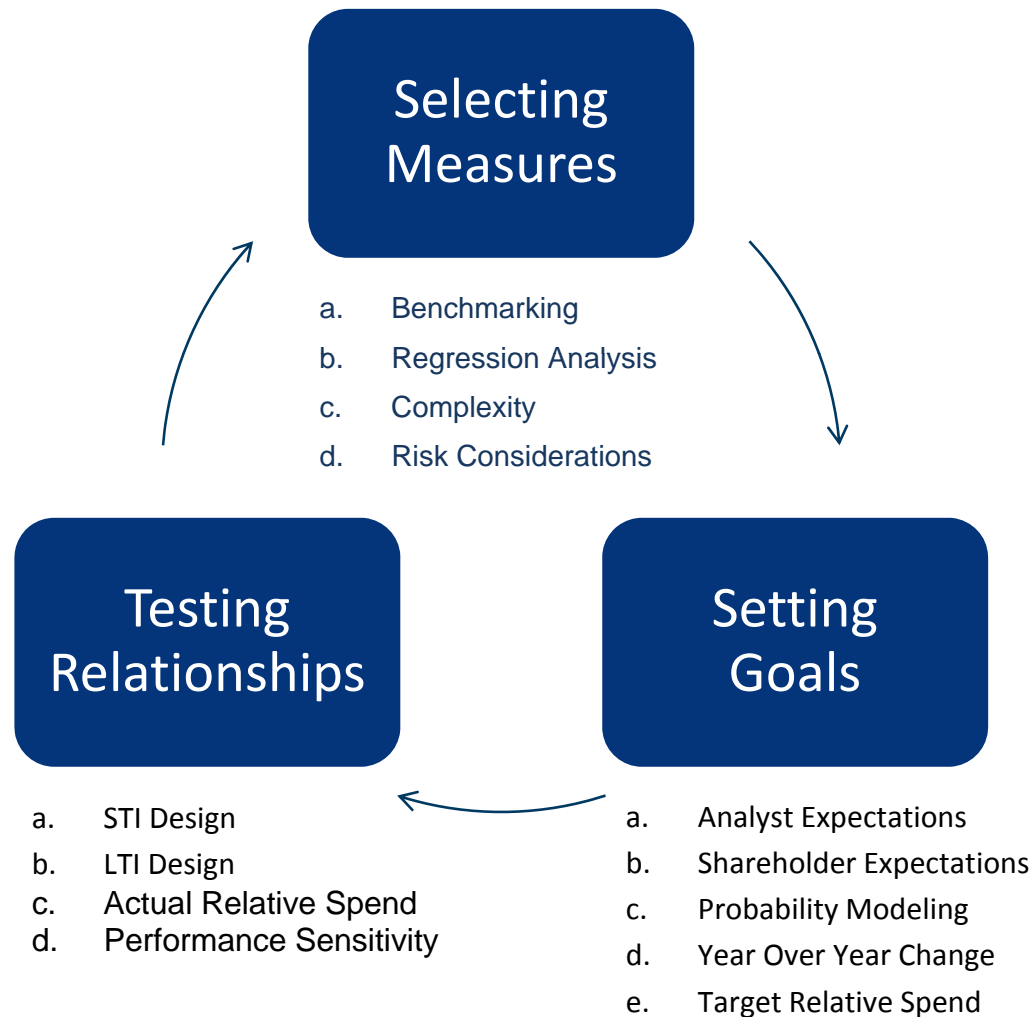
The Best Defense May Be a Good Offense





# 1. The Business Case for Pay-for-Performance

*Good Offense Requires Robust Tools & Techniques*



***Polling Questions 1 and 2***



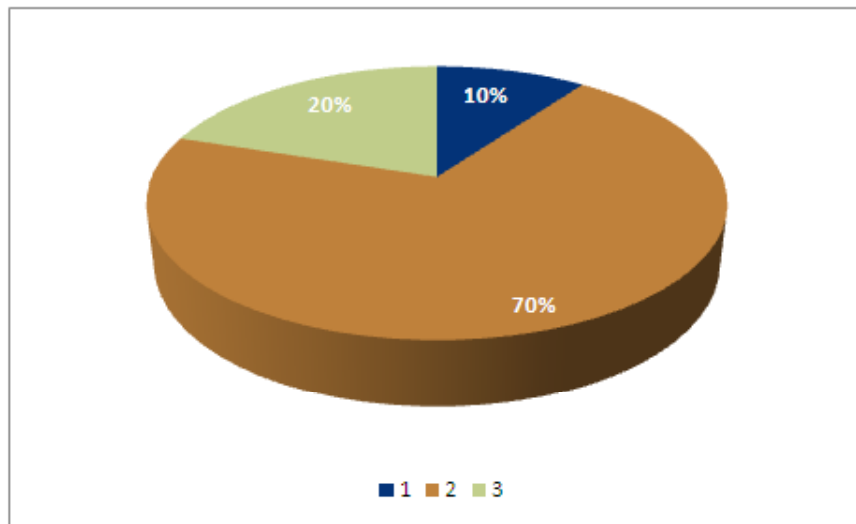


## 2. Selecting Performance Measures – Benchmarking

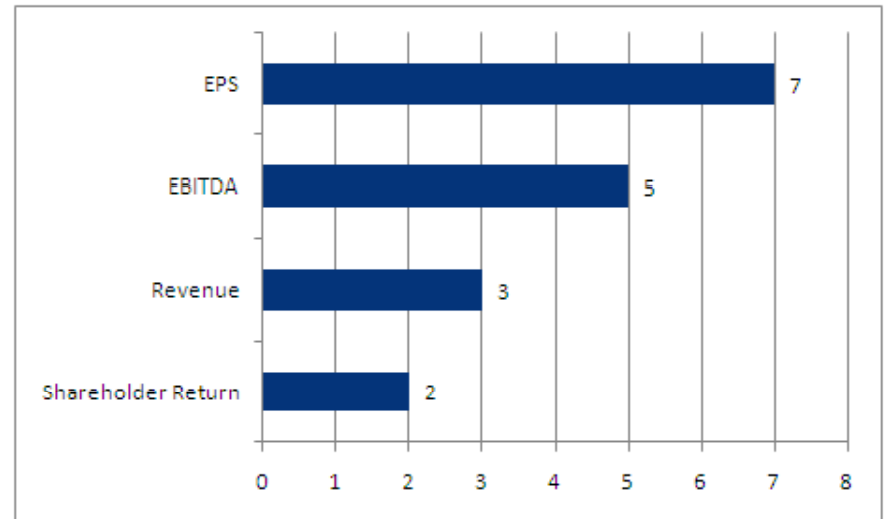
