

# ON POINT

TIMELY, ACCURATE, INSIGHTFUL

## **PM&P On Point: 2010 Executive Pay-for-Performance Survey**

Executive Summary

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## Introduction

As a result of recent economic turmoil and increased scrutiny of executive compensation practices, more pointed questions are being asked by investors, legislators and the media as to whether pay and performance are truly aligned. As Management and Boards of Directors engage in such discussions, they need to agree upfront on specifically how “pay-for-performance” should be defined.

The Pearl Meyer & Partners survey ***PM&P On Point: 2010 Executive Pay-for-Performance*** provides context around this important issue. It examines how a wide range of companies are approaching the selection of performance measure and goal-setting, as well as providing data and insights on related executive compensation issues.

The survey was conducted during February and March of 2010. The 630 respondents represent the views of both directors and employees at organizations from Fortune 50 companies to not-for-profits and mutual and cooperative companies.

This executive summary reviews the key survey findings and related trends, including:

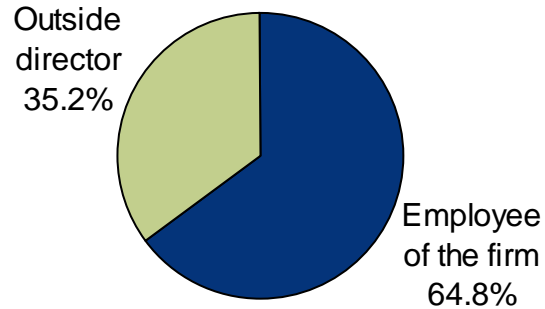
- The different levels of discretion companies are applying to incentive awards
- Changes in the respective roles of management and Compensation Committees in selecting performance measures and setting goals
- Concerns regarding compensation-related risk

The complete results from the survey ***PM&P On Point: 2010 Executive Pay-for-Performance*** are available for purchase at [www.pearlmeyer.com/performance](http://www.pearlmeyer.com/performance).

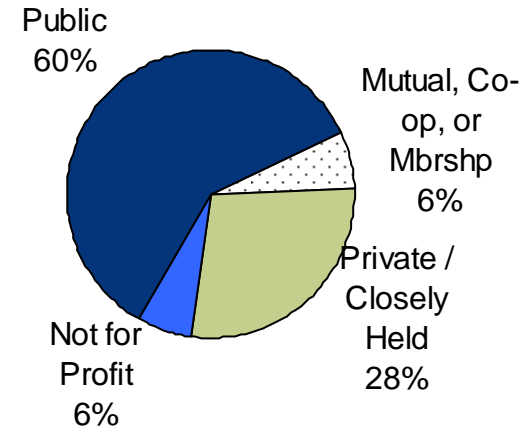
We hope you find this information useful. If you would like to discuss any aspect of these findings further, please contact Matt Turner at [matt.turner@pearlmeyer.com](mailto:matt.turner@pearlmeyer.com) or (312) 242-3051.

## Participant Demographics— Total Respondents: 630

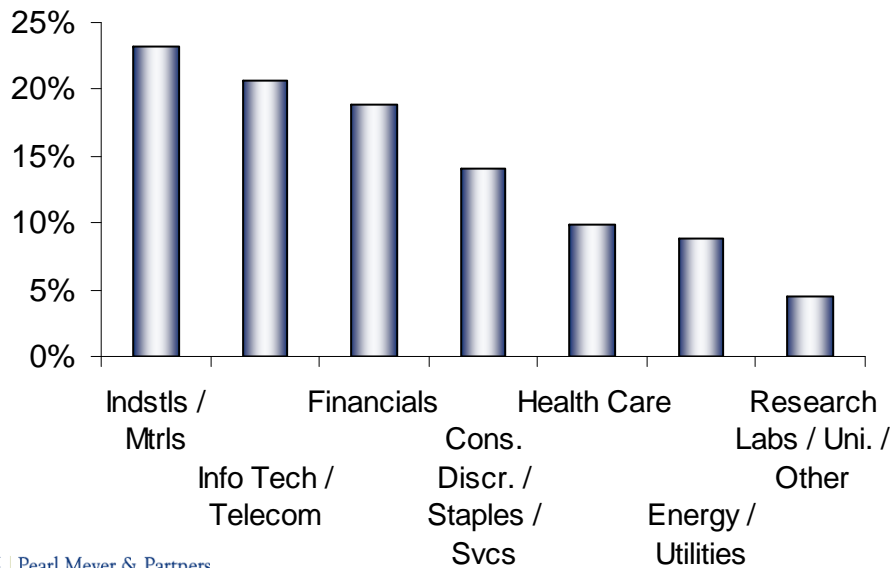
### Role



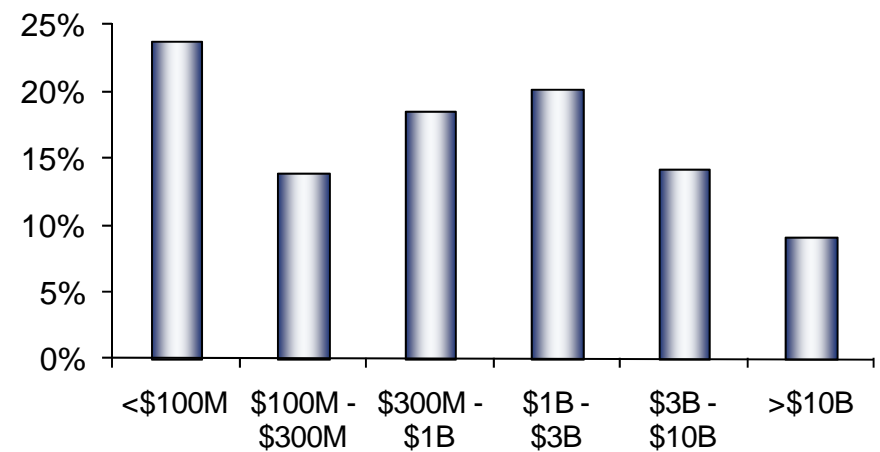
### Ownership



### Industry



### Rev. / Asset / Op. Budget



## Summary of Measure Selection and Goal-Setting Environment

The stated objective of most compensation plans is to “pay for performance.” In determining whether pay and performance are actually aligned, two critical factors should be considered: first, the selection and definition of performance measures and second, whether the measures represent an appropriate degree of difficulty. Given the countless choices and possible combinations of metrics, making the right decisions and gaining agreement between management and the Compensation Committee on the design of performance-based plans can be challenging.

Based on PM&P’s experience, following a few critical steps can greatly facilitate reaching a common understanding between management and the Compensation Committee on these issues:

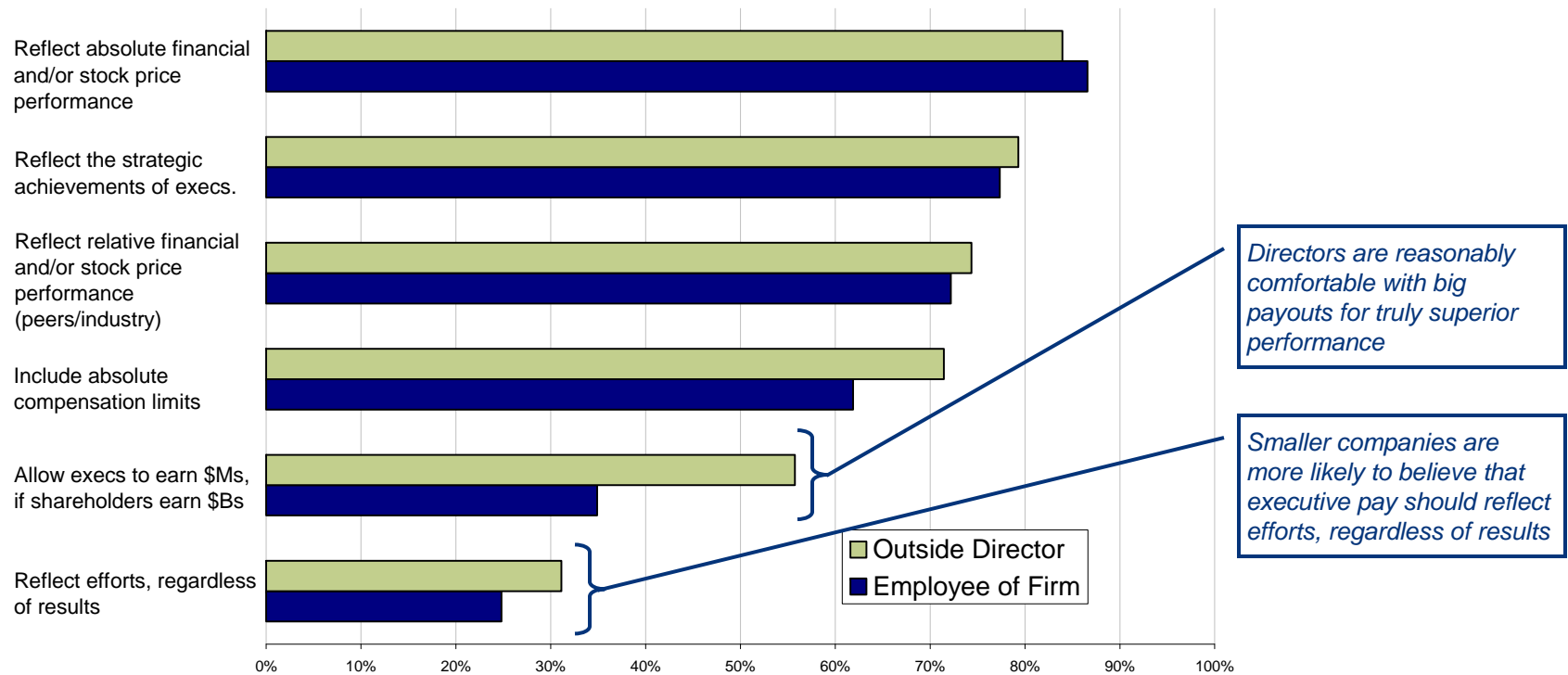
- *Get consensus between management and the Compensation Committee as to what really constitutes “pay-for-performance” for your organization*
  - Determine which performance measures are critical to the organization and are most indicative of underlying performance and firm value as well as the appropriate weight for each key measure.
  - Establish the level of discretion that should be available to the Committee in making payouts and the specific conditions under which discretion can be applied.
  
