Pearl Meyer

Quick Poll

# Impact of Foreign Currencies on Incentive Plans

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# Introduction

In an increasingly global and connected economy, the recent Pearl Meyer Quick Poll sought input on how boards and their management teams evaluate and deploy strategies for the treatment of foreign currency (FX) in their short- or long-term incentive compensation plans.

Fifty-six respondents (80% management and 20% directors) provided input to our survey. One-third of reporting companies conduct between 26 and 50% of their business outside the U.S. and 37% conduct more than half of their business outside the U.S. Seventy-three percent of the companies are publicly held and more than half are hedging foreign currency risk on a regular basis as a business strategy.

In this summary, we include key findings and our recommendations, as well as detail on the survey results.

Please feel free to contact me with any questions about this survey.

Melissa Means
Managing Director
melissa.means@pearlmeyer.com
(508) 630-1487

# Key Findings

- The majority of companies surveyed (71%) have not considered FX adjustments in either short- or long-term incentive plans at any time in the last three years.
- Of the 29% of those surveyed who have considered this, the majority (75%) have conducted the evaluation before the start of a new incentive plan period.
  - The majority (63%) considered taking a “constant currency” approach to hold the impact of foreign currency neutral.
  - A quarter considered a “collar” approach where no adjustments are made until the percent change in that foreign currency falls outside a set range versus the US dollar.
- Ultimately, of the 29% who considered FX adjustment options, only 42% elected to make a change and 60% of those took the constant currency approach.
  - Forty percent made the change in their long-term incentive plan, 20% made the change in their short-term incentive plan, and 40% made the change to both.

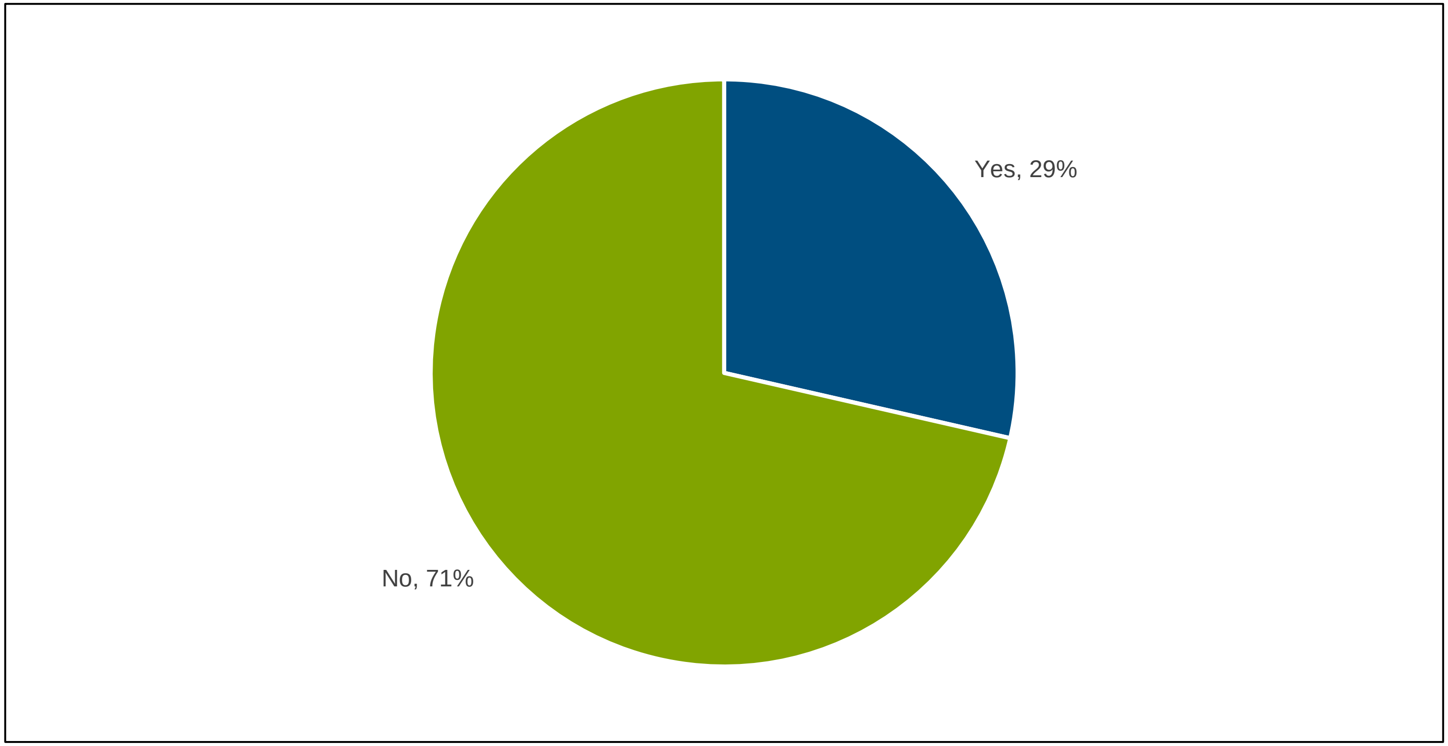
# Recommendations

Foreign currency issues and their impact on incentive program opportunities have been on the minds of senior management and directors over the past few years as currency fluctuation has been on the rise, yet a small number of companies have investigated ways in which to address such an issue.

We typically find that foreign currency becomes an issue when management brings it up to the compensation committee during an incentive plan year because their payout opportunity may be impacted more than in past years.

