2014 Remuneration Committee Agenda: Raising the Bar

A full version of this article, including more detail and action steps to take, can be found on our website:
www.pattersonassociates.co.uk/resources/2014-remuneration-committee-agenda-raising-the-bar.html

With executive pay coming under ever increasing scrutiny and, with the public spotlight turning on the work of the remuneration committee, the job of ensuring that pay programmes are designed in the best interests of companies, executives and, of course, shareholders is more important than ever. Proxy advisors continue to pressure companies to conform to “one-size-fits-all” pay practices and methodologies and so there is understandable nervousness of straying from “the norm.”

We believe there are five fundamentals to creating pay programmes which attract, retain and motivate high-performing executives:

1. **Align your pay programme to your business strategy**
2. **Ensure your pay programme supports your talent management strategy**
3. **Reward the right performance**
4. **Allow external viewpoints to inform, not drive, pay programme design**
5. **Ensure there is good, clear understanding of the pay programme with executives and shareholders**

1. **Business Strategy**
   
   **Does your pay programme align with your business value drivers?**

   Understanding performance – and measuring it - is a complex issue. Significant time and money are spent on compensation studies to determine appropriate pay levels, but comparatively little energy is expended on defining performance objectives and measurements specific to an organisation. One-size-fits-all is not a reasonable alternative. It fails to harness the power of incentives to signal – both internally and externally - the importance of reaching specific strategic goals.
   
   - **Understand what drives value creation at your organisation.**
   - **Develop a strategy-incentive map**
   - **Give equal weight to lead/driver metrics in relation to lag/outcome metrics**

   From just another ‘cost of doing business’, compensation costs can become a powerful competitive advantage that drives business results and long-term value creation.

2. **People Strategy**

   **Does your pay programme support your talent management strategy?**

   Talent management is critical to the long-term success of the organisation. Virtually all boards receive an annual talent overview as part of planning and development, and remuneration committees have an ongoing responsibility to contribute to this topic. However, talent management and compensation strategy are too often considered separately.

   We pay for that which we value. Ensuring alignment between the pay programme and how the organisation values talented senior executives, enables the building and maintenance of great management teams.

   There are two resources which help with the challenge of integrating talent and pay strategies: a strong human resources leader with good people development skills, and a truly independent remuneration consultant.
It is imperative that managers and outside advisors understand your culture and leadership team to ensure they assist in developing pay plans that support the talent management strategy that is appropriate for your organisation.

3. Performance Measurement
   **Does your pay programme reward the right performance?**

   The key link between business strategy and executive pay is performance measurement. However, how can you feel confident that measures are truly linked to the business strategy, and that performance against incentive goals will translate to shareholder value creation?
   - **Validate the measures**: periodic testing of the measures, using regression techniques (against market valuation multiples and TSR), can reinforce your intuition with analytic proof and help refine the measures. Growth and returns, in some form, almost always matter.
   - **Calibrate the goals**: knowing which performance measures matter is necessary – but not sufficient. Successful measurement also requires understanding what level of performance against these measures will produce desired changes in shareholder value.
   - **Analyse the actual results**: Rational, business-based pay-for-performance comes from close analysis which is then tested against the actual results at year-end. We advocate for a pay-for-performance review which goes well beyond the formulaic analysis used by proxy voting bodies. Financial performance measures should be used in collaboration with TSR.

4. Good Governance
   **Is your pay programme informed or dictated by external pressures?**

   Positive shareholder votes – and even the level of approval – have become viewed as the exclusive measure of good pay programmes and, by extension, governance. We believe this is a flawed standard of good remuneration governance.
   Instead of defaulting to generic programmes that mimic the marketplace, a well-tailored pay programme, supported by robust governance, is the best way to drive exceptional performance on key initiatives
   - **Allow external viewpoints and market practices to inform, not drive, pay programme design**: the hallmark of a well-designed programme is that it flows from and supports the company’s business and talent imperatives and it changes over time as the company’s strategies and priorities evolve.
   - **Recognise that good pay programmes often bear the management’s imprint**: while we applaud governance advances which have created more active and engaged remuneration committees, it is critical that the voice of the management is not lost.
   - **Exercise business judgement**: the key to widespread acceptance of discretionary actions is having previously established a solid foundation of good governance.
   - **Be transparent**: the ultimate goal of a strong governance process is to provide shareholders with a high degree of confidence that you are working in the best interests of the company.

5. Clear Communication
   **Does your pay programme resonate with executives and shareholders?**

   It is no longer just major investors and proxy advisors who pay attention to remuneration; everyone wants to know who is getting paid what and why. This can be a daunting task: not only is compensation a complex and sensitive topic, but the number of internal constituents involved in its management has grown which makes the development and delivery of compensation communication a more complex process.
   This is a shared responsibility between remuneration committees and company management. In today’s highly visible pay environment it is vital to articulate the rationale for incentive programme design – how it supports the company’s strategy and business imperatives, and where and why it deviates from prevailing external practices.
   This is not just about communicating your pay programme in the remuneration report; it is part of an ongoing, year-round outreach effort to shareholders and executives.
Break the Mould. Raise the Bar. Now’s the Time.

We believe that putting a company’s business and leadership strategies ahead of generic approaches to pay programme design is the most effective way to properly motivate executives to implement the strategies which will create real long-term value for shareholders. Not only should companies go beyond compliance and conformity in programme design, they need to raise the bar to ensure that everyone with vested interests in the organisation fully supports those incentive pay decisions — they understand the goals everyone is striving to achieve and believe the process is sound, responsible and essential to fuelling long-term growth and success.

About Pearl Meyer & Partners and Patterson Associates

For 25 years, Pearl Meyer & Partners (www.pearlmeyer.com) 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 for multinational companies ranging from the Fortune 500 to not-for-profits as well as emerging high-growth companies. These organizations rely on Pearl Meyer & Partners to develop global programs that align rewards with long-term business goals to create value for all stakeholders: shareholders, executives, and employees. The firm has more than 100 full-time employees and more than 30 Managing Directors in 10 offices worldwide. Along with its London office, Pearl Meyer & Partners maintains U.S. offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, San Francisco and San Jose.

Patterson Associates LLP, a Pearl Meyer & Partners Practice, (www.pattersonassociates.co.uk) is an independent remuneration advisory firm established in the UK in 2005. It advises publicly listed and privately backed companies outside North America with independent expertise in the design, implementation and communication of effective incentive compensation programs. Founder Simon Patterson is a recognized expert in remuneration governance, incentive compensation design and performance measurement. Mr. Patterson previously co-founded the London office of SCA Consulting and, after the SCA partnership was acquired by Mercer in 2001, served as Worldwide Partner in charge of Executive Compensation in Mercer’s London office.