- *Focus performance goals on value creation, grounded in analytics and reflecting economic reality*
  - Use multiple data and analytic resources to set performance goals and ranges.
  - Fully engage and provide support to the Compensation Committee.
  
- *Conduct a risk assessment process that recognizes the different perceptions of management and Directors about risk issues*

Following these steps will help ensure that the Compensation Committee and management arrive at a common and useful understanding of what “pay for performance” really means within a particular organization and focus incentive programs appropriately.

## How is Performance Defined?

Management and Boards of Directors agree on general performance objectives.

### % of Individuals that Strongly Agree or Agree that Executive Pay Should...

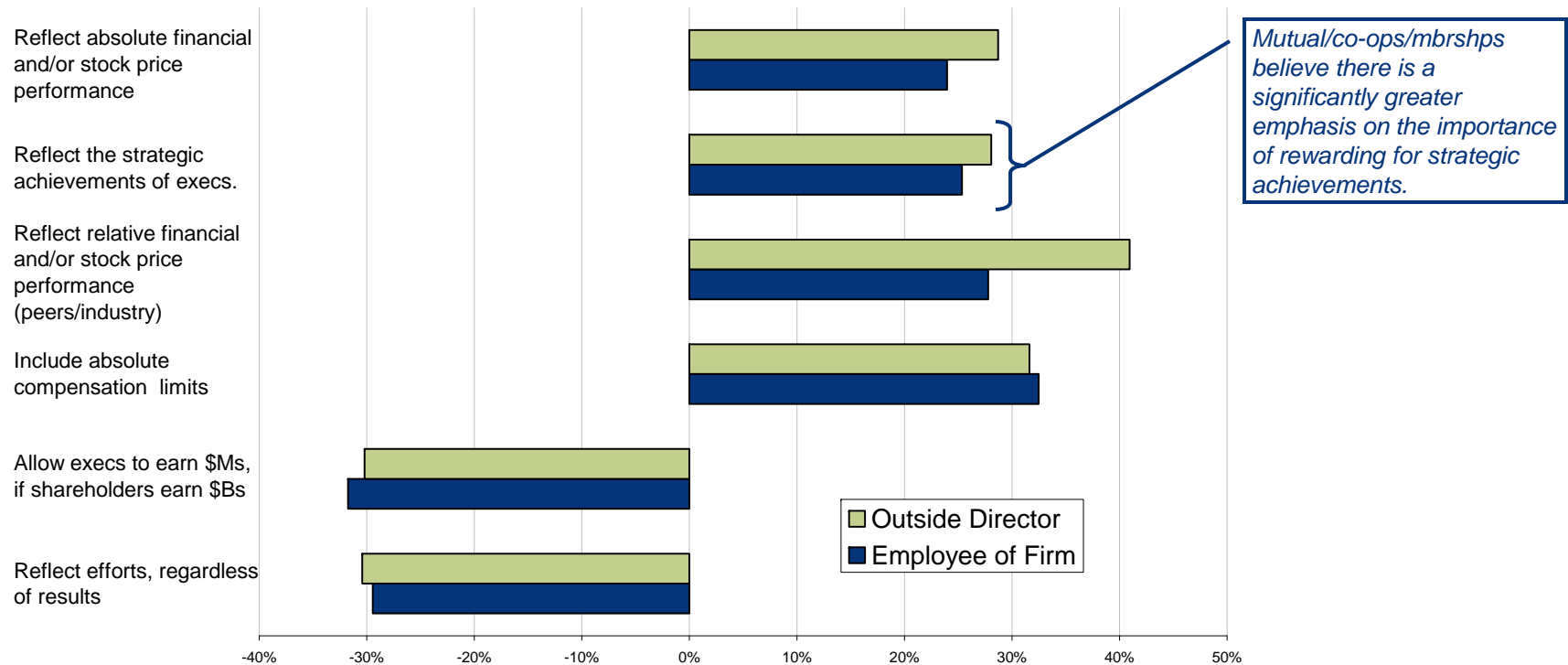


**Key PM&P Observations:** Survey respondents generally agreed that performance should incorporate absolute, relative and strategic measures. Directors somewhat more strongly support compensation limits, but are also much more willing than employees “to pay millions if shareholders earn billions.”

## How is Performance Defined?

Views on performance objectives have changed significantly in recent years.

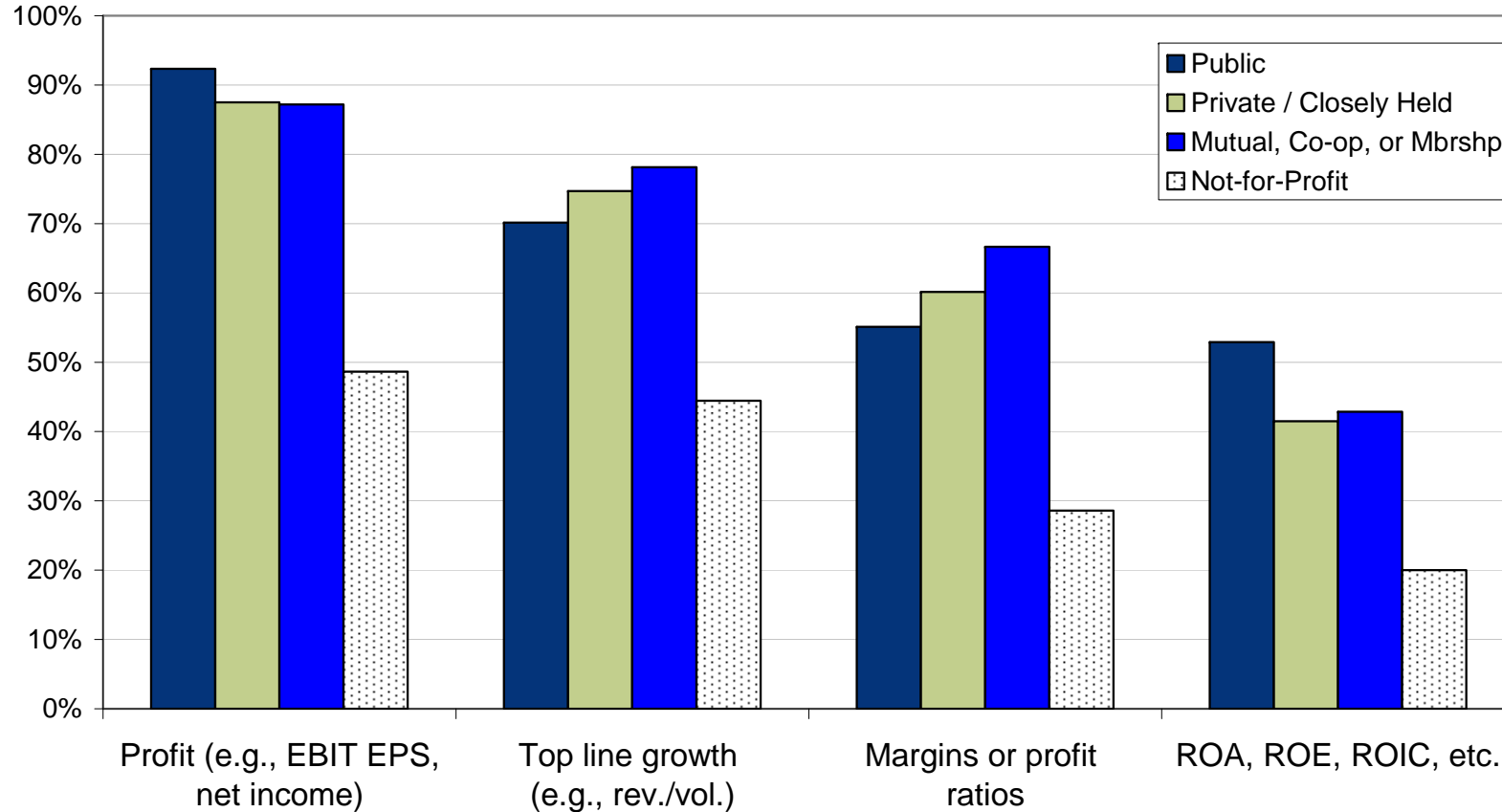
### Difference in Perceived Emphasis of Importance Relative to the Past Several Years Executive Pay Should...