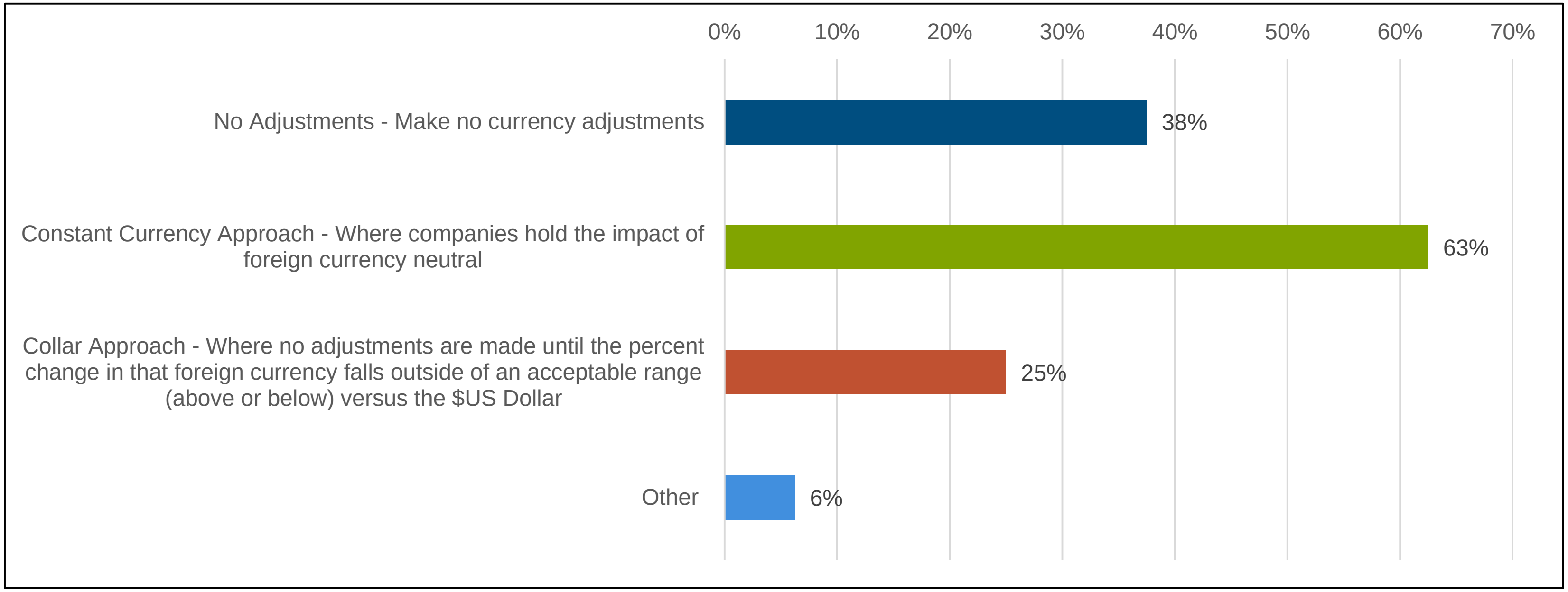
We encourage understanding the various alternatives for addressing foreign currency in incentive programs as something companies doing business outside of the U.S. should do to determine a preferred approach on how to handle, and to revisit this approach every few years to ensure alignment with the company’s business strategy.

# Has your company considered adjusting its treatment of foreign currencies in either the short- and/or long-term incentive programs in the past three years?



