The Morning Risk Report: High-Performing Businesses Ignore Pay Critics

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Evidence is mounting that shareholders are better off when companies shrug at criticism of executive pay, especially from proxy advisors. A new study from Towers Watson focused on compensation practices of the 50 companies in the S&P 1500 with the highest sustained performance over a 15-year period and found they paid differently than lower performers, "sometimes in ways that many observers, including proxy advisory firms, would view unfavorably." Not only did these companies get better performance, they got more bang for the buck. Although their chief executives earned more than peer CEOs in absolute dollars, they got a lower share of their companies' market capitalization.

The report notes that the high-performers changed their compensation programs as they grew, sometimes using only a single incentive plan metric in their early years. Options were a weightier factor in the compensation plans of high performers, which "place less emphasis on long-term performance plans," it said. Both practices are at odds with proxy-advisor recommendations. With respect to size, according to the report, proxy advisors don't distinguish bigger from smaller companies in their pay analyses. With respect to options, the proxy advisor Institutional Shareholder Services itself explained that in its methodology, options and other awards "that are not granted due to the attainment of pre-set goals are not considered strongly performance-based."

Towers Watson is not the first to call into question such cherished notions as "pay for performance." "There's no empirical evidence performance based pay is good for companies, it just sounds good," said Mark Hodak, managing director of advisory firm Hodak Value Advisors, and author of a recent article in the Journal of Applied Corporate Finance entitled The Growing Executive Compensation Advantage of Private vs. Public Companies. Researchers at Stanford have previously demonstrated that companies are better off when they flout proxy advisor strictures against option exchanges and hold the course on compensation programs in the face of criticism. For more on how ignoring compensation critics can help performance, see the recent Risk & Compliance Journal article How Skimping on CEO Pay Can Drive Public Company Underperformance.

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