*Understand market / peer group practices*



Number of Measures Used



Most Prevalent Performance Measures



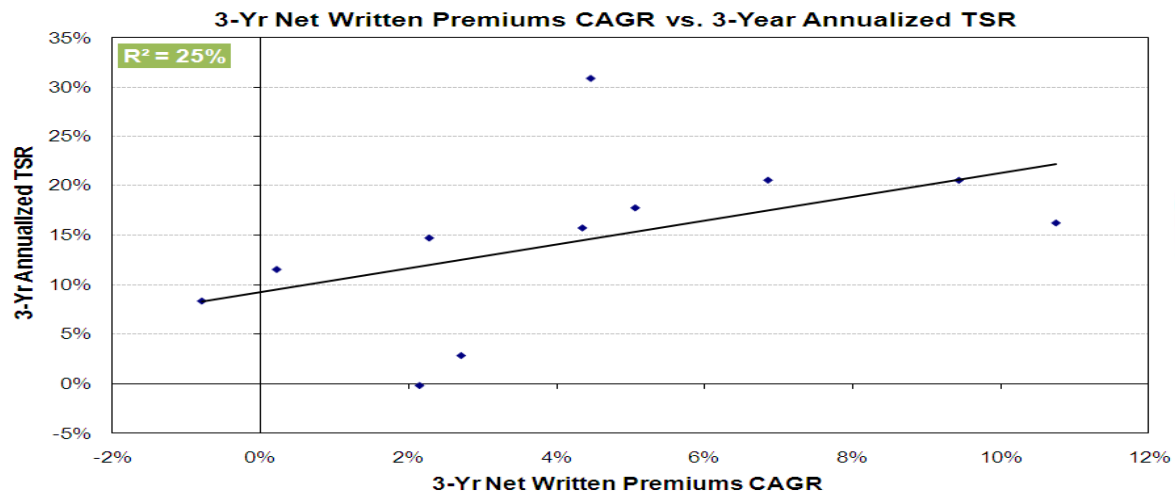
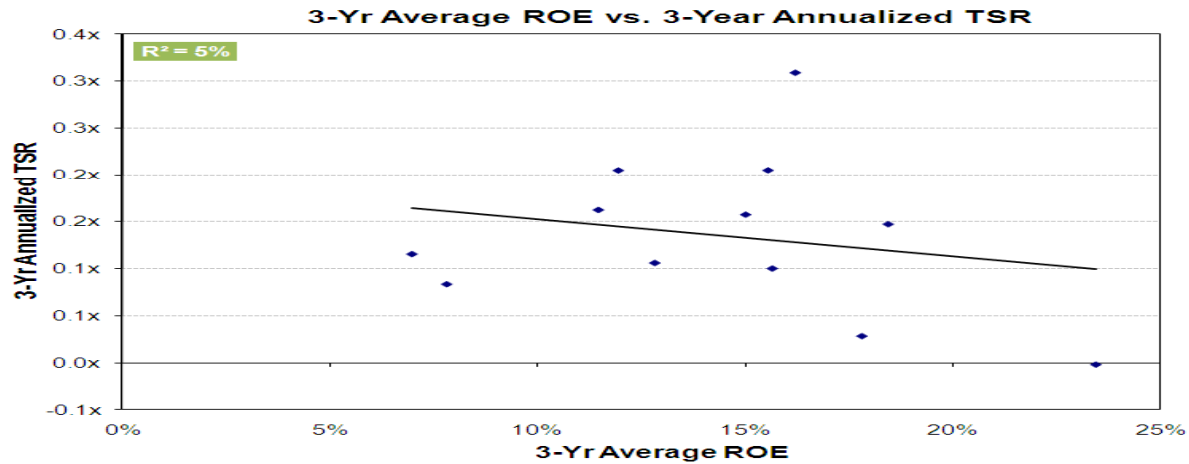
***What everyone else is doing may not be right for your company***





