

# Pearl Meyer



NACD New England Chapter  
November Breakfast Forum

Compensation Strategies  
That Drive Value

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**Panel Members:**

Ellen Zane

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Theo Sharp (Moderator)



## Compensation Strategies that Drive Value

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- 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)

- 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
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- 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 long-term value creation than any current financial measure

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



## What about Total Shareholder Return?

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- 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?

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

- 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 it 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?



- 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](http://www.nacdonline.org)

COMPLIMENTARY DOWNLOAD FOR NACD FULL BOARD MEMBERS



**NACD BLUE RIBBON COMMISSION REPORT**  
**Align Short-Term Results With Long-Term Strategy**

[Download](#)



## 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.pearlmeier.com](http://www.pearlmeier.com)

**Pearl Meyer**

**Total Shareholder Return:  
It's Not the Magic Metric**

**As We See It:** The widespread and growing use of Total Shareholder Return (TSR) as an incentive measure for top executives is likely to continue to grow as more companies realize the need to measure and improve long-term performance.

**To Not Let the Grasses Grow Underneath:** Pearl Meyer collaborated with the Council on Corporate Governance (CCG) to conduct original research on the use of TSR as a performance metric over a ten-year period.

**The Era of TSR**

The research use of TSR as a long-term incentive has made it one of the most significant and long-lasting trends in executive compensation program design. Over the past decade, many Compensation Committee Chairs changed incentive structures to include TSR, jumping from roughly 17 percent of the total pay in 2004 to almost 50 percent in 2012. At the same time, the need to measure performance has been consistently used TSR to drive performance in the CEO pay-for-performance relationship, and only recently the CEO has experienced less discussion than the average executive about the use of TSR as an incentive metric.

The assumed benefits of linking pay to TSR have received considerable media attention and widespread boardroom discussion over the past few years. Some of the common benefits include:

- Measuring TSR on a relative basis leads the playing field by removing overall market movements and industry cycles from the equation of executive performance.
- The use of TSR ensures incentive awards are aligned with shareholder interests.
- The use of relative TSR allows a company to avoid use of hard-to-set multiple financial goals.

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**Compensation as a Catalyst  
Value Creation and Executive Compensation**

**As We See It:** The growing use of value creation metrics, combined with its limitations on strategy, although in some cases where a company is struggling to recover, the information can be more about value creation. However, both situations need to answer the question, "What are we going to do differently?" The more questions in these areas we answer that we get from those who have put our own compensation to sleep for the "long term."

**Chair's Statement:** In the first case—adding value—the focus of the discussion will move away from the use of financial metrics, to the use of strategic, short-term actions and short-term business developments. The second case—value creation—will be the focus of the discussion. The underlying message is that the metrics used to measure value creation are not the same as the metrics used to measure value creation. The strategic results can be achieved when these compensation plans are designed and implemented after developing the right business plan to place and taking into account differences in perspective among the levels of leadership.

**Assessing the Annual Business Plan**


Simply speaking, there are two ways of creating value over the long term. The first is creating an approach that is ready to invest and rebalance it over time. For example, making incremental improvements in current operations. The second is developing and executing a new strategy—creating the value and its financial and operational goals. The use of metrics such as TSR is an incentive to participate in technology or business to the benefit of a new and greater future value creation strategy. The Board wants to ensure that both approaches are being used on a combined basis. The Board then has to determine if both approaches are being used in a balanced way. The Board then has to determine if the annual review of the company's year-to-business plan, which is a different exercise and normally separate from a review of proposed executive pay plan. Some questions to ask at this time include:

**TSR evaluates the value that was already created rather than creating new and better value to increase the value.**

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**RESEARCH REPORT**  
**The Myth and Reality of  
TSR as an Incentive Metric**  
November 2013

**Pearl Meyer**



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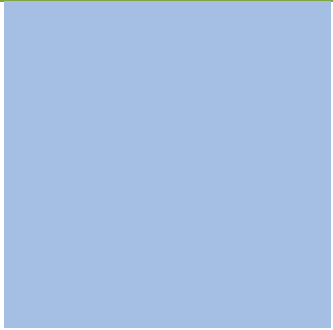
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