Pearl Meyer

ADVISOR BLOG

Paying for Performance is So Yesterday

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There have been many column inches written about one particular big pharma company in the last few weeks. I shall not name them here, but you may well have taken their vaccine. I have.

The media storyline triggered a memory. Weren't investors happy to pay executives for "real performance" before COVID-19 hit us for six? I thought they were, but obviously something must have happened during lockdown which has shifted everyone's perception. (Perhaps all those institutional investors working from home had an unwelcome dose of real life outside an office in London. Having to make your own lunch every day for a year will do that.)

The story of the Big Pharma Co. is that the CEO took a heck of a risk, it paid off, and the remuneration committee now wants to pay him the large sum they feel he deserves. "That's too much!" say investors, business editors, and politicians. It is one variation on a familiar story that gave rise to an organisation called the High Pay Centre, now in its tenth year since being established as a pressure group focused on executive greed. Their research has focused on the ratio of CEO pay to employees, and the fact that the ratio has risen from 50:1 in the 1990s (they say) to 183:1 today. I question the maths behind this ratio, but their point is valid: if you are going to pay big, you better deliver performance in a big way.

We have tried to bring an objective view to this topic by means of our UK CEO Value Index, a simple "rule-of-thumb" to guide compensation decision-making. It measures how much value a CEO adds to their company for every pound they are paid. We look at value added to shareholders over four years, which captures change in market cap, dividends, and share buybacks, and we divide that by the total realized pay for the CEO over the same period.

Our most recent index (which covers the four-year period 2016 through 2019 for the FTSE 100) shows median total value added over the four-year period for all companies was £3.2bn.

Big Pharma Co. was ranked sixth (out of a hundred) in terms of total value added. Total value added for the four years we reviewed was around £60bn. Clearly, they are a very large contributor to shareholders' funds.

Yet, controversially, they are fourth in terms of remuneration. In other words, they deliver massive value, but they also pay for executive talent at the top end. Even after paying all those incentives their CEO is still the 14th best value for money out of a hundred of the largest companies listed in the UK (a CEO Value Index of around 1,000—well ahead of most).

And let's not forget, this was before the pandemic of 2020, before the CEO's huge gamble, and the incredible payoff—not just for shareholders, but for all of us.

This is not to say that all CEO performance—value returned to shareholders—must be globally significant in order to deserve a corresponding pay-out, but it is hard not to see the case for paying for performance at Big Pharma Co.

About the Author

Simon Patterson is a managing director and head of the firm's London office. He is actively engaged as advisor to the remuneration committees of several FTSE 100 companies and consults widely on executive compensation, incentive compensation design, and performance measurement.

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 Atlanta, Baltimore, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Rochester, and San Jose.

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