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Can Improved Communication About Executive Compensation Pay Off?

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In developing carefully calibrated executive compensation programs, compensation committees aim to drive business priorities, as well as attract, retain, and incentivize their leadership teams. But do they place equal emphasis on explaining how these programs align to long-term organizational goals or the potential wealth-creation opportunities they offer? If this communication is mediocre, boards could be overlooking a chance to strengthen leaders' focus on pay and performance and enhance the impact of the compensation strategy.

Pearl Meyer's *On Point Survey: Clearly Communicating Executive Pay* examines how boards and their management teams educate participants about executive compensation opportunities. Specifically, the survey asked if boards and their management teams believe that executives understand how their compensation is structured and delivered. It also asked if boards and management teams believe executives appreciate the value of their compensation and how it compares to the compensation of their internal colleagues and external peers.

The resulting data indicate that there is some misalignment between directors and management about the effectiveness of communicating executive pay plans. For example, directors view the perceived value of total target direct compensation (TTDC) favorably compared to management: 52 percent and 29 percent rated the value as "high," respectively. Directors (32.3%) are also more likely than management (16.7%) to believe that executives' understanding of their TTDC opportunities is "excellent."

What shapes these value perceptions and individuals' understanding of their compensation opportunities? It all comes down to planful communication efforts and how everyone talks with one another about pay programs, pay philosophy, and progress toward goals. The data show that while the majority of survey respondents view overall communication about TTDC positively, there is still significant room for improvement: 20 percent rated the quality of TTDC communication as just "fair" and only 20 percent rated it as "excellent."

Digging deeper into TTDC, the real issue for compensation committees is just how well executives do—or do not—understand their incentive plans, and in particular, their long-term incentives (LTI). The news is not dire, but it does signal a significant opportunity for improvement. Consider that executives are likely, based on their position, well versed in corporate financials. Yet just over a quarter of the surveyed executives feel that they have an "excellent" understanding of the LTI program.

Yes, these plans can be complex and overlap previous years' plans, further complicating a clear picture. But at the heart of any well designed LTI program is a tie to the most important corporate performance metrics. These plans are presumably carefully constructed with the goal of incentivizing executives to drive the organization's long-range strategy, they are vetted by shareholders and proxy advisors, and much of the communication about them is mandated and highly regulated (at least for public companies). That's in addition to the time and expertise that goes into their development and disbursement.

It seems logical, then, that a significant amount of effort and reinforcement would go into the communication of these plans to their participants, yet less than half of respondents (47%) indicated that there is a regular cadence for communicating progress toward LTI goals, while almost 70 percent say that they have regular communication regarding short-term incentives (STI). (One positive point is that when progress toward STI and LTI goals is communicated, it is overwhelmingly shared in person.)

Most importantly, a path toward better understanding was laid out by the survey respondents. Almost half indicated that they would like more information on progress toward goals and 45 percent would like more detail overall regarding their plans. Thirty-eight percent noted that increased frequency in communications, more opportunity for questions and discussion, and more transparency about the goal-setting process would be beneficial.

Ultimately, this information gives leadership teams and board members a chance to synchronize their views and reevaluate how they talk about executive pay programs. Devoting time to evaluate the existing pay communication strategy, and if warranted, formulating a new approach that better illustrates the opportunity and value of the pay program will be well worth the effort.

About the Author

Sharon Podstupka is a managing director at Pearl Meyer. She is a trusted advisor to boards and executive management teams in the areas of executive and broad-based employee compensation communication and change management. With over 25 years of consulting experience, she is one of the original pioneers of executive compensation disclosure best practices and has proven success in creating effective strategies and delivering content in challenging business environments and under intense scrutiny from investors and proxy advisory firms. Sharon has extensive experience in a broad range of industries, including financial services, manufacturing, oil and energy, retail, biopharma/biotech, and healthcare.

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