**Key PM&P Observations:** Directors are now much more focused on relative financial performance, supporting an objective performance measurement framework that is aligned with investor views. Boards and management both have become more sensitive to large payouts.

## Annual Performance Measurement

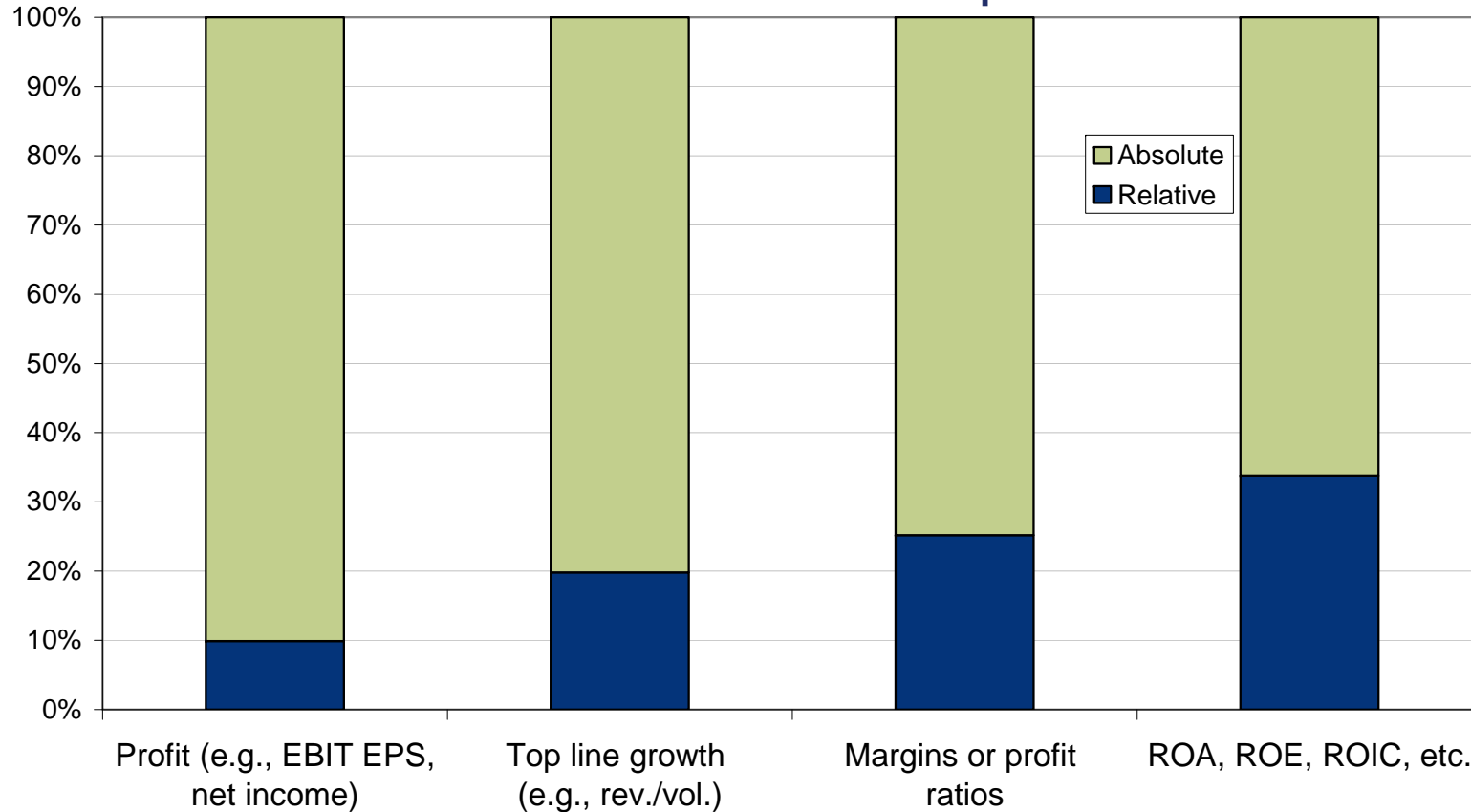
### % of Organizations that Include Financial Performance Measures in Annual Incentive Plans



**Key PM&P Observations:** Financial metrics are used twice as often in annual plans at public companies than at not-for-profits. Mutual, co-ops, and memberships generally look to performance measures such as growth, capital and operating efficiency.

## Annual Performance Measurement

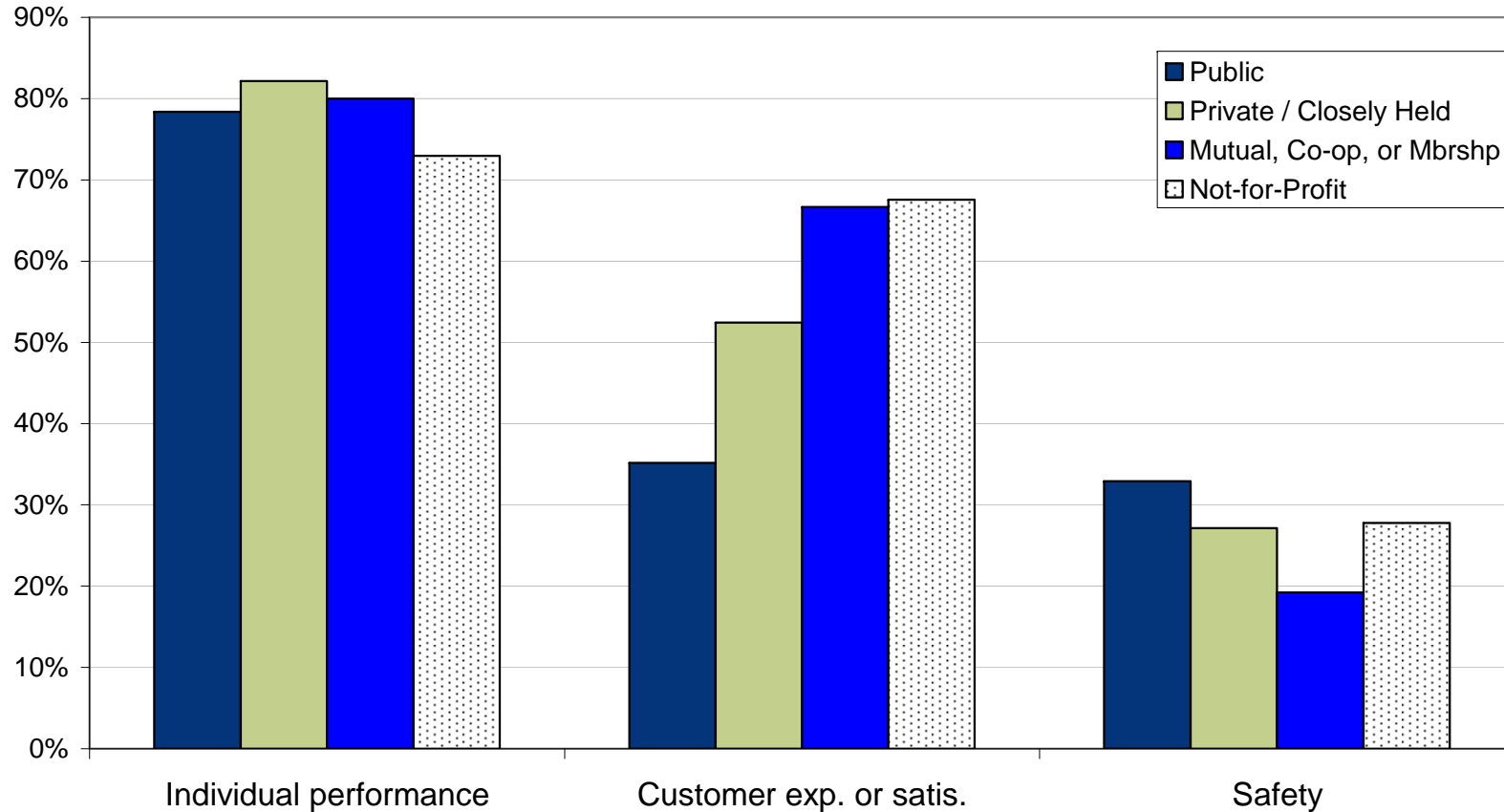
### Split Between Absolute and Relative Financial Performance Metrics in Annual Incentive Plans within Public Companies



**Key PM&P Observations:** Financial performance is normally measured against absolute internal standards, with relative performance measures used most often for returns or margins.

