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Video Transcript: Why Relative TSR Falls Apart

Jan Koors: I think there are actually some implementation problems. I think a lot of companies have been very hasty in adopting TSR by virtue of the fact that everybody, they think everybody, else does it so we should do it too. I think that when you look at what drives that decision making, and how it actually gets implemented, there are not a lot of companies who really can create a relevant peer group with which to measure to TSR. Relative TSR falls apart when you're not comparing yourself to an apples-to-apples type of peer group. That's hard to do for a lot of companies. Harder than most companies appreciate.

The other thing that TSR does is TSR—because it is a point to point measure, so you're taking a point in time three years hence, to a point in time, and you're measuring movement over that point in time—it creates some natural spikes. You know, what goes up must come down. What happens in TSR plans, and what a lot of companies who are now coming up on that third, and fourth, and fifth year of having a TSR plan in place are finding, if you're in the top quartile and at the end of your three, you have vastly improved, the likelihood is that you are going to be in the bottom quartile at the end of year six. It's just the nature of the way TSR works.

What TSR really values, and what TSR rewards, is being a “steady Eddie” in the middle of the pack. And again, if that's what you want to reward, that's fine. Alternately, if you're rewarding very, very high performance, chances are at some point in that cycle you're going to get low performance. One of the downfalls of TSR over time is, while you'll even out overtime, and get average payouts of median or target, you'll get a lot of spikiness in those payouts. As a company and as a management team, are you prepared for the ups and downs of those inevitable spikes? It's not as easy a measure as you think.

My preference for companies is figure out, take the time, do the homework. Figure out what measures are really correlated to shareholder value. Which internal measures, which are in control of the management, really drive that shareholder value? Reward people for what they do. If you get that right, it will be a correlated to value creation in the end, and then you have happy executives and happy shareholders.