## 2. Selecting Performance Measures – Regression Analysis

*Test Relationships Between Measures and Value Creation*



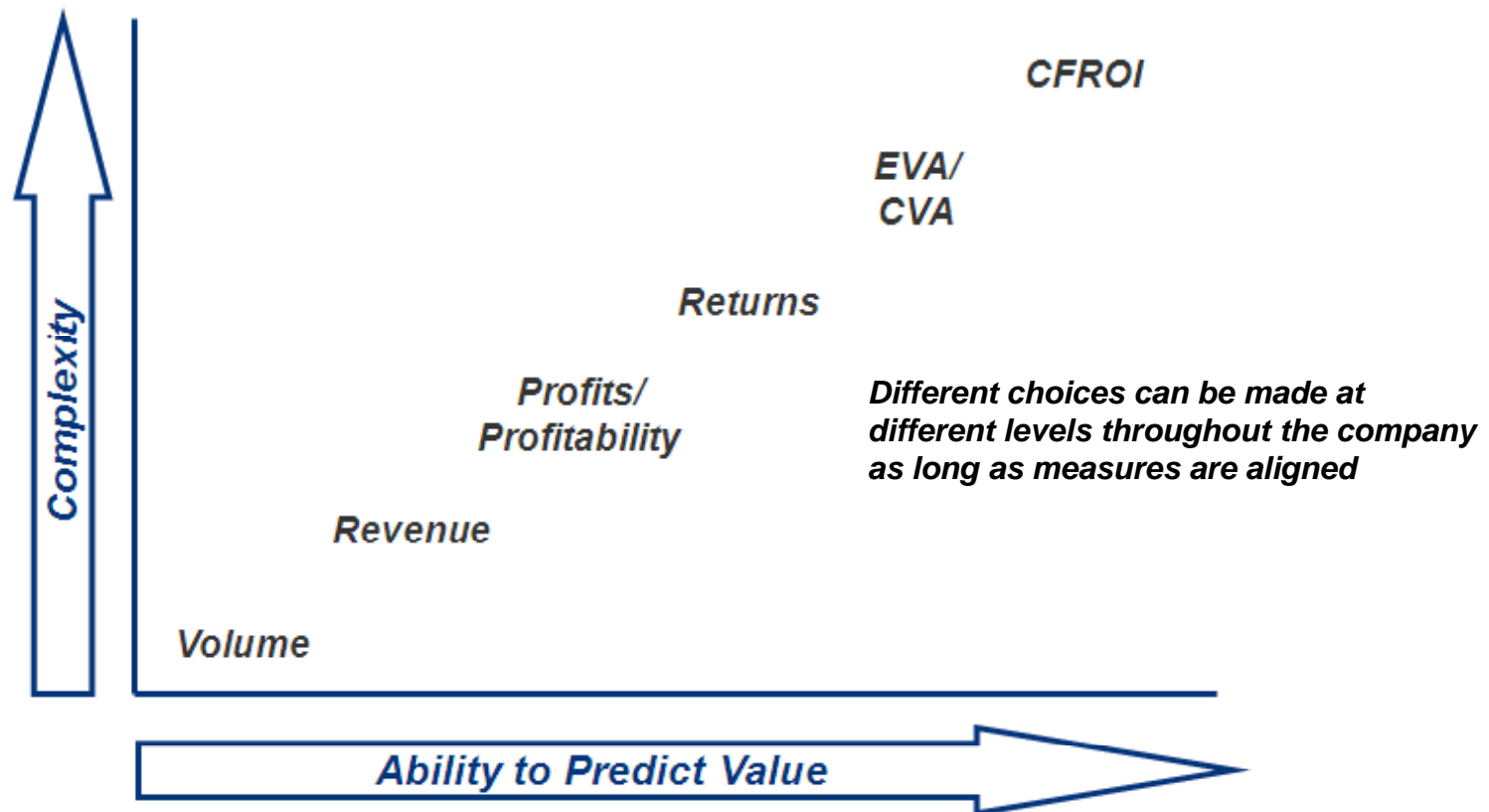
*Intended to provide directional not absolute guidance*





