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Peer Group Development for Life Sciences Companies

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A recent Q&A with Managing Director Rob James, who works extensively with companies in the life sciences space.

Q: Which criteria are most important for life sciences companies to consider when developing their peer groups?

It's difficult to pick one, but I think market capitalization is probably the most important factor for life sciences companies simply because of its broad relevance across the industry as a gauge of size and complexity. Revenue is also important, but often only for commercial biopharmas or other revenue generating life sciences companies in med tech, med device, or tools and services. Operating and R&D expenses can also be useful indicators of size and complexity, but I generally use these as secondary screening criteria.

> "Peer groups are a starting point and the data obtained from the group is just one input among many."

Another way to think about this question is from an equity strategy perspective. For instance, if a company benchmarks equity on a value basis, market cap is important to consider in order to get a reliable picture of competitive value-sharing among employees. However, if a company benchmarks equity as a percentage of common shares, then factors which give a clearer sense of organizational structure might be more important. Employee headcount is one such factor. In general, lower headcount companies provide larger grants per employee than higher headcount companies, making headcount an important criterion for companies seeking to grant competitive award sizes.

Q: That makes sense. Although, one of the challenges with market cap is that it changes daily and can be particularly volatile in life sciences. Over what period should companies evaluate market cap?

My preference is to evaluate market cap over multiple timeframes, usually the current or "spot" market cap and the market cap over the last six months. The spot market cap is useful to get a sense of recent market sentiment and near-term prospects for a company. A six-month average market cap gives a clearer sense of "long-term" market value without the day-to-day noise in share price, and is more likely to incorporate the period of time during which the compensation committee made its decisions and equity was ultimately granted. Be on the lookout, though, for companies whose market values have decreased significantly relative to their long-term average. They may be more likely to make one-off or unusual pay decisions and are therefore less ideal peers. Obviously, there won't ever be total alignment between these two data points, but it's important to understand the reasons for any significant differences between them.

Q: How important is geographic location in peer selection, particularly given the perception that certain markets pay more than others?

While it would be nice to have a peer group chock-full of local competitors, there are rarely enough companies to choose from to allow that. So, I typically use geographic location as a secondary factor to narrow down a larger list of companies identified from the initial market cap or revenue screens. With executive compensation, I am not concerned by the inclusion of peers from higher paying market such as California, provided that final group is balanced overall. While some pay premium may exist in other markets, I'd argue that market for executive talent is national, or even global, and that public life sciences companies need to pay at a competitive national level regardless of whether they are headquartered in California, Massachusetts, or any other major market in the US. Moreover, within a relatively small sample size of 15 to 20 peer companies, I think you'll find more variance in pay data due to the the skills and experience of the individuals at each company than due to geography alone.

Q: Does the same apply to other qualitative criteria such as therapeutic area?

Yes, in general. Outside of certain focus areas like oncology, companies will struggle to find 15 to 20 companies operating in the same therapeutic area that also meet the other primary screening parameters. Moreover, while the science may different, the skills required to excel at the executive level are often similar and transferrable. For these reasons, I think therapeutic overlap mostly falls more in the "nice to have" category rather than "must have" category when selecting peers.

Q: Lastly, do you have any other suggestions or advice for life sciences companies when reviewing their peer groups?

I'd reiterate the importance of reviewing the peer group annually to ensure its continued suitability, especially given the volatility and M&A activity we've seen in the industry over the last two years. I'd also stress the importance of keeping the peer group in perspective. Committees can sometimes get caught in the pursuit of a "perfect peer group" which doesn't exist. I've seen this happen at companies with very unique business models, or when there are deeper philosophical differences among the board or management teams about compensation levels and design. When this happens, don't let perfection be the enemy of progress by reminding those involved that peer groups are a starting point and that the data obtained from the group is just one input among many in the overall decision-making process.

About the Author

Rob James is a managing director with Pearl Meyer with almost 15 years of experience in executive compensation and finance. He serves as a trusted advisor to boards and senior management at public and private firms across North America. He works with companies in all industries, but he has in-depth knowledge and expertise in designing compensations strategies for organizations in life sciences and technology, particularly emerging and high growth companies that are pursuing or have recently completed a M&A transaction or public offering.

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