Frank Answers on TSR and Value Creation

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Ask the Expert.

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Q. Consider the debate about total shareholder return (TSR). Is TSR the right metric to measure value creation?

A: The short answer is no. We recently published a study in conjunction with Cornell University around TSR because TSR is one of the most common metrics for performance share plans.

Over the past decade or so there's been a push toward performance-based pay that proves your pay-for-performance relationship. The default metric most companies use is relative TSR. TSR started as the easy answer because when companies went from time-vested equity to performance-vested equity, the biggest challenge that I heard in boardrooms was: "How do we set three-year goals that have any kind of real traction? We don't have a crystal ball to predict what's going to happen three years out."

Management is happy to put in a strategic plan and talk about it with the board, but it's another issue entirely when you tell management, "I'm going to tie your pay to that strategic plan." All of a sudden, things get really hard to measure. It's the old joke: it doesn't matter how fast I run as long as I run faster than the guy behind me. Relative TSR gave companies that benefit. Here's the downside: relative TSR has a lot of shortfalls as an incentive measure when considering what an incentive measure is meant to do.

TSR is an output, not an input. People don't go into the office and say, "I'm going to raise the stock price today." People go into the office and they increase sales, they market, they develop new products, and they cut expenses. Those are the things we should be rewarding people for, the things they do day in and day out as part of their jobs to impact TSR, and if they're doing the right things, then TSR should take care of itself.

In the study with Cornell, we looked at S&P 500 companies going back a decade that use relative TSR in their incentive plans. Did it actually help them? Did they perform better? Guess what? It turns out that they didn't. The increase in relative TSR by companies over that decade went from about 13 percent of companies using relative TSR as a metric in their incentive plan back in 2004 to over 50 percent in 2013–2014, so we had a pretty good sample size of companies to test it. What the study found was that companies that use relative TSR don't actually perform any better on TSR than companies that don't use it.

"If they're doing the right things, then TSR should take care of itself."

About Jan Koors

Jan Koors, Managing Director and head of the firm's Chicago office, joined Pearl Meyer in 2001. She has more than 20 years of experience in all areas of executive compensation, including value-based annual and long-term incentive plans, salary structure development, subsidiary pay programs and performance measure selection. She has consulted extensively in the retail, apparel and consumer goods sectors.

Prior to joining Pearl Meyer, Ms. Koors was a Principal at SCA Consulting. She previously worked in the compensation consulting practices of Towers Perrin and PricewaterhouseCoopers. A member of the faculty for the NACD Directors Institute programs, Ms. Koors received her B.A. from Wellesley College.

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, Los Angeles, and San Francisco.

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