## 2. Selecting Performance Measures – Complexity

*Manage Trade-Off's to Minimize Complexity*



***Participants need to understand the measure and how they can impact it***





## 2. Selecting Performance Measures – Risk Considerations

*Evaluate Measures and Combinations from a Risk Perspective*



### Measure Selection Sample Risk Considerations

Single or Multiple Measures

Same or Different in STI and LTI

GAAP or Non-GAAP Definition

Objective or Subjective Result

Include or Exclude Financing Activities

Experience Tracking and Reporting

Historical Base Line

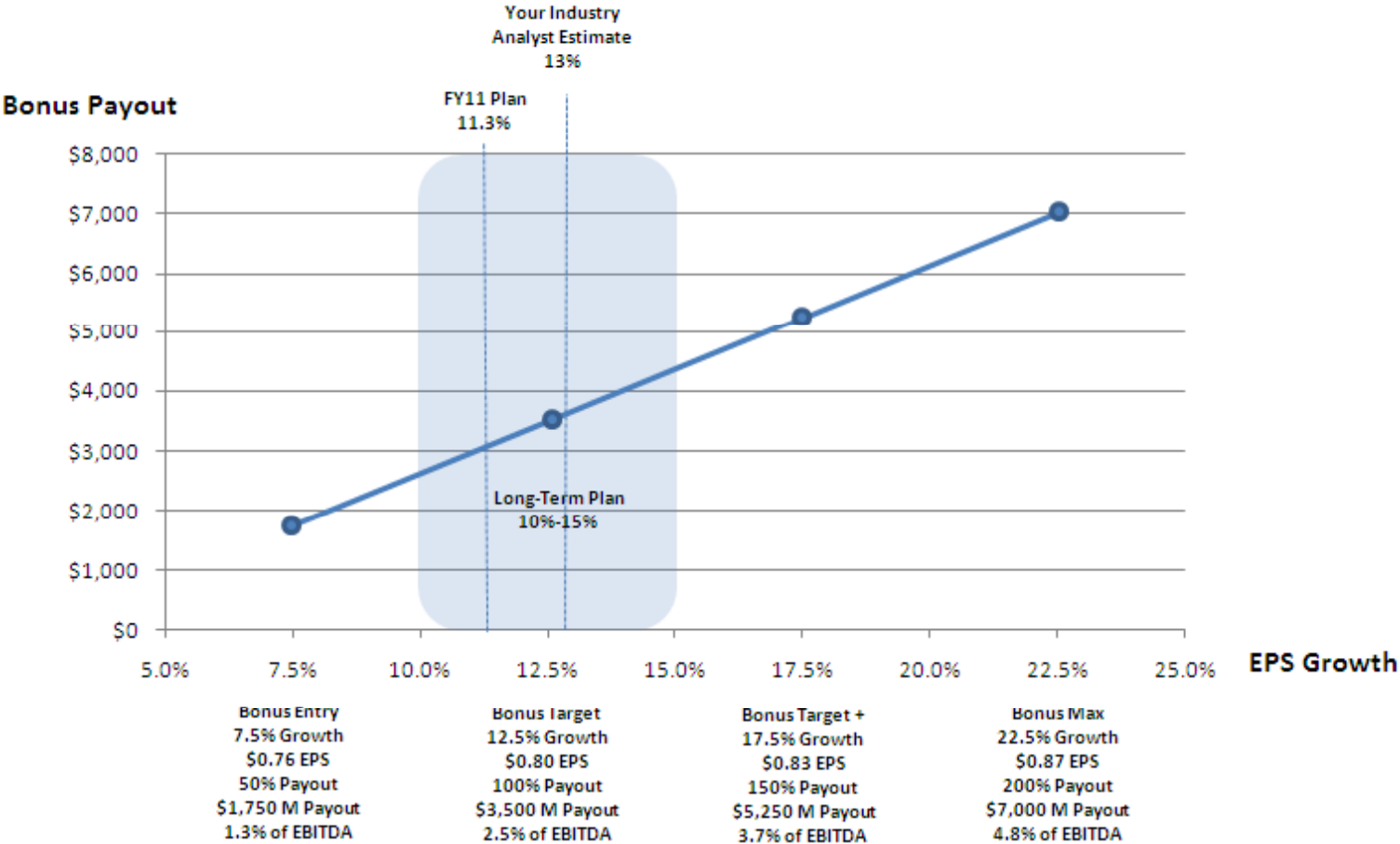
*Document discussion,  
observations,  
and conclusions as part of  
the measure  
selection process*