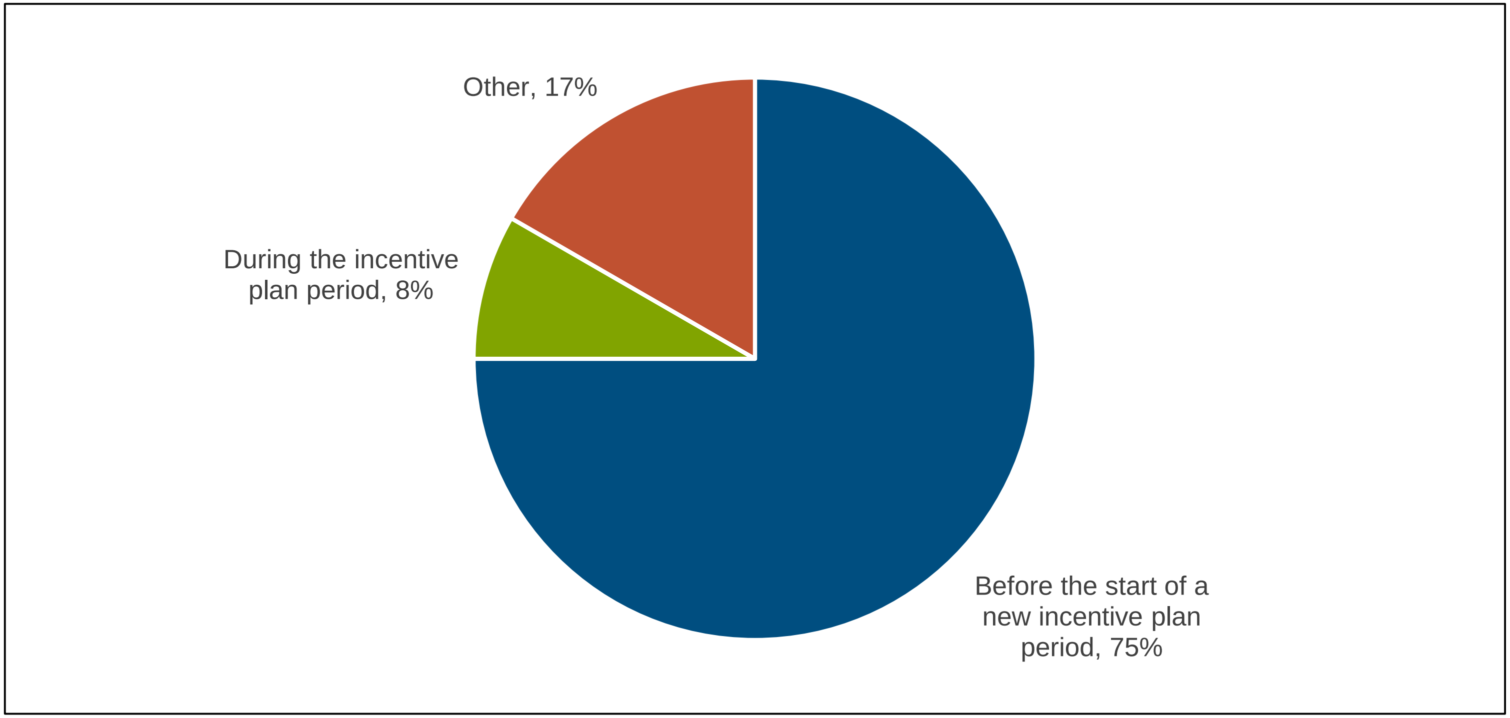

A majority a reporting firms (71%) have not adjusted their incentive programs, either the short- or long-term plans, for foreign currency fluctuation in the past three years.

# If so, what foreign currency approaches did your company consider?



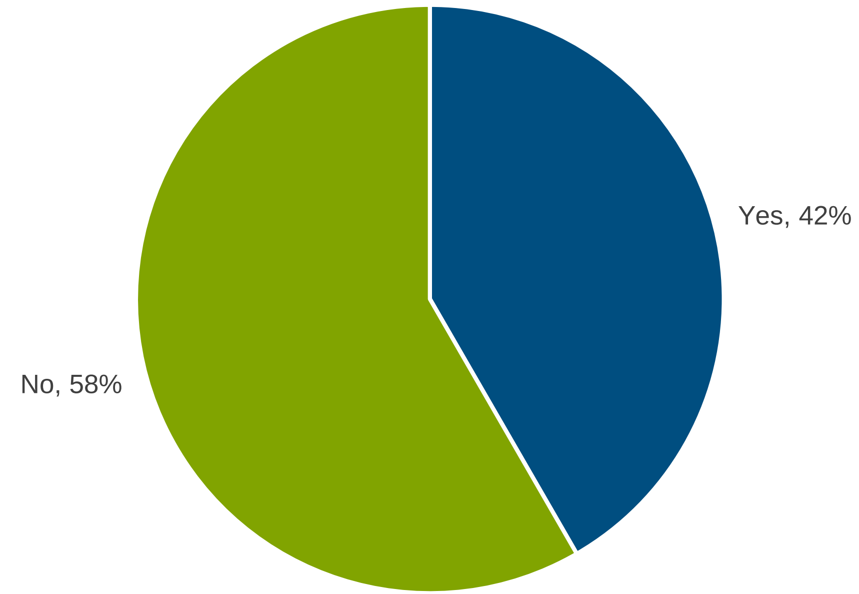

Of the companies that considered potential alternatives for addressing foreign currency in their incentive plans, many considered three alternatives including making no adjustment, using a constant currency or a collar approach as defined in the table above.

