Pearl Meyer

ADVISOR BLOG

Align Your Executive Compensation Program To Your Business Strategy, Period

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Every time compensation committees discuss changes to their executive compensation programs, the questions take center stage:

- Are these changes consistent with peer practices?
- How will shareholders react?
- Do we have to consider environmental, social, and governance issues?
- How will the economy impact our business?
- Will the changes resonate with the executive team?
- What about proxy advisory firm reactions?

A potentially simple plan change creates volumes of white noise, making discussions of plan changes needlessly complicated and time-consuming. The goal is simple—align your executive compensation program to your business strategy. All other considerations are secondary.

Of course, compensation committees need to discuss all stakeholder considerations when deliberating a change. And this priority roadmap will improve the decision-making process.

- **Will the change support your business (and talent) strategy?** Too often, the committee's discussion of change starts with a review of peer practices. This step is essential, but it should not be your first step. Business strategy alignment should initiate the discussion, and then understand if the changes deviate from standard peer group practices. And it is okay, or maybe beneficial, to steer away from peer practices if needed to support your business strategy. While you're at it, ask if your executive compensation program supports your talent strategy. It is not unusual for a company to discuss talent strategies during a governance committee or full board meeting. If this is typical practice on your boards, consider initiating these discussions in the compensation committee with a follow-up during the full board meeting. To put teeth in the process, review your compensation charter and include talent management as a compensation committee responsibility. After all, it's well within the power of a thoughtful compensation program to drive progress on talent and leadership development.

- **How will your major institutional shareholder react?** It is rare for institutional shareholders to provide a detailed critique of your executive compensation program, even when total shareholder returns have been disappointing. For companies that regularly meet performance expectations, institutional shareholders may offer no comments, which means shareholders likely will be comfortable with minor plan changes. In other cases, institutional shareholders may provide unabashed high-level feedback such as:
  - Noting a CEO pay-for-performance disconnect;
  - Questioning the incentive plan metrics, including expressing concern about using adjusted non-GAAP incentive plan metrics; and
  - Asking why individual performance ratings are inconsistent with company financial results.

If you are considering changing your executive compensation program in response to negative shareholder feedback, ensure these changes support your business strategies. A committee may instinctively agree to include a relative total shareholder return (rTSR) metric in the long-term incentive plan in response to addressing a CEO pay-for-performance disconnect. But before proceeding, ask if using rTSR, with its inherent volatility, is the best way to solve a CEO pay-for-performance disconnect, and will this potential change address or aggravate a pay disconnect given the company's long-term business strategy.

- **What about other stakeholders?** With the explosion of interest in ESG, compensation committees have a heightened awareness of stakeholder interests, which will differ by company. This step might include identifying your primary stakeholders and discussing if the committee should modify the potential changes based on stakeholder feedback or concerns.
- **Do you understand proxy advisory firm reactions?** You need to understand proxy advisory firm reactions, but this should be your last consideration—everything else is more important. I am not suggesting ignoring proxy advisory policies, but they should not impose undue influence, especially when dealing with difficult issues. The committee may make the right business decision to deal with a challenging environment, and this decision may fly in the face of proxy advisory policies. In these situations, understand potential proxy advisory firm reactions, and start an extensive shareholder outreach program, if needed, to explain the plan design changes and your rationale.

Even with this roadmap, the plan design white noise may not disappear entirely. Still, the committee will be able to take comfort knowing the executive compensation plan design supports the primary consideration—the company's business and talent strategy.

About the Author

Pete Lupo is a senior managing director and head of the Atlantic Region. Pete has worked extensively with compensation committees and management covering a variety of needs including the development of total compensation programs for the senior leadership team, aligning pay to performance, designing annual and long-term incentive plans, developing board of director pay programs, and advising on change-in-control, executive benefits, perquisites, and governance-related matters.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Baltimore, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.

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