### 3. Setting Performance Goals – Analyst Expectations

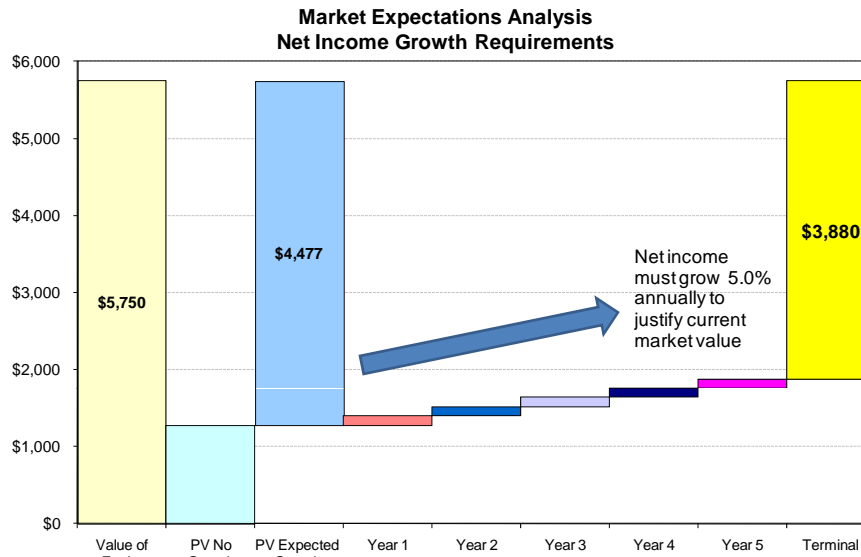
*Understand How Your Targets Compare to Analyst Expectations*



***Consider analyst expectations when setting targets***

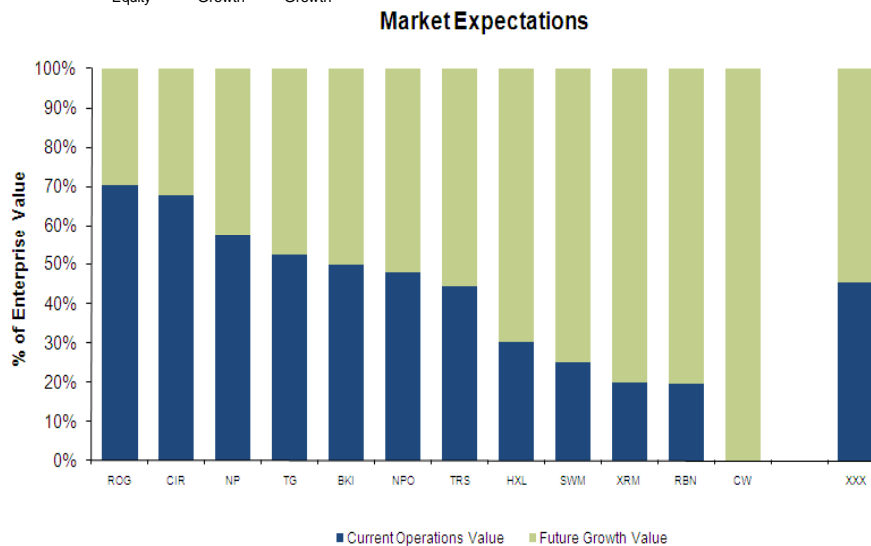


### 3. Setting Performance Goals – Shareholder Expectations Understand Growth Expectations Implied by Current Stock Price



#### Your Growth Expectation

- What rate of earnings growth is implied by your current valuation?
- In theory, this is the minimum level of growth required to support the current stock price