## Annual Performance Measurement

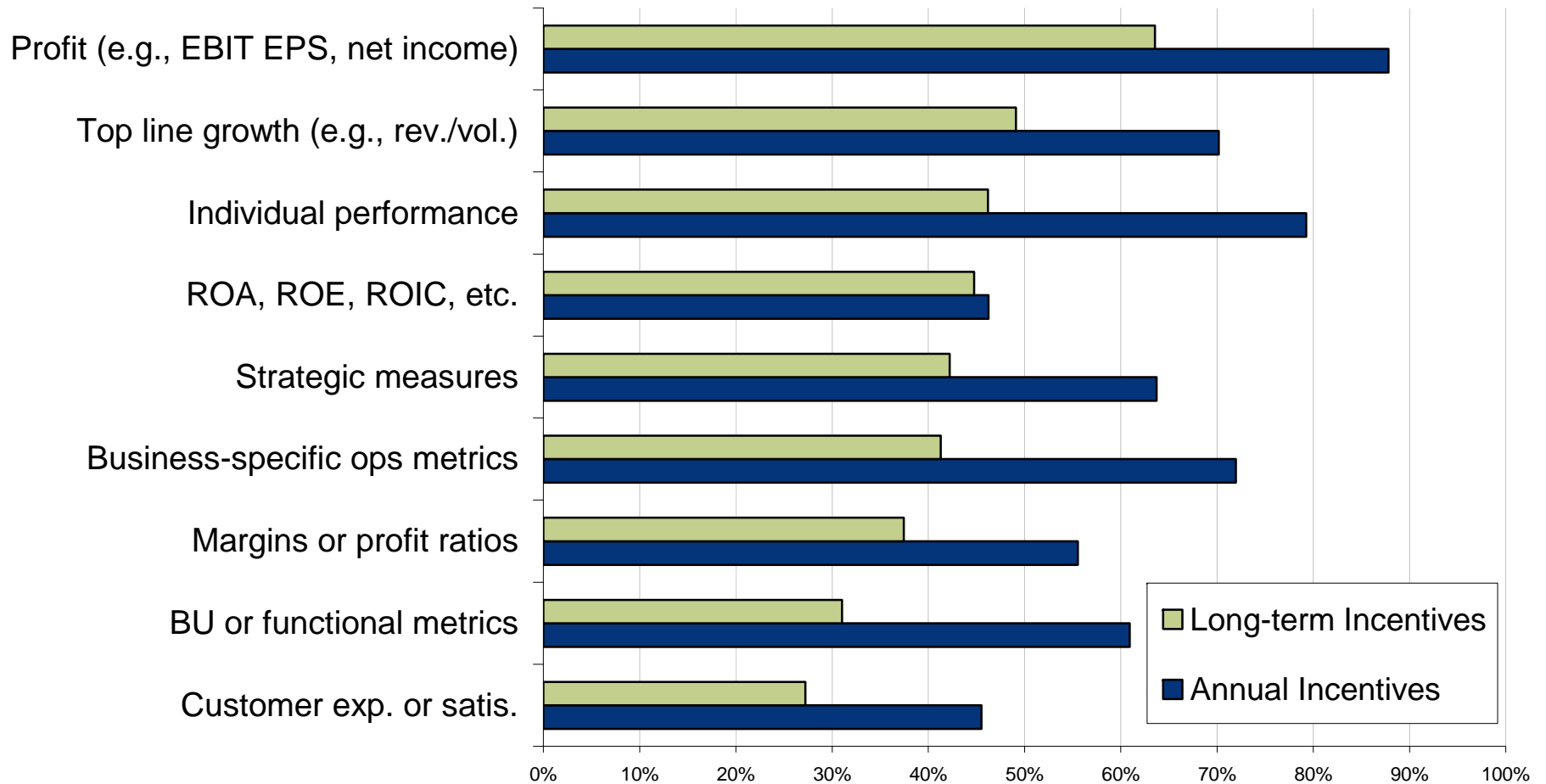
### % of Organizations that Include Non-Financial Performance Measures in Annual Incentive Plans



**Key PM&P Observations:** Individual performance is widely used as a compensatory factor. At organizations without true “shareholders,” customer experience or customer satisfaction is a commonly used “proxy” for value. Safety measures are a frequent metric for industrial companies.

## Annual vs. Long-Term Performance

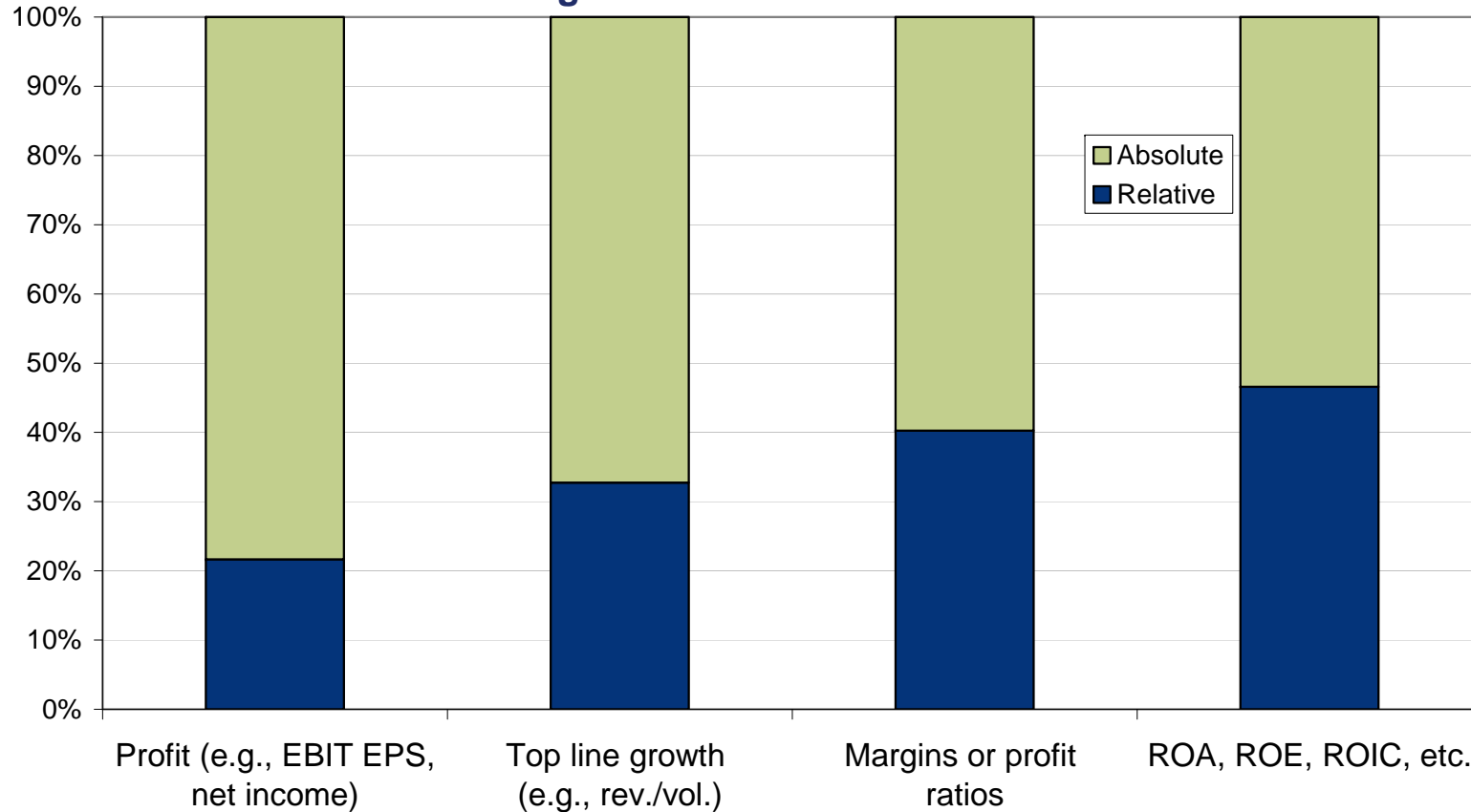
### % of Organizations Using Measure in Long-term Incentives vs. Annual Incentives



**Key PM&P Observations:** Long-term incentive plans generally incorporate fewer measures than annual plans and focus on total company financial performance.

