Pearl Meyer

Ask the Expert.

How Industry and Business Lifecycle Influence Executive Compensation Design

Jan Koors, *Managing Director*

The following is based on a conversation with Jan Koors, the head of Pearl Meyer's Chicago office. Here she discusses the value of incorporating a firm's industry and operating environment into its executive compensation design.

Q. What are the business factors that you consider when designing a compensation plan?

A: As a firm, we always caution clients and stress they not allow external *influencers* to drive their plans. What we're referring to are the outside optics of a plan, what proxy advisors recommend, market "best" practices, and such.

There are, however, numerous external (and internal) *factors* that critically affect the organization itself, like its industry and competitive position; market undercurrents and economic pressures; and also whether it's public, private, family-owned, or not-for-profit and its life cycle stage. These dynamics directly impact a company's business and leadership strategies and therefore must be thoroughly explored and understood before an effective executive pay program can be structured.

I'll use the retail industry as an example. First, it's important to understand the context in which *all* consumer-based companies are operating. For example, with consumer discretionary income, there's a high sensitivity to macro-economic conditions. That can breed a level of uncertainty and volatility in a company's financial forecasts. Further, there are pricing and margin pressures and the ever-present reality of shifting consumer buying habits and patterns. Some of the external environmental challenges are evolutionary and you can see them coming, such as brick-and-mortar versus online, but others are less predictable. How is the management team approaching these challenges?

Then, if we narrow the focus to a single retail entity, a company in a mature phase may struggle to find growth opportunities that do not cannibalize its existing operations. It may be so large and geographically dispersed that there are regionally-based performance differences or problems in creating a cohesive corporate culture. By comparison, many new, high-growth retailers battle to convert revenue growth to profit margin, often because there has been insufficient investment in "back-office" systems and processes. And all retailers struggle with the HR challenges posed by high turnover among customer-facing positions.

These kinds of issues must be very well understood by the compensation committee and its advisor in order to know how they might affect the business strategy. Without that deep understanding, it's going to be very difficult to create executive pay programs that point everyone in the right direction.

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Q. How do you make the leap from understanding issues like these to implementing a pay program that addresses them?

A: That's where the rubber meets the road. I'll again rely on an example. We had a client working to shift their business from one based on low margins but high-volume to a high-margin, value-add model. We suggested additional weighting and leverage in the long-term incentive plan, understanding that transformation takes time. We also knew that focusing on leading performance indicators in the annual plan (e.g., average transaction value, gross margin) could incent the achievement of important near-term milestones and signal early success of (or problems with) the strategy. A wider range in the incentive goal-setting calibration built in some needed flexibility. Three years into the transformation, company performance against the plan has been strong and so has shareholder return.

About Jan Koors

Ms. Koors is a managing director with Pearl Meyer and leads the Chicago office. She has more than 25 years of experience in executive compensation and governance, and has consulted to companies of all sizes and industries. She advises company boards and management teams on all aspects of executive and director compensation design, performance measure selection and calibration, and related corporate governance issues. She is also responsible for the firm's annual Director Compensation Study, published in conjunction with the NACD.

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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