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Does Pay Versus Performance Data Tell Us Anything New?

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When does analysis of meaningless data become a fool's errand? There's no doubt that the new pay versus performance (PvP) disclosure in 2023 proxies contains a treasure trove of data. It's human nature to want to explore the information and determine what it means. Despite the heavy lift that was required to produce this disclosure, the fundamental question remains: Does this information tell us anything useful we didn't already know? Perhaps it offers useful information about how companies compare to peers or possibly helpful insights into specific industries or the overall market?

These are the questions compensation committees, management teams, and advisors are starting to ask. Now, as committees turn from their own PvP disclosures to looking at their peers' numbers, there are certain things they must bear in mind.

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First, the new disclosure introduces a concept called Compensation Actually Paid (CAP), which is the US Securities and Exchange Commission's attempt to capture realizable pay. Proxy advisors, institutional investors, and compensation consultants have their own methodologies to capture realizable pay. After all, the number in the summary compensation table is a mix of cash when paid and equity when granted. Having a way to look at what is actually earned makes sense. But it is important to consider whether this variation on how to look at pay is actually useful, particularly because CAP is not compensation actually paid, as will be detailed below.

Once the CAP figure is calculated, which is not a simple task, companies are required to compare it to their total shareholder return, their peer group's total shareholder return, generally accepted accounting principles net income, and a company-selected measure. These comparisons have to be made for the CEO and the average of the other named executive officers for each respective year. In addition, there is a requirement to list three to seven performance metrics. It's a lot of data.

Some companies are shocked to see that their CAP numbers seem to be outsized or even negative, largely impacted by the company's stock price during the year in issue. The same swings and occasional negative numbers are likely to also be reflected in their peer groups' PvP tables. None of this is truly shocking however, as CAP is highly correlated to the company's stock price. It is best practice that the majority of an executive's compensation is equity-based, and generally the larger the company, the more equity as a percent of total compensation. Further, long-term incentives are almost all stock-based. (If an executive's compensation is heavily weighted in cash, it has probably had a comment or two from a proxy advisor or investor.) Equity pay is also often leveraged—more equity is earned as performance increases—meaning the incentive has potentially done its job. More equity and a higher stock price mean a higher CAP.

Perhaps the most surprising thing about CAP is that it can be negative. How can something actually paid be negative? Because of the high correlation with stock price, as stock prices decline, so does CAP. If an executive has a significant amount of unvested stock outstanding and the stock price declines, the magnitude of the decrease can be greater than cash compensation in any given year.

Beyond CAP, is there anything new to learn? On the whole, most companies have taken the position that this is a compliance exercise. There is very little extra narrative to explain any of the information. And that's because the extra explanation is simply not necessary. The compensation discussion and analysis generally makes up the largest portion of the proxy and does a pretty good job explaining how the company's compensation plans work. Nonetheless, a handful of companies have chosen to provide additional narrative to their PvP tables, which seems to happen when the CAP is very large.

Unfortunately, effectively looking at all of this data requires even more work. A multi-year average, instead of mark to market (or year-end stock price) for each year, will smooth out the volatility of the stock market and provide a closer number to realizable pay. While there are just three years of data in this first disclosure, we will add additional years until five full years are disclosed. At that point, we may have data, that with some additional work, adds value to our PvP analysis.

The new PvP rule has undoubtedly added a significant additional layer of disclosure, the likes of which we have not seen more than fifteen years. However, despite the outsized effort required to produce this disclosure, the information doesn't seem to tell us anything we didn't already know. It's easy to get caught up in an analysis vortex comparing any given company to its peers, but doing so would not likely be a worthwhile exercise. While CAP attempts to capture realizable pay, it's not a perfect measure, it has inherent flaws, and we may need to do additional work to get a more accurate reflection of pay versus performance. Overall, while we're seeing interesting graphics and some remarkable CAP numbers, we need not let ourselves fall into the trap of analysis paralysis.

About the Author

Mark Rosen is a managing director and consulting team leader at Pearl Meyer. In his management role, he oversees a team of senior compensation consultants in the execution of the firm's growth strategy and in the development of consultants at various stages in their careers. Mark has consulted on executive and board compensation issues for more than 20 years for a broad range of public companies, as well as tax-exempt organizations and academic institutions. He has extensive experience with benchmarking, retirement plan design, governance issues, and tax and accounting considerations.

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