# At what point did your company conduct this evaluation of foreign currency alternatives?



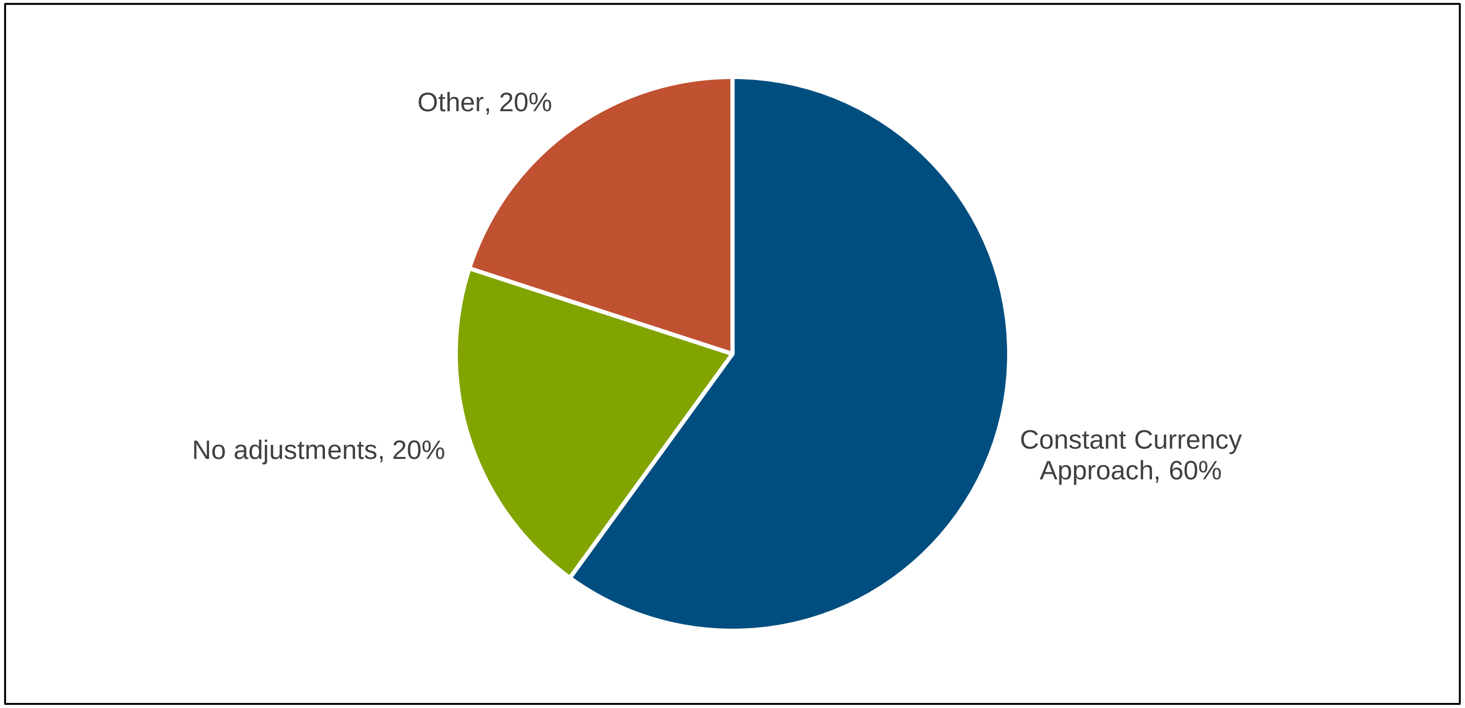

Most companies (75%) conducted their review of foreign currency adjustment proactively before the start of the incentive plan year; it is also possible and common to address this issue as the year goes on especially if there are substantial swings in foreign currency happening during that period of time.

# Did your company elect to make a change in its foreign currency practices once it considered all of the various alternatives?



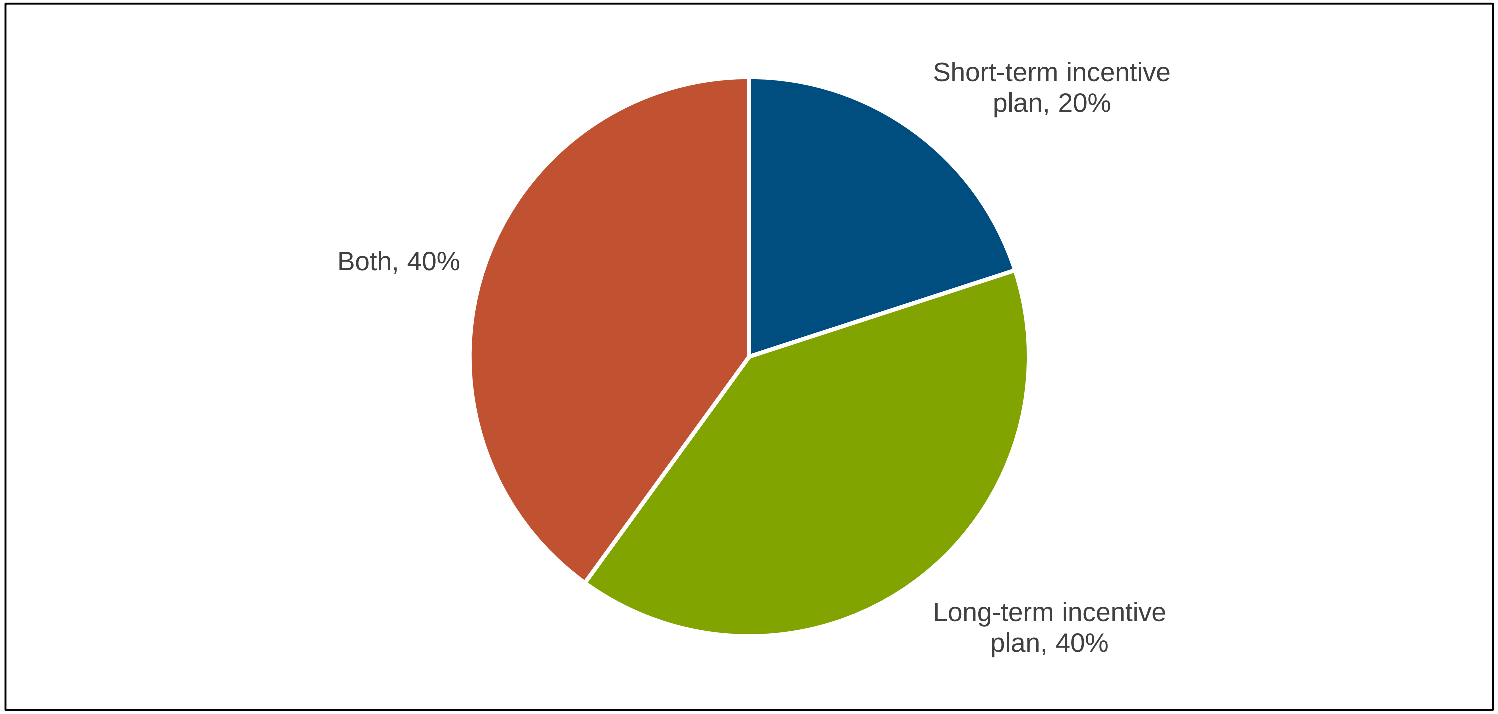

Forty-two percent of companies that evaluated alternatives for addressing foreign currency adjustment actually selected an agreed to approach, the remainder (58%) either didn’t ultimately need to come to agreement on an established approach or informally did so by not doing anything.