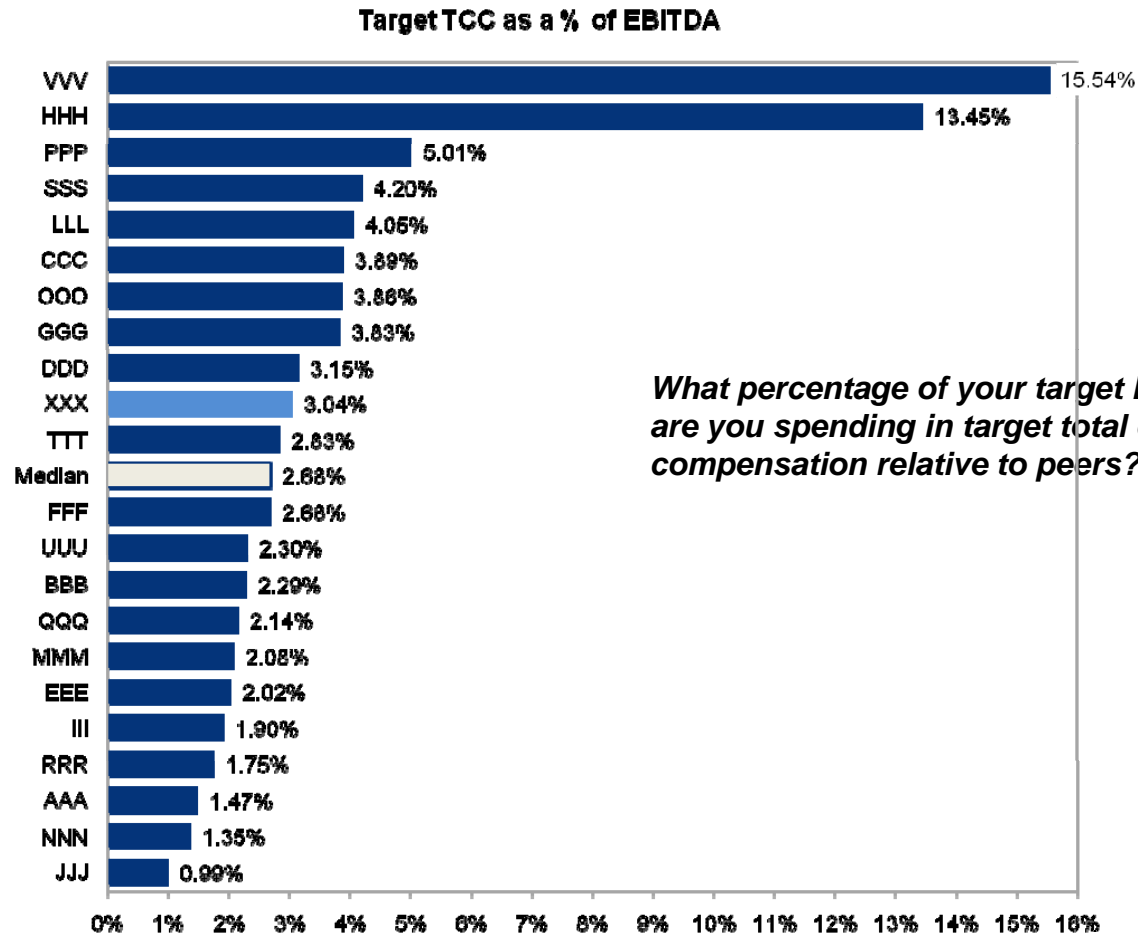
#### How it Compares to Peers

- How does your implied growth rate compare to peers?
- In theory, your targets may need to be higher or lower than peers to support the current stock price



### 3. Setting Performance Goals – Target Relative