## Long-Term Performance Measurement

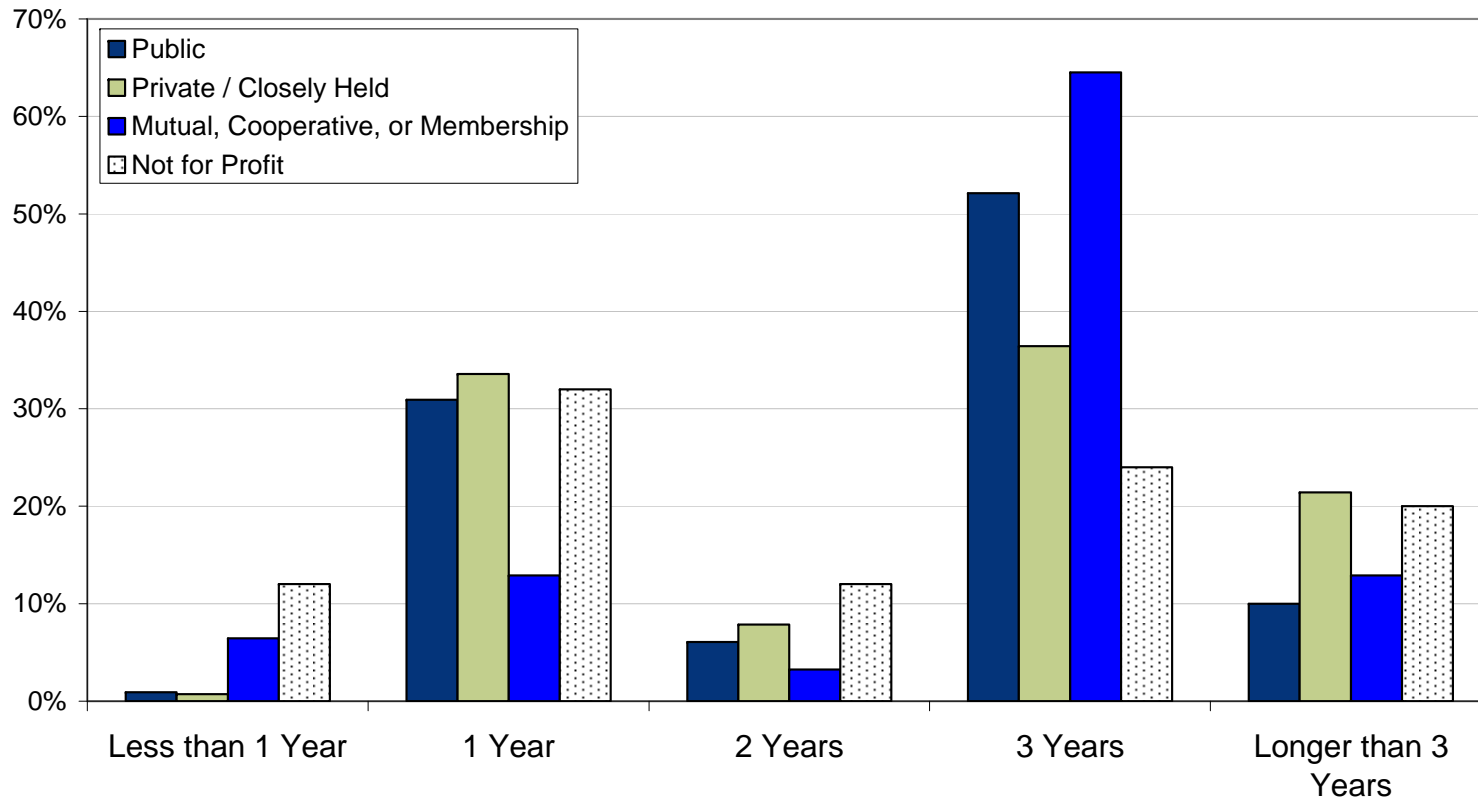
### Split between Absolute and Relative Financial Performance Metrics in Long-Term Incentive Plans



**Key PM&P Observations:** Long-term incentive plans are more likely than annual plans to consider relative financial performance, most often for return measures.

## Long-Term Performance Measurement

### Performance Measurement Period or Plan Cycle for Long-Term Incentive Plans

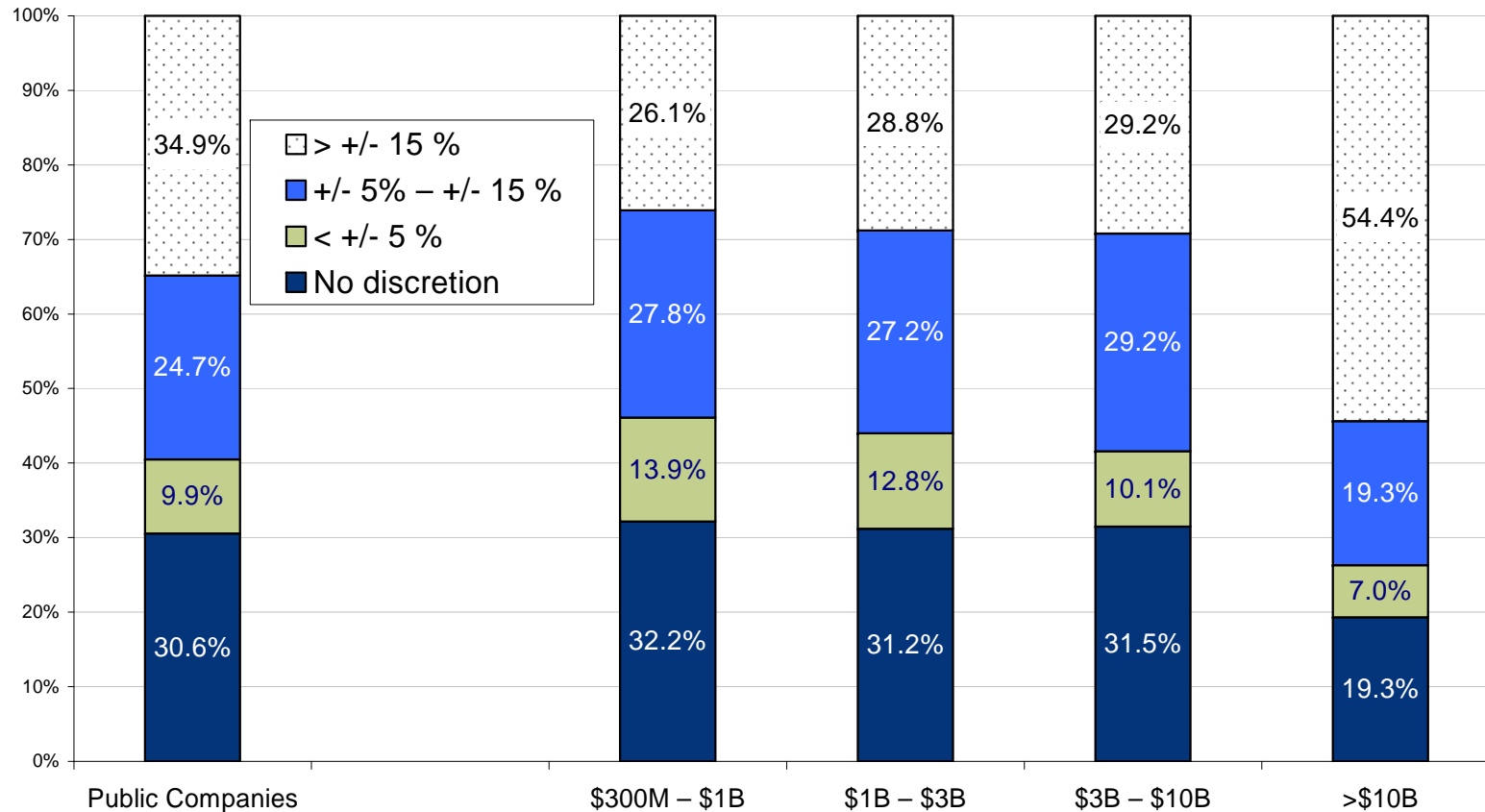


**Key PM&P Observations:** Three years is the most common performance period for long-term plans. One-year plans with time-based vesting on performance-granted equity are also common, particularly among high-tech organizations.