# What approach did your company select to use?



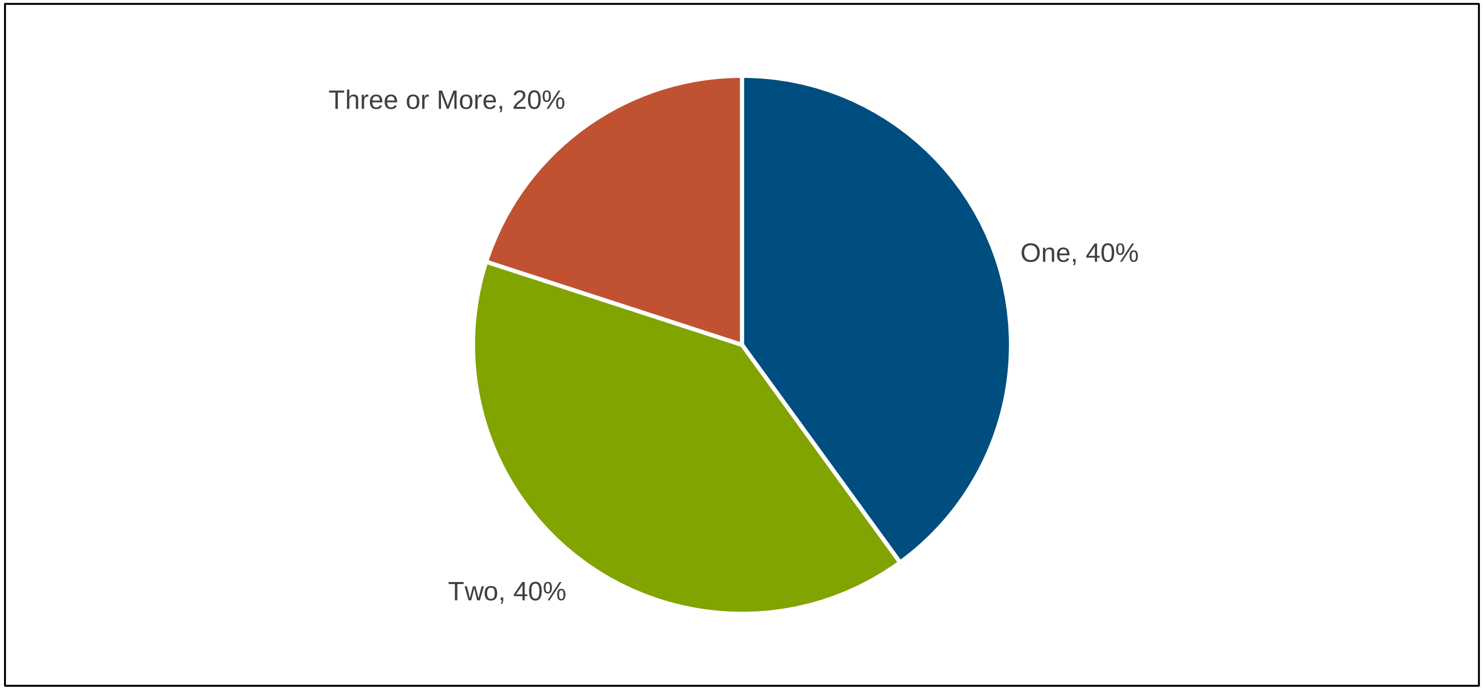

Most companies (60%) elected to use a constant currency approach in their incentive plans where they hold the impact of foreign currency neutral and 20% elected to make no adjustments to their incentive plan metric(s).

# In what incentive plan did your company apply its newly-selected foreign currency approach?



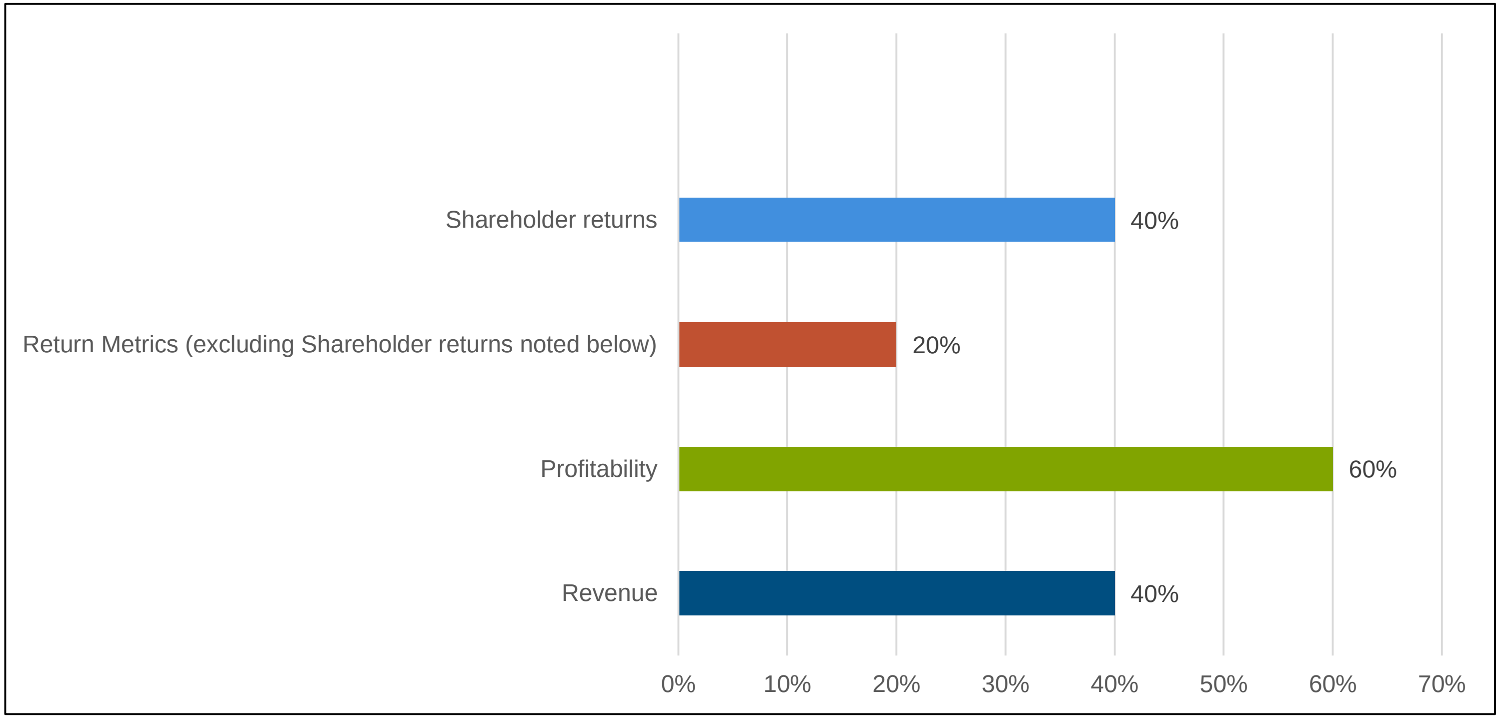

Adjustments were equally applied to primarily the long-term incentive or both the long- and short-term incentive plans (80%).

