

Video Transcript: The Case Against TSR as an Incentive Metric

David Swinford: We've recently done some work with Cornell University and the Institute of Compensation Studies researching how total shareholder return is used in incentive plans, their prevalence, and whether or not they're effective in generating value. We didn't expect to find a very good relationship between using TSR as a measure and either the TSR or the other economic performance indicators of the company, and we didn't. TSR is a summary measure. It's a lagging measure so there's not much information there telling the executives what to do, and it comes after the fact, and of course, it's subject to a lot of things going on in the stock market that aren't the result of specific company management actions.

The surprising thing was how prevalent it has become. Many companies have adopted it in part because of the challenges of setting long-term goals. After the financial crisis of 2008/2009, how comfortable were companies establishing earnings growth goals for the next three years? In general, pretty uncomfortable. So people moved to TSR because you didn't have to set a goal. The surprising thing about TSR in our study was that not only wasn't there very much connection between economic performance and using TSR as a measure, what little connection there was, was negatively correlated.

Industry after industry where companies were using TSR, they weren't performing quite as well as the companies not using TSR. I think that is a result of their adopting TSR because they weren't sure which turns to take, which measures to use. The other interesting thing is that not only did the use of TSR not show a correlation with higher rates of earnings growth, better returns—like return on equity or return on capital, higher cash flows, anything like that—it didn't even result in better TSR!

The companies that use TSR overall in this S&P 500 database of ten years of data, basically the companies that adopted TSR performed about 2 percent worse than the companies that didn't. Implementing TSR is not a strategy—it's a default for not having something better that has better line of sight for the executives and has a more sure business strategy behind it.

