Pearl Meyer

NACD NATIONAL ASSOCIATION OF CORPORATE DIRECTORS NEW ENGLAND CHAPTER

NACD New England Chapter November Breakfast Forum

Compensation Strategies That Drive Value

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Panel Members:
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Theo Sharp (Moderator)

Compensation Strategies that Drive Value

- Long-term value creation is what all companies seek
- According to the NACD's Blue Ribbon Commission on Long-Term Value Creation, it is incumbent on the Board to support management as they seek to create value
- Several questions face Boards regarding long-term value creation:
  - How is long-term value created? (Full Board)
  - Are short-and long-term corporate strategies aligned with value creation? (Full Board)
  - How should value creation be measured? (Full Board and Compensation Committee)
  - How should value creation be supported or rewarded? (Compensation Committee)

Compensation Strategies that Drive Value

- The Commission report outlines actions and processes for the Board to address these questions
- In simple terms, the Board should:
  - Be sure the corporate strategy is clearly developed and aligned with long-term value creation
  - Assess how well executives are aligned with the strategy
  - Measure progress against the strategy
- An effective tool to drive strategic goals is an integrated short-and long-term incentive plan
  - The Compensation Committee leads plan design
  - The Committee is responsible for integrating corporate strategy in compensation

Compensation Strategies that Drive Value

- Compensation Committees help support value creation through pay program design by actively linking business strategy to compensation
  - Consider, but don't be bullied by short-term pressure for short-term results
- It's not easy…
  - Directors should be actively involved with strategy development
  - 75% of Directors say that their involvement in metric selection has increased*
  - 75% of Directors also say that the Board's involvement in goal setting has increased*

Long-Term Corporate Strategy

Long-term Incentive metrics

Short-term Incentive Plan

Short-term Metric – Strategic

Short-term Metric – Annual

* Source: NACD Public Company Governance Survey

What's important for the Committee to consider?

Should these be reversed?	▪ About 70% say that the short-term operating plan is very important in determining metrics and goals* ▪ 50% say that long-term strategic plan is very important*
Should be an input in strategy discussion	▪ Business cycles ▪ Corporate maturity ▪ Corporate culture ▪ Financial results

- Strategic goals should be making a comeback
  - It's easy to fall back on financial goals
  - The Blue Ribbon Commission notes that strategic goals are sometimes better indicators of <u>long-term</u> value creation than any current financial measure

* Source: Pearl Meyer On Point: Looking Ahead to Executive Pay Practices 2016

What about Total Shareholder Return?

- Our recent study with Cornell shows that including TSR in long-term incentive plans does **not** necessarily correlate with value creation
- TSR is the ultimate indicator of long-term value creation, but it is also ultimately backward looking
- This is a challenge with the new pay-for-performance disclosure regulations looming
- If not, TSR then what?

Experience and Insights

Let’s discuss with our panelists their experiences and insights into how long-term value is created and how compensation plans are used to support that value creation

Experience and Insights

- What is the definition of Long-Term Value?

  And…Do Boards explicitly discuss it or is it just a part of the strategy development?

- How does the Compensation Committee integrate the short- and long-term strategy into their discussion?

  And…Does is get muddled with the short-term pressures of the market or proxy advisory groups?

- How willing do you think Boards are to go against the short-term market pressures?

  And…ISS?

Experience and Insights

- Do you think its better for short-term incentives to be linked to longer-term goals

  Or…Should there be tension between the two?

- How about integrating strategy goals into incentives even though they are harder to measure?

- Should Committees conduct an exercise to map the annual plan goals to the long-term strategy?

- How about just using TSR as the long-term metric?

Additional Resources

NACD Blue Ribbon Commission Report
The Board and Long-Term Value Creation

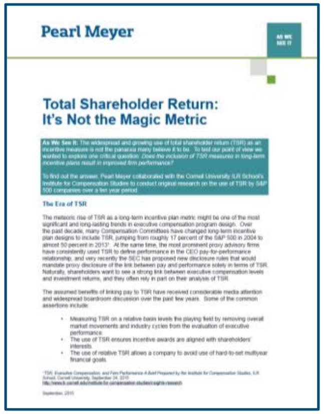
www.nacdonline.org

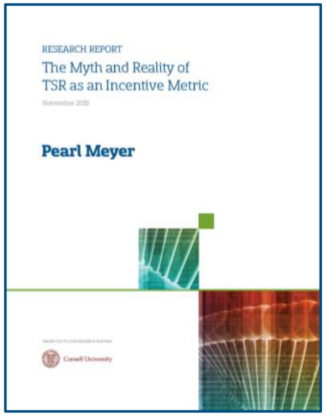
Total Shareholder Return:
It's Not the Magic Metric

Compensation as a Catalyst
Value Creation and Compensation

Pearl Meyer Research Report:
The Myth and Reality of TSR as an Incentive Metric

www.pearlmeyer.com





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