# How many different incentive plan metrics did this new foreign currency approach apply to?



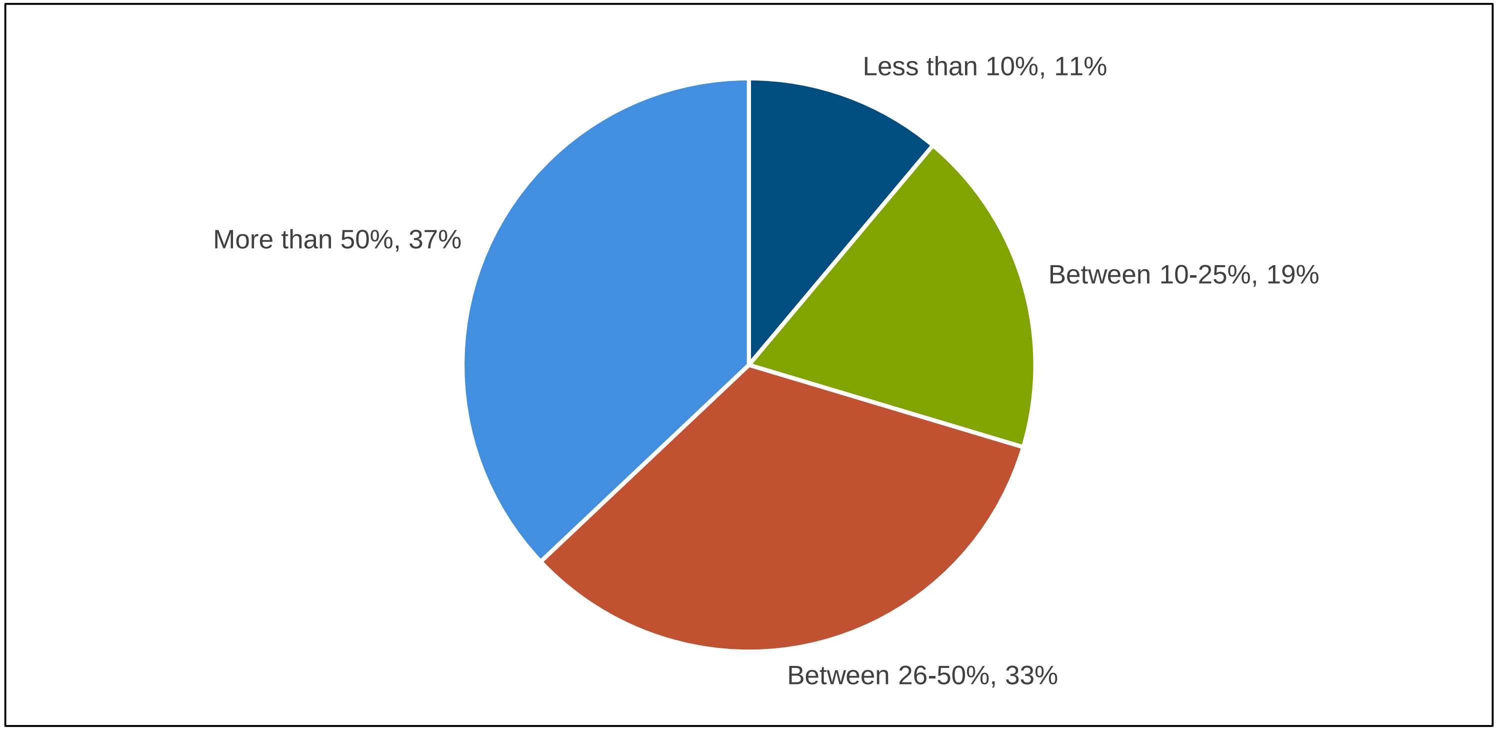

Typically, foreign currency adjustments focus on 1-2 metrics (80%).

