

Changing Perceptions of Pay

Use the CD&A to proactively communicate to key audiences.

By Jack Dolmat-Connell and Maureen Wolff-Reid

The public, the news media, governance watchdogs, and Congress have long believed that executive pay is out of control and completely unlinked to performance. Now, with a global-market meltdown in full swing, executive compensation has become even more of a lightning rod for economic frustrations, a pressure point for activist investors, and fodder for the media in their bid to portray “greedy” executives.

Perception equals reality, and corporate America is doing little to change the perception of greed and extravagant pay. As a case in point, consider the Compensation Discussion and Analysis (CD&A) section of corporate proxy statements, where the Securities and Exchange Commission has mandated that public companies thoroughly explain their executive compensation practices. More effective use of the CD&A could begin to correct the misperceptions about executive compensation, but few are taking advantage of the opportunity.

The goals of the SEC in mandating CD&As were to have companies disclose, in plain English, a clearer and more complete picture of the compensation earned by their senior executives. After the first proxies with CD&As were issued in 2007, many of which contained little more than boilerplate language, the SEC sent out comment letters to more than 350 companies.

The letters asked for greater clarity and better analysis of certain features of the companies’ compensation programs, but the SEC was not specific in spelling out the expected improvements. A year later,

the advances made in the latest round of CD&As have been modest. Most boards and executive management still see the CD&A merely as another new compliance requirement to be satisfied as minimally as possible.

So, how do we move from viewing the CD&A as a regulatory hurdle to seeing it as an opportunity to proactively communicate with key audiences? First, let us consider who accesses the CD&A. It includes a wide variety of audiences: investors, financial analysts, competitors, customers,

the compensation program designed to address (i.e., retention concerns, growth, need for margin improvement) and in what ways will the incentives in the plan drive improvements in these areas?

■ What are the specific performance targets? If the targets will be withheld due to competitive concerns, why are these concerns justified?

■ Why did the board select the metrics used for performance targets?

■ How did the key executives actually perform versus their targets?

■ How did this year’s targets compare to the company’s performance in prior years, and how did this affect target payout?

■ Who are the key decision-makers involved in developing the compensation program?

gram?

■ How did each decision-maker contribute to the process?

■ What was the reasoning used to determine change-in-control and severance benefits and how does the company control “pay for failure?”

Most board-level discussion involving metric disclosure in the CD&A focuses on “competitive harm.” Remember: performance metrics are critical to the valuation of the company. Stakeholders benefit from knowing whether management’s focus is on top-line growth, profitability, total shareholder return, or other measures. The metrics a company uses and discloses in the CD&A need to be consistent with those reported in earnings calls, investor presentations, and other communications. This will demonstrate that management’s

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employees, and the media, all of whom have different points of view and often competing objectives and perspectives.

Answering Investors’ Questions

What is it that investors want in the CD&A? At the end of the day, they want to know that executives will be rewarded for taking actions that are in the best interests of shareholders. Companies that consider themselves truly interested in transparency should begin by ensuring that their CD&A answers each of the following questions:

■ How were base salary and incentive pay determined?

■ Were they based on peer companies? If so, who were the peers and in what way are the peers comparable to the company?

■ Which strategic business areas was

interests are closely aligned with those of the company and its shareholders.

Make the CD&A 'Investor Friendly'

Finally, the CD&A needs to be "investor-friendly" in its approach and presentation. There are some simple, highly effective ways to make this happen:

- Include a table of contents
- Use present tense
- Limit redundancies
- Draft short sentences clearly understandable to the average reader
- Incorporate high-level callouts
- Organize information in graphical and tabular formats
- Employ headlines and sub-heads
- Consider a Q&A format covering the "what, why, and how" of each element of compensation.

The most effective process for developing

a strong CD&A is a task-team approach, beginning with agreement between the board and compensation committee that transparency in disclosure is in the best interest of the company's shareholders. The team should include key members of management—the investor relations officer (IRO), as well as human resources, finance, and legal counsel and the outside executive-compensation consultant.

Serving as the company's key contact with shareholders and its "eyes and ears" on Wall Street, the IRO brings investment-community feedback and perspective into the CD&A process. Involving the IRO also ensures that the content and messaging of the CD&A is aligned with the company's other investor-relations channels. The compensation consultant and attorneys bring their professional perspectives. Each member of the team—including legal

counsel—should have an equal voice in determining CD&A language, subject matter, and format.

There is a definite value in creating an investor-friendly CD&A. It builds trust and fosters a reputation for transparency. It provides a broad context for the executive compensation and benefits programs, which is what has been historically lacking. It increases public understanding of the company's pay-for-performance plans and how the plans are linked to the creation of shareholder value. Finally, it transforms a regulatory obligation into an investor-relations opportunity. It is time that more companies seized this opportunity. ■

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