Spend

*Assess Your Relative Target Spend vs. Peers*



*What percentage of your target EBITDA are you spending in target total cash compensation relative to peers?*

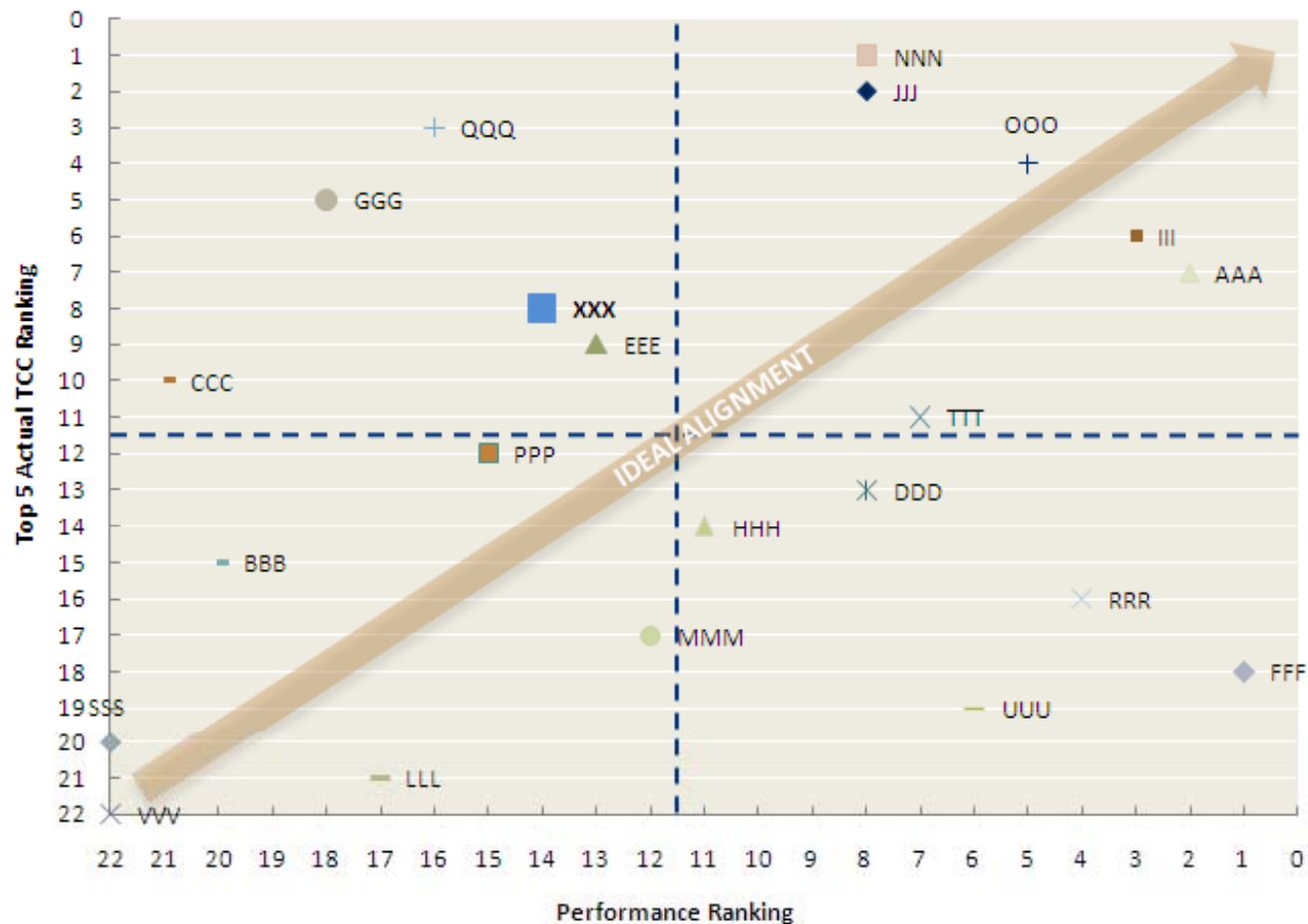
***Avoid the extremes, but consider life-cycle stage and other factors***