# What type(s) of incentive plan metric was this new foreign currency approach applied to?



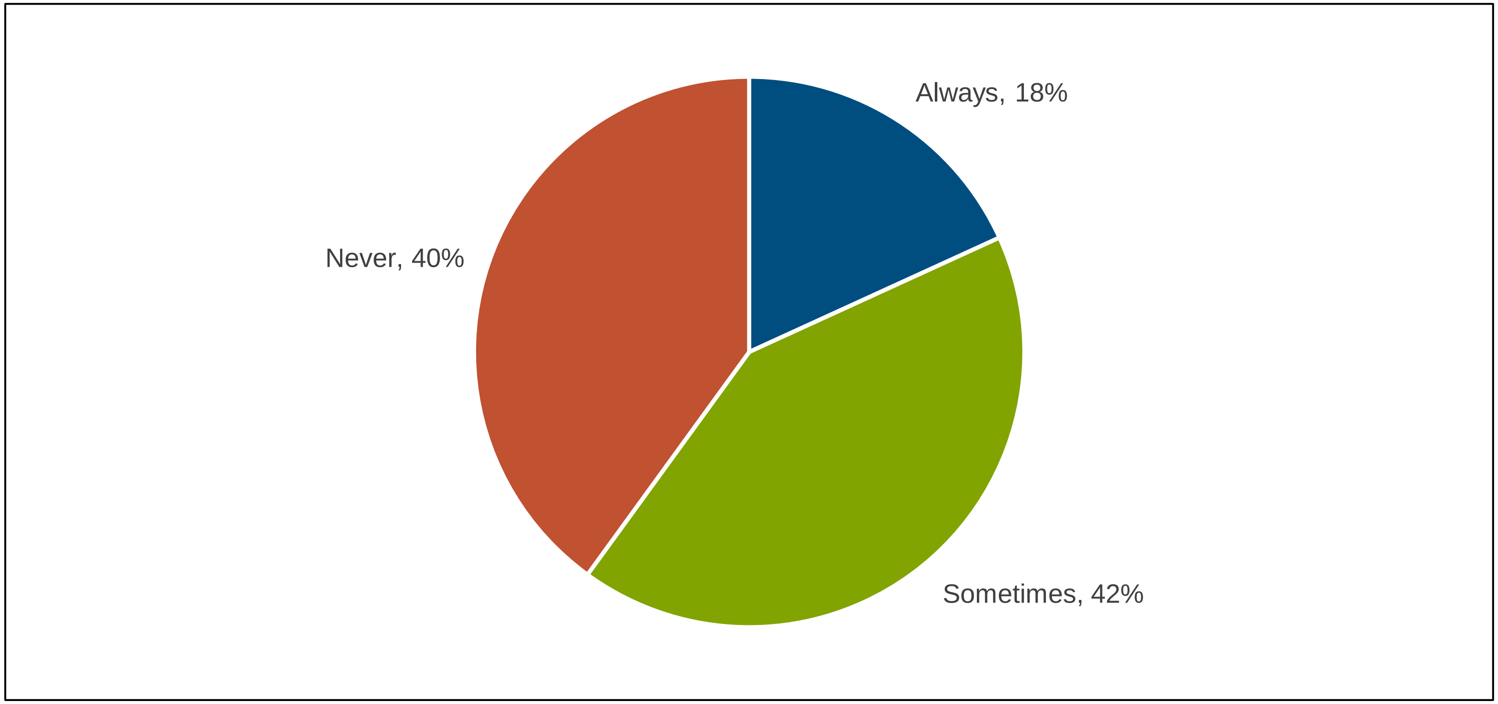

Foreign currency adjustments tend to impact profitability metrics (60%), the most of the surveyed population, with revenue and total shareholder returns following each with 40%.

# Approximately what percent of your company's business is conducted outside the U.S.?



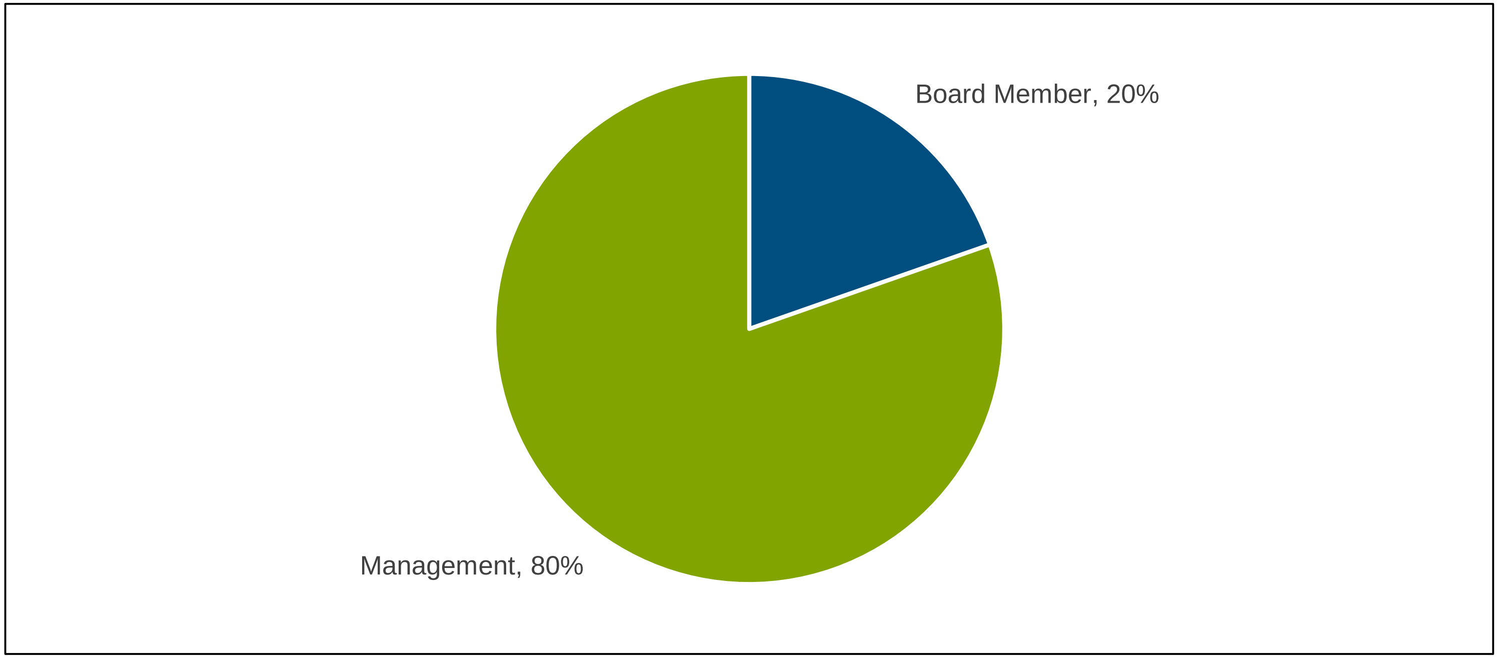

Seventy percent of surveyed companies conduct 26% or more of their company's business outside the U.S.