## How is Discretion Applied Within Annual Incentives?

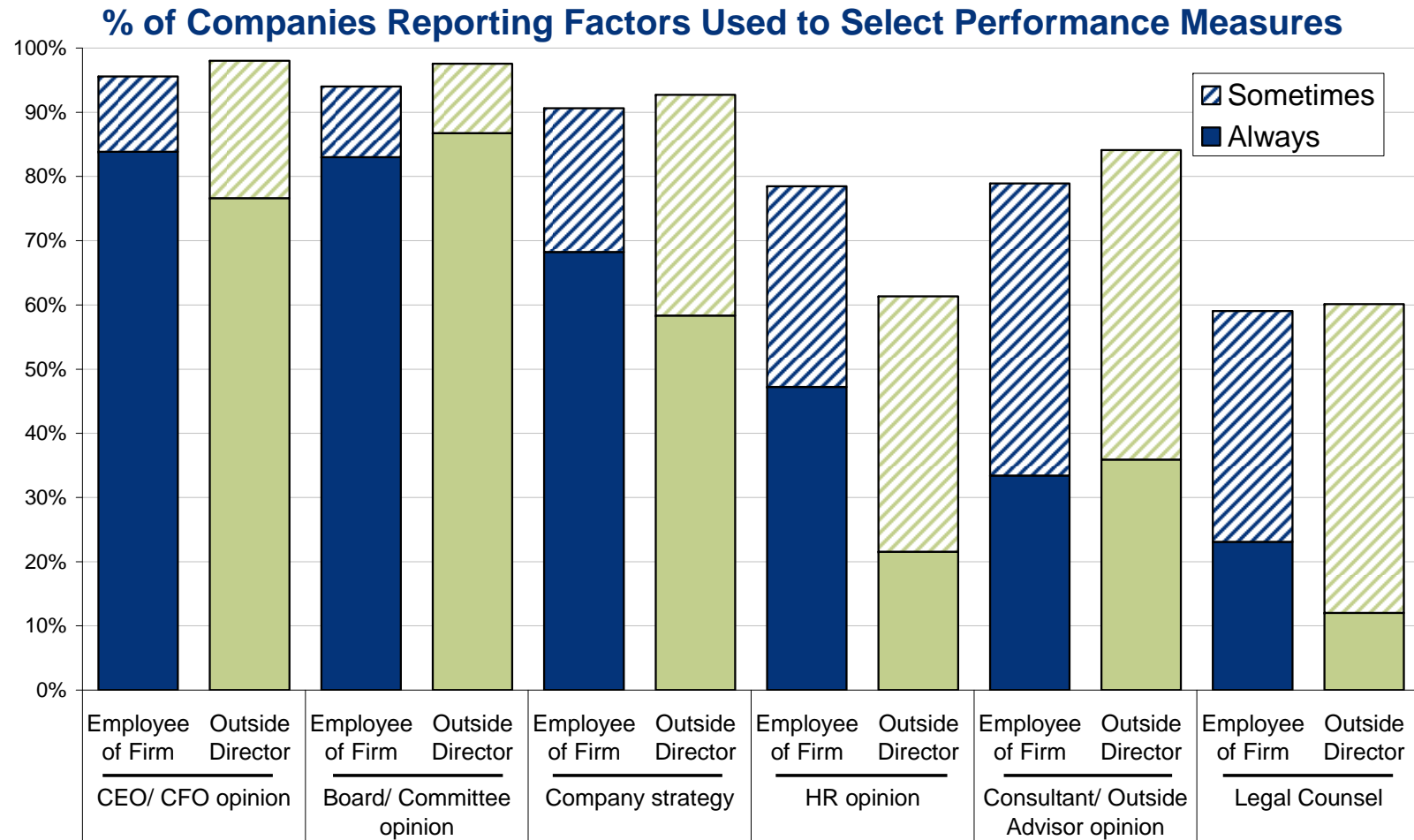
Directors say the use of discretion is similar to past years and is most often applied to promote fairness.

### Level of Discretion Permitted in Annual Incentive Award Determination



**Key PM&P Observations:** Outside of 162(m) considerations, Directors at large companies may be willing to exercise a larger degree of discretion because of their familiarity with discretion within the context of 162(m).

## How are Performance Measures Selected?

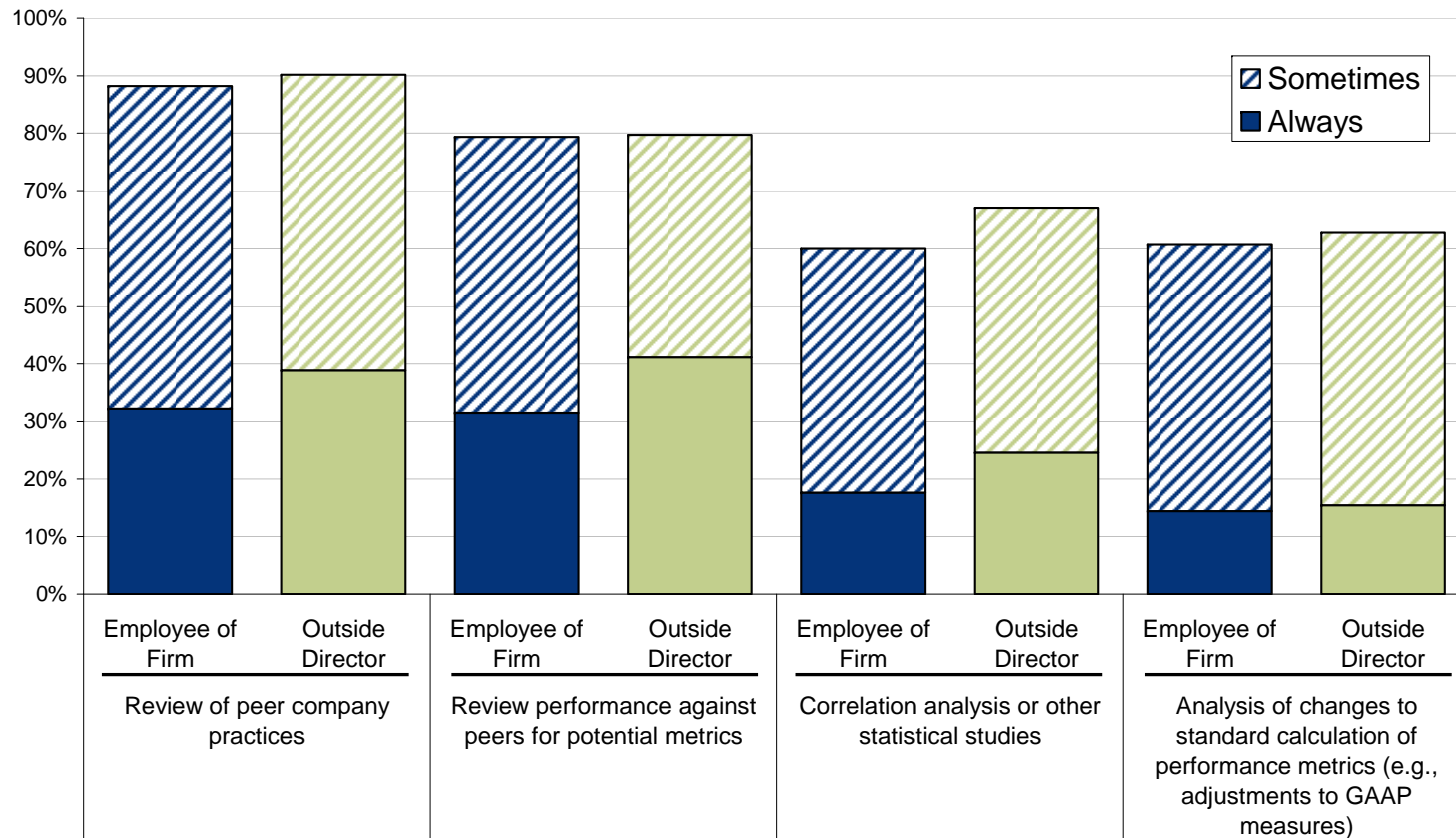


**Key PM&P Observations:** The opinions of the CEO/CFO and Directors are paramount to performance measure selection. Directors appear to be more receptive to the opinion of the outside consultant and less sensitive than management to HR's opinion.

## How are Performance Measures Selected?

Simple prevalence surveys and performance comparisons are more commonly used than statistical analysis or exploration of tailored measure definitions.