## 4. Testing Relationships – STI Design

### Graph Short-Term Pay and Performance Rank Against Peers

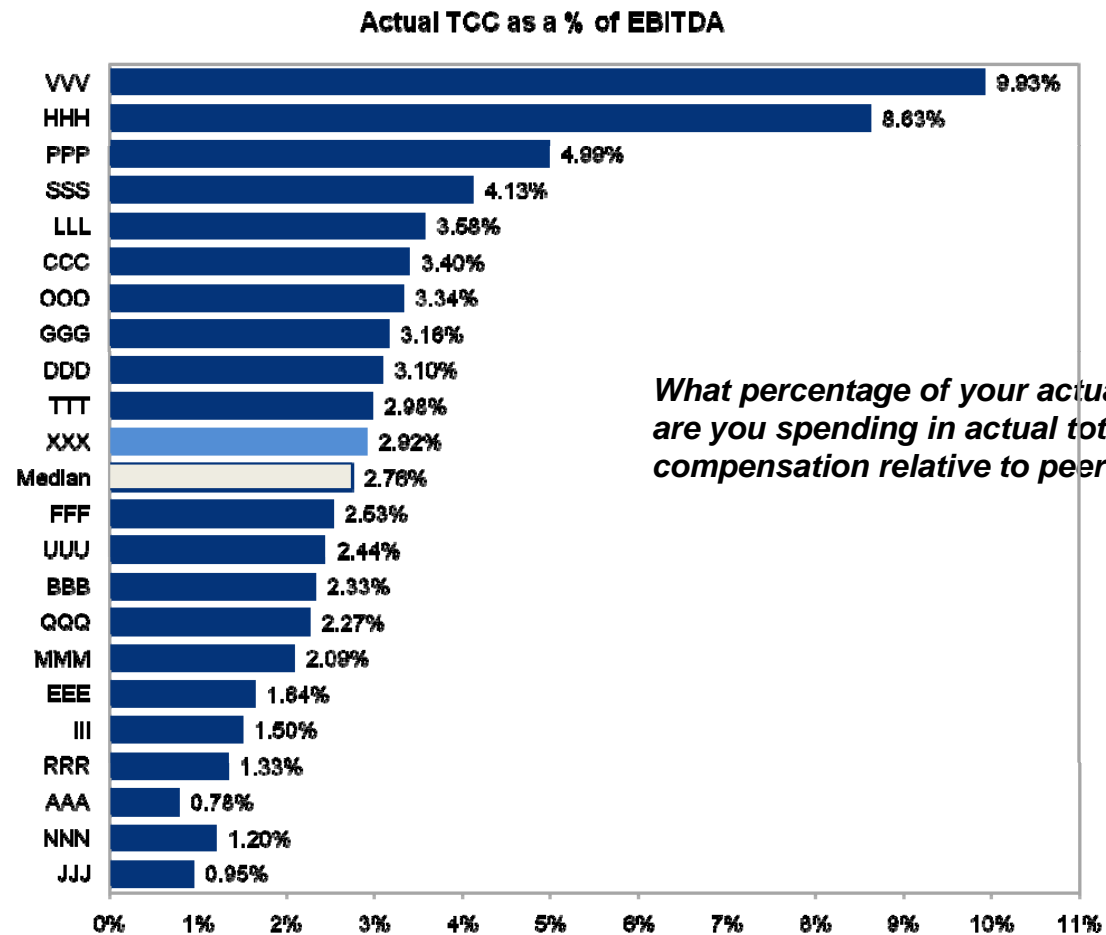


*Rear view mirror – prior year pay and performance alignment vs. peers*





## 4. Testing Relationships – Actual Relative Spend *Assess Your Relative Actual Spend vs. Peers*



*Rear view mirror - Avoid the extremes, but consider performance*





## Key Takeaways

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- A vast majority of executive compensation is performance-based, and this compensation needs to be justified by performance
- Failure to achieve and demonstrate pay and performance alignment has increased consequences when shareholders have a Say on Pay
- Compensation Committees and their advisors should be spending more time on achieving and demonstrating pay and performance alignment
- There are effective tools and techniques for assessing and recalibrating the relationship between pay and performance
- The intention of these tool and techniques is not to produce an answer, but rather to further inform decision-making





## Additional Resources



Report of the NACD Blue Ribbon Commission on

### Performance Metrics Understanding the Board's Role

Published by the National Association of Corporate Directors



SUPPORTED BY  
The NACD Center for Board Leadership

AND ITS PARTNERS  
Heidrick & Struggles  
KPMG's Audit Committee Institute  
Oliver Wyman  
Pearl Meyer & Partners  
Well, Gotshal & Manges LLP



## Report of the NACD Blue Ribbon Commission on Performance Metrics: Understanding the Board's Role

Two ways to purchase:

- Over the phone: (202) 775-0509
- Online: [www.NACDonline.org/store](http://www.NACDonline.org/store)





## Don't Miss Our Next Webinar in This Series

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Join NACD and Pearl Meyer & Partners for our next  
Compensation Series webinar

**CEO Succession Planning:**

**Ready, Set...Pay!**

*Thursday, August 11, 2011 @ 2:00 PM – 3:00 PM (ET)*

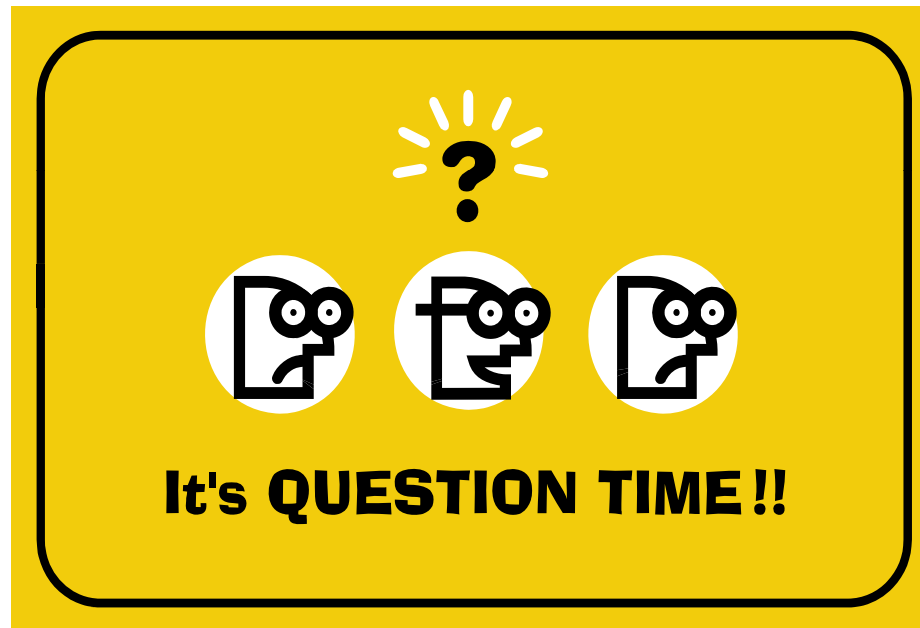
To register or check out the archives of earlier webinars in  
this series, visit [www.NACDonline.org/webinars](http://www.NACDonline.org/webinars).





# Questions?

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## NACD Credit and Fellowship Information

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**If you have any questions regarding NACD credit or the Fellowship programs, please contact:**

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Email: [Fellowships@NACDOnline.org](mailto:Fellowships@NACDOnline.org)

**To learn more about the National Association of Corporate Directors, visit [www.NACDOnline.org/](http://www.NACDOnline.org/)**





**Thank You**