# Does your company hedge foreign currency risk on a regular basis as an overall business strategy?



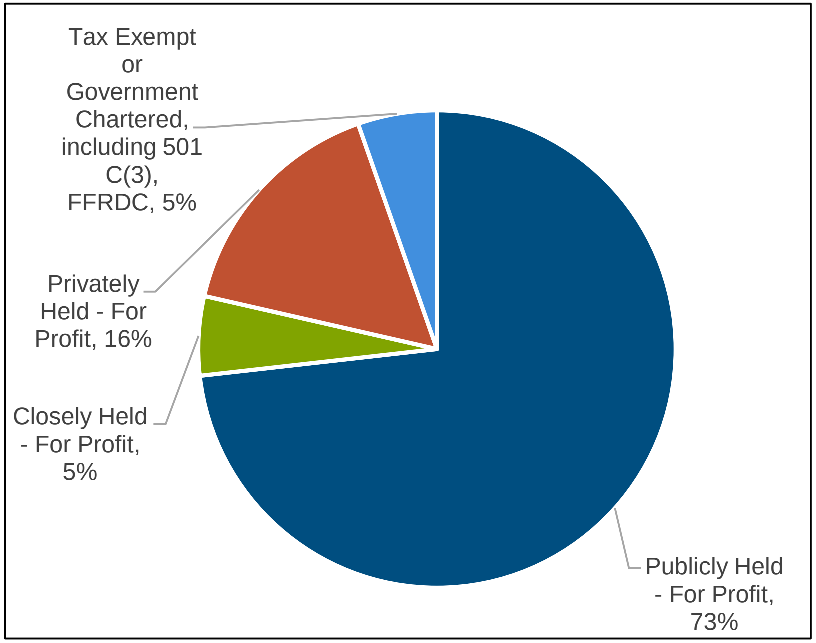

Lastly, we find that 42% of companies sometimes use a company-wide hedging strategy to address foreign currency risk, 40% never do and 18% always do.

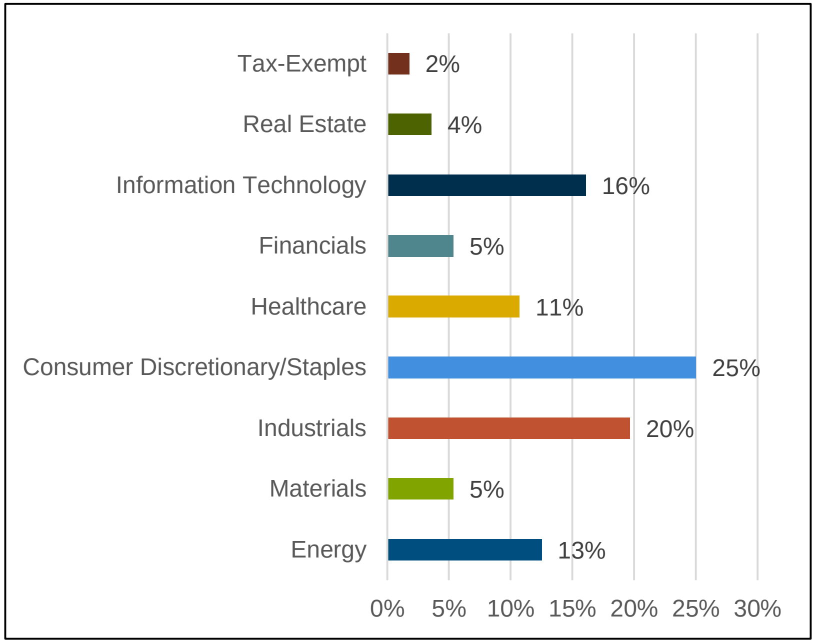
# About the Survey




This online survey, conducted in February 2017, queried management team members (80%) and directors (20%). Survey results are based on data obtained from the 56 respondents.

# About the Survey, cont.




Seventy-three percent of participant companies are publicly held, while 27% are in the private, family-held, or not-for-profit space. A majority of reporting companies are in consumer discretionary/staples, industrials, or information technology industries.

# 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.

# Pearl Meyer


**NEW YORK**
570 Lexington Avenue, 7th Floor
New York, NY 10022
(212) 644-2300
newyork@pearlmeyer.com

**ATLANTA**
One Alliance Center
3500 Lenox Road, NE, Suite 1708
Atlanta, GA 30326
(770) 261-4080
atlanta@pearlmeyer.com

**BOSTON**
93 Worcester Street, Suite 100
Wellesley, MA 02481
(508) 460-9600
boston@pearlmeyer.com

**CHARLOTTE**
3326 Siskey Parkway, Suite 330
Matthews, NC 28105
(704) 844-6626
charlotte@pearlmeyer.com

**CHICAGO**
123 N. Wacker Drive, Suite 860
Chicago, IL 60606
(312) 242-3050
chicago@pearlmeyer.com

**HOUSTON**
Three Riverway, Suite 1575
Houston, TX 77056
(713) 568-2200
houston@pearlmeyer.com

**LONDON**
3rd Floor
58 Grosvenor Street
London W1K 3JB
+44 (0)20 3384 6711
london@pearlmeyer.com

**LOS ANGELES**
550 S. Hope Street, Suite 1600
Los Angeles, CA 90071
(213) 438-6500
losangeles@pearlmeyer.com

**SAN FRANCISCO**
1390 Market Street, Suite 200
San Francisco, CA 94102
(415) 651-4560
sanfrancisco@pearlmeyer.com


**For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.**