Pearl Meyer

ADVISOR BLOG

Your Compensation Committee Has Important Work to do—Don't let CEO Pay Ratio Data Set the Agenda

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Publicly traded companies invested no small amount of time in preparing for Dodd-Frank mandated CEO Pay Ratio disclosures in the months leading up to the 2018 proxy season. Media, watchdog groups, proxy advisors, and consulting firms (including our own) have invested no small amount of bandwidth in summarizing statistics from these disclosures and leveraging them to either further an ongoing narrative (headlines relating the gap between CEO and worker pay are fantastic at driving outrage and clicks) or addressing questions raised by clients (companies generally are looking for evidence that they are not outliers, labor advocates wish to target outliers, and the default position of those selling services to institutional investors seems to be that any data point can be monetized).

We are curious to understand the extent to which topics such as CEO Pay Ratio disclosures actually drive the agenda for compensation committees. In other words, will committees be spending time over the next few months reviewing these statistics and benchmarking their own company's ratio relative to the broader market?

Accordingly, we established a new Pearl Meyer Quick Poll series called **Setting the Compensation Committee Agenda**. Our intent for this series is to challenge whether items that appear to be capturing public attention—for good or ill—translate into actual time spent in review and discussion at compensation committee meetings. The CEO Pay Ratio certainly checks the box in terms of capturing public attention!

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We received 120 responses to our poll this April. Detailed below are responses from board members at publicly traded companies where CEO Pay Ratio disclosure is applicable to our simple question:

Will you benchmark your company's CEO Pay Ratio relative to peers this year?

28% Yes, we're eager to see how we compared to others in our industry.

14% Yes, but begrudgingly. We don't see this as a value-added exercise.

31% Possibly. We're waiting to see just how much attention the topic received this proxy season.

28% No, this is a distraction from more important items.

We find it interesting that less than one out of three respondents indicate they are eager to undertake this type of benchmarking exercise. And we are in agreement that benchmarking CEO Pay Ratio results should not be a priority agenda item for most compensation committees.

Having said that, we do recognize that there is sizeable group of companies that should be proactive in reacting to employee questions triggered by CEO Pay Ratio disclosures and essentially reinforcing the message that comparing yourself to the median employee and/or the CEO is unproductive. But we believe that management, and not the compensation committee, should take the lead on these initiatives.

We also recognize that some companies will need to be more aggressive and detailed than others in explaining to investors their compensation policies and workforce strategies that drive pay ratio results. For example, if your ratio skews high, you may find that some institutional investors…think public pension plans…will be expecting an explanation during shareholder engagement activities. (We also have thoughts on this dynamic.)

But for the vast majority of companies, the compensation committee has other, important work to do that should take priority over benchmarking of a statistic that speaks more to workforce dynamics (where employees are located and what functions are outsourced) than to the reasonableness of executive compensation programs.

Ideally, compensation committees move through a sequence of annual tasks and analyses that are predictable and allow for discussion and review of key topics prior to when approval is required. For most companies, Q1 is when actual pay decisions (determining payouts of prior year incentive plans, approving goals for current year incentive plans, approving base salary changes, and granting of new equity awards) take place. The pay reviews that assist in determining targeted pay opportunities and the diagnostics that support goal-setting should not be jammed into this same time period. Doing so is a recipe for rushed, ill-considered decisions.

Instead, consider what items might take place earlier in the year that will help build knowledge and ultimately drive better decision making. For example, December fiscal year-end companies may wish to address the following in the next few months:

- Review proxy advisor reports to understand if there are particular critiques of the pay program that merit modification on a go-forward basis, or at least suggest items that deserve a deeper dive later in the year.
- Revisit peer group rosters that are used for benchmarking executive pay, to determine whether existing peers remain appropriate given the company's size, complexity and other factors, or if modifications would improve matters.
- Conduct committee self-evaluations.
- Revisit committee charters (many companies are considering expanding committee remit with respect to areas such as management development and succession planning).
- Assess the board of directors compensation program.

We do not pretend that CEO Pay Ratio statistics are not interesting. But committee members have limited time and much to do. We suggest that most companies would be well served by addressing the items above first.

About the Author

Jim Heim began his career working in the human resources departments of OneBeacon Insurance, The Gillette Company, and EMC Corporation, performing roles of increasing responsibility and focusing on the design and management of executive compensation programs. Since joining Pearl Meyer in 2004, he has worked extensively with clients in the technology, life sciences, manufacturing, and aerospace & defense industries. Much of his work focuses on the customization of incentive programs to shifting strategic priorities and business stage, and his current clients range from Fortune 500 firms to pre-IPO start-ups.

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 New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, and Los Angeles.

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