

Top 5 most common executive compensation issues

- 1 | ISS SCRUTINY ON EXECUTIVE INCENTIVE PLAN DESIGN
- 2 | DIFFERENTIATING FOR PERFORMANCE – MAKING THE MOST OF YOUR INCENTIVE PLAN DOLLARS
- 3 | ESTABLISHING THE “RIGHT” ELIGIBILITY LEVEL FOR LTI PLANS
- 4 | USE OF TSR AS A PERFORMANCE MEASURE
- 5 | MERIT INCREASES VS. MARKET ADJUSTMENTS

Source: Korn Ferry Hay Group

2) Differentiating for performance

The following company utilizes a formulaic approach to determine LTI grants

(“5” and “4” performers receive additional RSUs and Performance Shares)

Performance Rating	Percent of Employees	Restricted Stock Units	Performance Share Program
5 – Significantly Above Expectations	Up to 5%	“5” performers typically receive +20%	“5” performers typically receive +15%
4 – Above Expectations	30%		
3 – Met Expectations	50%	“4” performers typically receive +10%	“4” performers typically receive +10%
2 – Below Expectations	10%		
1 – Unsatisfactory	5%		

Source: Korn Ferry Hay Group

3) Right eligibility level for LTIs?

LTI Eligibility by Job Level

Job Level	% of co. that grant at this level	% of eligible population that receives LTI
CEO	100%	100%
President/COO	100%	100%
EVP	100%	99%
SVP	100%	98%
VP	100%	98%
Senior Director	85%	97%
Director	85%	95%
Manager	38%	83%
Other Exempt Professional	16%	74%

Source: Korn Ferry Hay Group

4) Advantages and disadvantages of TSR as performance condition

Advantages of TSR

- **Preference by large, influential institutional shareholders** and other key stakeholders
- **Prevalence as a performance measure** within large public company long-term incentive plans
- **De facto definition of performance per pay-versus-performance** disclosure requirements established under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
- Usage as the singular definition of performance for Institutional Shareholders Services' quantitative CEO pay-for-performance assessment
- **TSR is generally a good measure for:**
 - Companies targeting substantial growth
 - Companies in a turnaround situation
 - Companies that are not competing with others for customers or investors to any meaningful extent
 - "Grow or die" companies

Disadvantages of TSR

- **TSR depends on two random, arbitrary points in time.** The same company can simultaneously be the best among its peers for one timeframe and the worst for another
- **TSR is not actionable.** Theoretically speaking, expectations on earnings and future performance, coupled with supply and demand, should be the primary considerations affecting share price
- **TSR is a short-term performance measure.** Irrespective of the timeframe selected, TSR fluctuates with the daily vagaries of the capital markets.
- **TSR is generally a bad measure for:**
 - Companies in highly volatile or cyclical industries
 - Companies in a highly competitive environment
 - Companies in industries that are undergoing a significant amount of transformation

Source: Korn Ferry Hay Group

5) Merit increases vs market adjustments?

- Companies have traditionally provided annual base salary merit increase budgets (with median increases of 2-4%), with differentiation provided for performance
- Some companies are considering eliminating the annual merit increase and replacing it with periodic market adjustments

Merit Increases Advantages

- Directly and visibly links performance with pay increases
- Is perceived as equitable – since it is a process that includes all employees
- Is most valuable in organizations that do not have broad participation in other programs that link pay and performance (e.g., STI)

Disadvantages

- In the very low wage increase environment we have had for 10+ years, the ability to truly distinguish between average and top performers is challenging
- Requires significant time and effort from line management

Market Adjustments Advantages

- Provides a mechanism to quickly align pay levels with the market
- Provides more flexibility to the company in allocating compensation increase dollars since it is a less public program
- Most prevalent in organizations that have broad participation in other programs that link pay and performance (e.g., STI)

Disadvantages

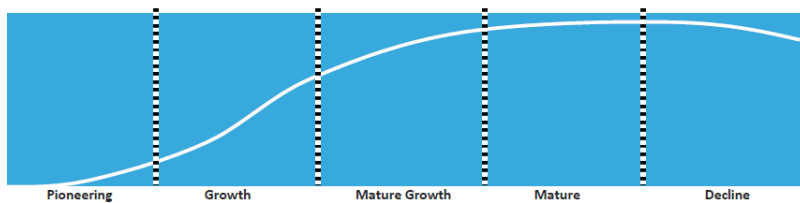
- Requires considerable effort to monitor market data for all jobs
- More challenging to communicate and provide transparency to managers and employees on who is getting increases and why

Source: Korn Ferry Hay Group



Performance conditions at different company life cycles

Where in the Company's Life Cycle?



	Pioneering	Growth	Mature Growth	Mature	Decline
Focus	<ul style="list-style-type: none"> • Pre-Revenue • Creating Offering 	<ul style="list-style-type: none"> • Revenue • Creating Demand 	<ul style="list-style-type: none"> • Revenue/Profitability • Profitable Growth 	<ul style="list-style-type: none"> • Profitability • Return on Existing Investment 	<ul style="list-style-type: none"> • Rationalization • Return on Existing Investment • Shedding Non-Performing Assets
Pay Mix	<ul style="list-style-type: none"> • Minimal Base and STI • All LTI in stock options based on % of company 	<ul style="list-style-type: none"> • Low Base and STI • Mix of options and RSUs based on expected value 	<ul style="list-style-type: none"> • Meaningful base salary and STI target • Mix of PSUs, RSUs and some cases options based on competitive value 	<ul style="list-style-type: none"> • Meaningful base salary and STI target • Mix of PSUs and RSUs based on competitive value 	<ul style="list-style-type: none"> • Meaningful base salary and STI target • Mix of PSUs and RSUs and possibly Cash LTI based on competitive value
STI Metrics	<ul style="list-style-type: none"> • Milestones measures • Non-financial 	<ul style="list-style-type: none"> • Market Share • Revenue 	<ul style="list-style-type: none"> • Revenue • EBITDA • EBIT 	<ul style="list-style-type: none"> • EBIT • Net Income/EPS 	<ul style="list-style-type: none"> • Net Income/EPS • Cash flow • ROIC • "Success" measures
LTI Metrics	<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • Revenue or EBITDA if any at all 	<ul style="list-style-type: none"> • Relative TSR • Revenue • EBITDA • EBIT 	<ul style="list-style-type: none"> • Relative TSR • Return measures combined with growth measures 	<ul style="list-style-type: none"> • Stock price hurdles • ROIC • "Success" measures

Source: Meridian compensation partners