### % of Companies Reporting Factors Used to Select Performance Measures

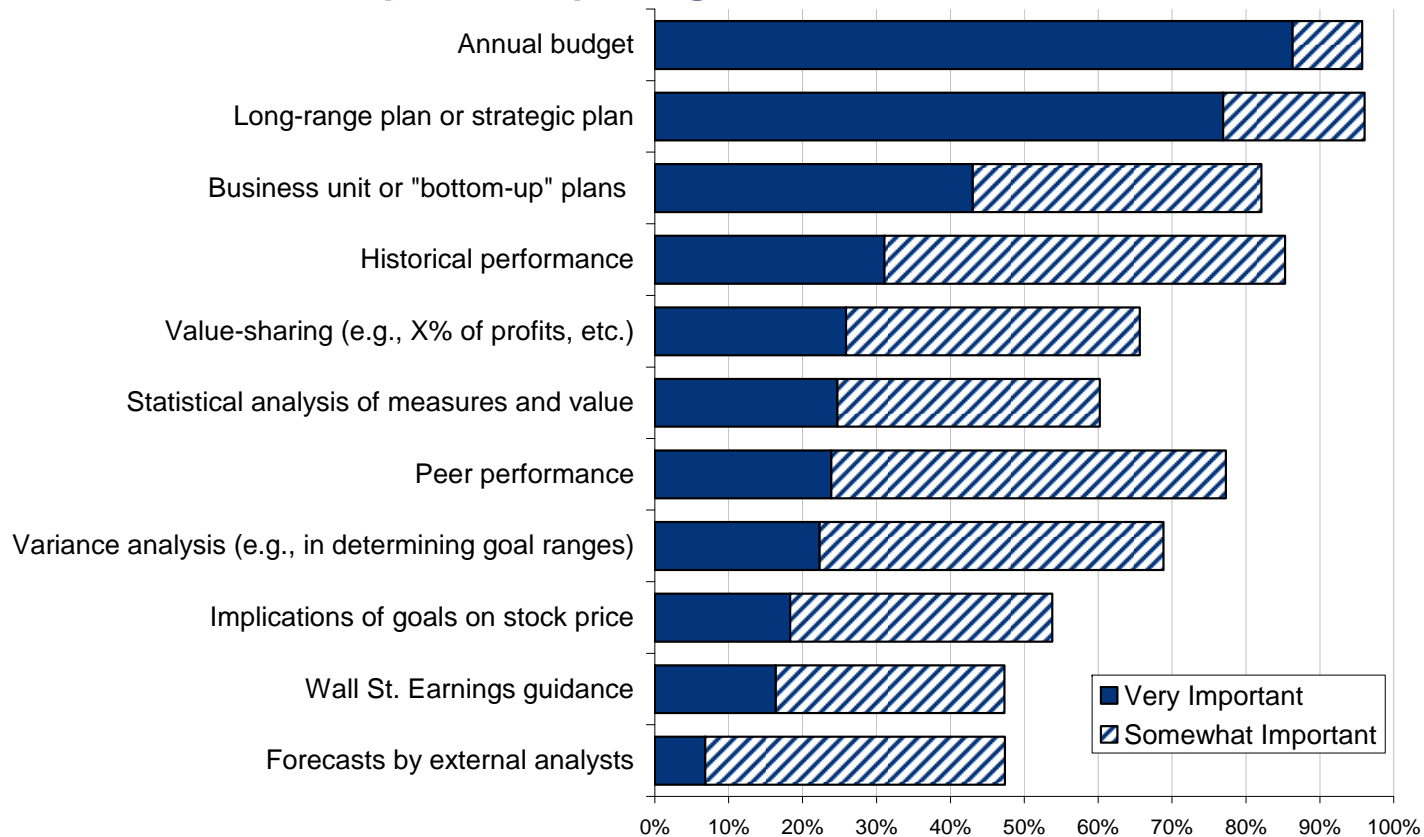


**Key PM&P Observations:** Complexity and transparency may be discouraging companies from conducting advanced analytics or tailoring the selection of financial performance goals.

## How are Performance Goals Set?

A minority of companies make use of the advanced analytics, but many appear to be using multiple perspectives.

### % of Companies Reporting Factors Used to Set Performance Goals

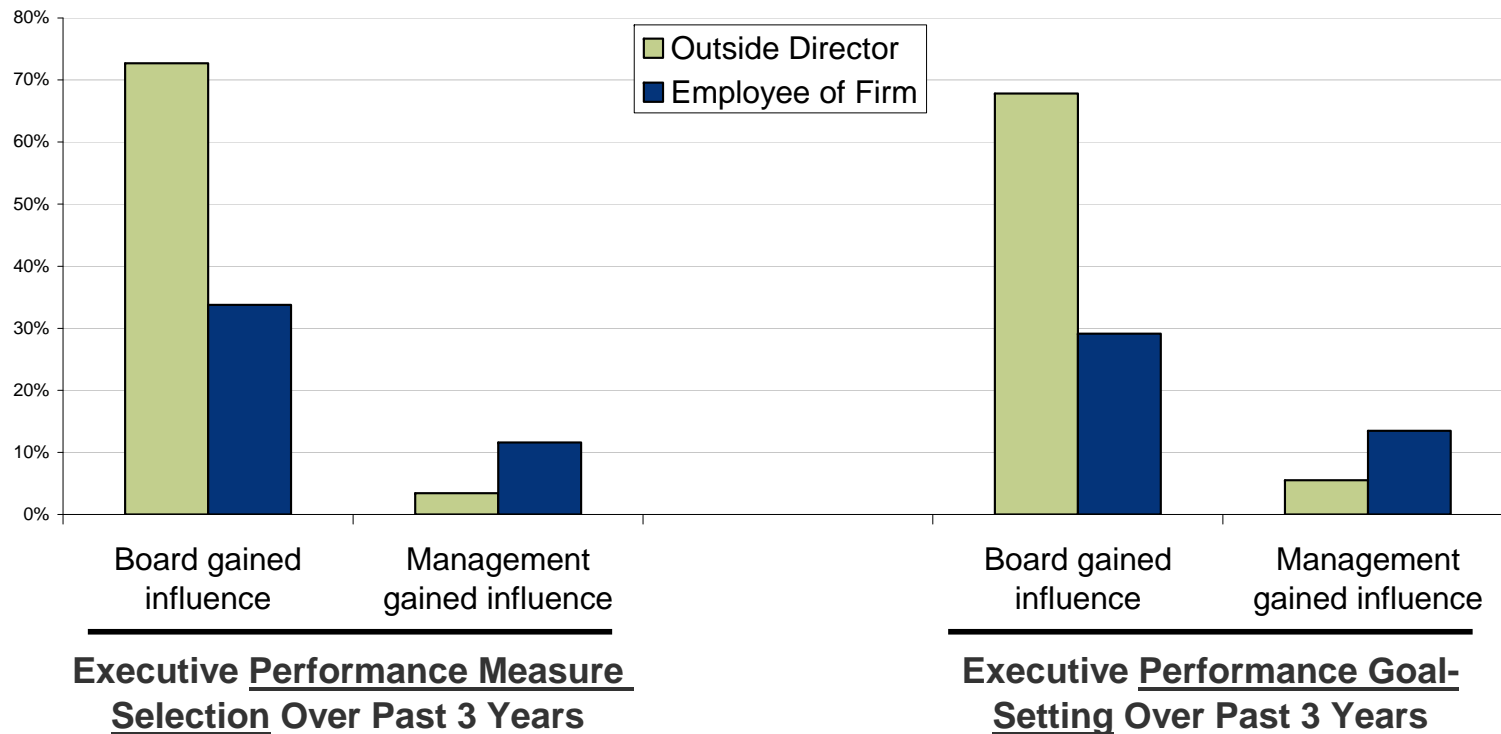


**Key PM&P Observations:** Not surprisingly, the annual budget and long-range plan are key to goal-setting. Historical and peer comparative performance are also fairly common, with advanced analytics and modeling used less often.

## How Has the Influence of Board and Management Changed?

Not surprisingly, Directors and management agree that Boards have gained broad influence over performance measure selection and goal-setting in recent years.

### Relative Influence of Management and Board in Performance Measure Selection and Goal-setting for Executives

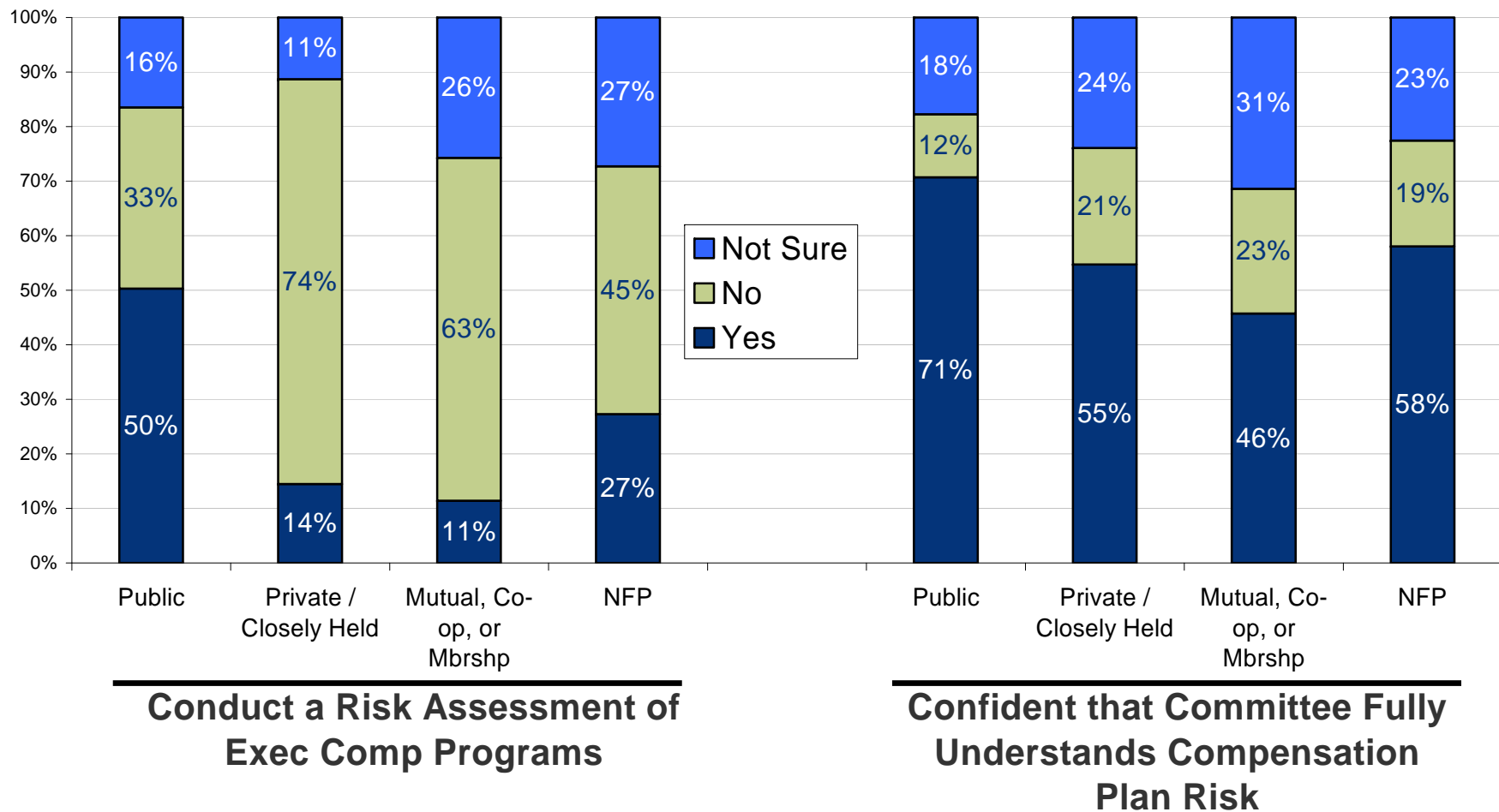


**Key PM&P Observations:** The gap between the perceptions of management and Director may result in confusion over Boards' ownership of some executive compensation processes.

## How Well is Compensation Risk Understood?

Public companies are more likely than other types of companies to be conducting explicit risk reviews and also express more confidence in their understanding of compensation-related risk.

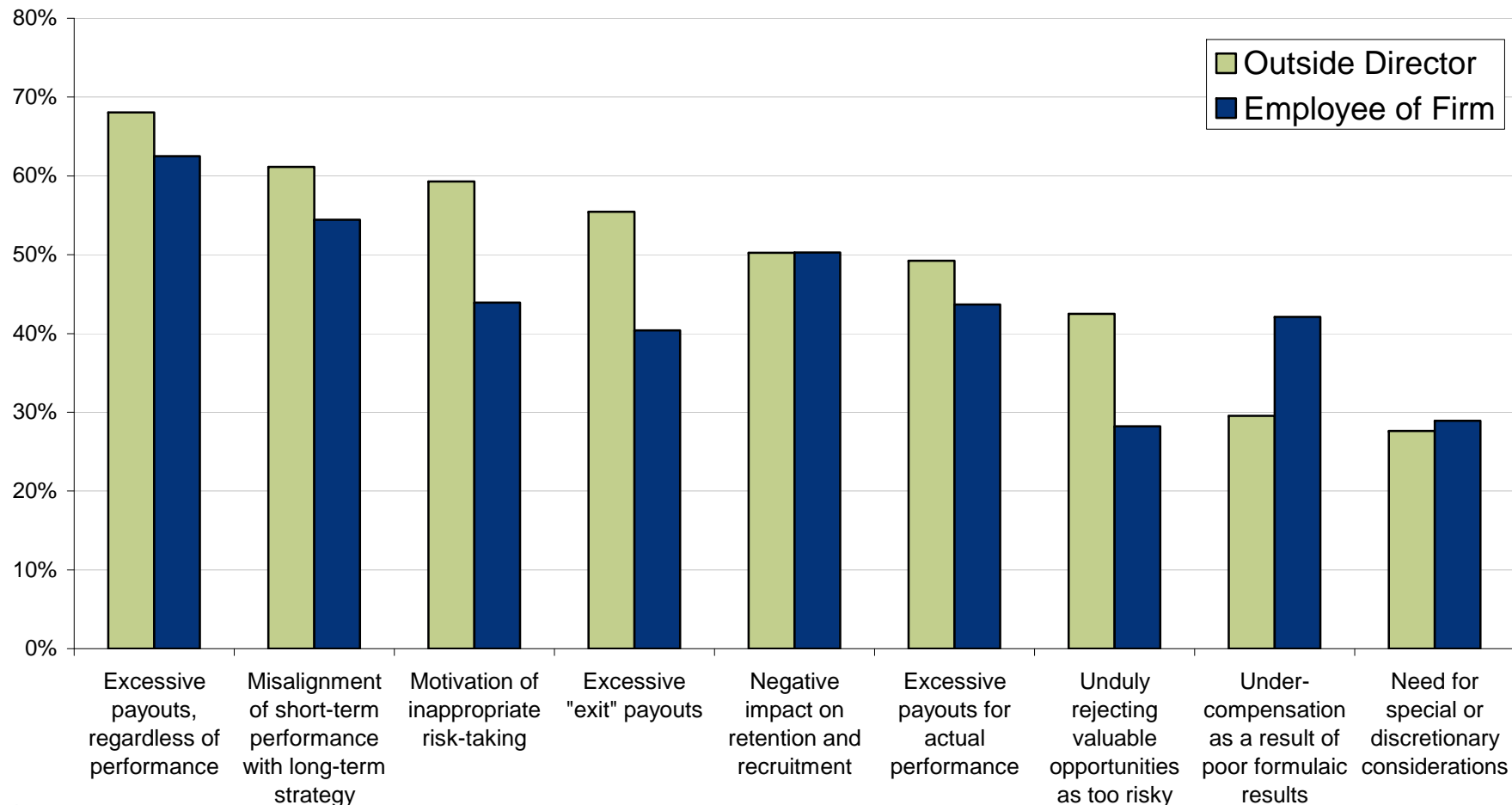
### % of Companies Assessing and Understanding Risk



## What Compensation-Related Risks are of Most Concern?

Directors express more concern over the potential misalignment of pay and performance and the need to ensure that incentive plans balance, rather than mitigate risk.

### Importance of Compensation-Related Risks % of Responses that were a "4" or "5" (5 = Most Critical; 1 = Least Critical)



## About Pearl Meyer & Partners

For over 20 years, PM&P has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. The firm provides comprehensive solutions to complex compensation challenges through the development of programs that align rewards with business goals to create long-term value for all stakeholders: shareholders, executives and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles and San Jose.

## Contact Us

For other information and guidance on compensation issues, or to learn more about Pearl Meyer & Partners' services, please feel free to contact any of our offices by email at the addresses listed below. Full contact information is listed on the next page.

New York  
[newyork@pearlmeyer.com](mailto:newyork@pearlmeyer.com)

Atlanta  
[atlanta@pearlmeyer.com](mailto:atlanta@pearlmeyer.com)

Boston  
[boston@pearlmeyer.com](mailto:boston@pearlmeyer.com)

Charlotte  
[charlotte@pearlmeyer.com](mailto:charlotte@pearlmeyer.com)

Chicago  
[chicago@pearlmeyer.com](mailto:chicago@pearlmeyer.com)

Houston  
[houston@pearlmeyer.com](mailto:houston@pearlmeyer.com)

Los Angeles  
[losangeles@pearlmeyer.com](mailto:losangeles@pearlmeyer.com)

San Jose  
[sanjose@pearlmeyer.com](mailto:sanjose@pearlmeyer.com)



[www.pearlmeyer.com](http://www.pearlmeyer.com)

**NEW YORK**

570 Lexington Avenue  
New York, NY 10022  
(212) 644-2300  
[newyork@pearlmeyer.com](mailto:newyork@pearlmeyer.com)

**ATLANTA**

One Alliance Center  
3500 Lenox Road, Suite 1708  
Atlanta, GA 30326  
(770) 261-4083  
[atlanta@pearlmeyer.com](mailto:atlanta@pearlmeyer.com)

**BOSTON**

132 Turnpike Road, Suite 300  
Southborough, MA 01772  
(508) 460-9600  
[boston@pearlmeyer.com](mailto:boston@pearlmeyer.com)

**CHARLOTTE**

3326 Siskey Parkway, Suite 330  
Matthews, NC 28105  
(704) 844-6626  
[charlotte@pearlmeyer.com](mailto:charlotte@pearlmeyer.com)

**CHICAGO**

123 N. Wacker Drive, Suite 1225  
Chicago, IL 60606  
(312) 242-3050  
[chicago@pearlmeyer.com](mailto:chicago@pearlmeyer.com)

**HOUSTON**

Three Riverway, Suite 1575  
Houston, TX 77056  
(713) 568-2200  
[houston@pearlmeyer.com](mailto:houston@pearlmeyer.com)

**LOS ANGELES**

550 S. Hope Street, Suite 1600  
Los Angeles, CA 90071  
(213) 438-6500  
[losangeles@pearlmeyer.com](mailto:losangeles@pearlmeyer.com)

**SAN JOSE**

2880 Zanker Road, Suite 203  
San Jose, CA 95134  
(408) 954-7399  
[sanjose@pearlmeyer.com](mailto:sanjose@pearlmeyer.com)

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