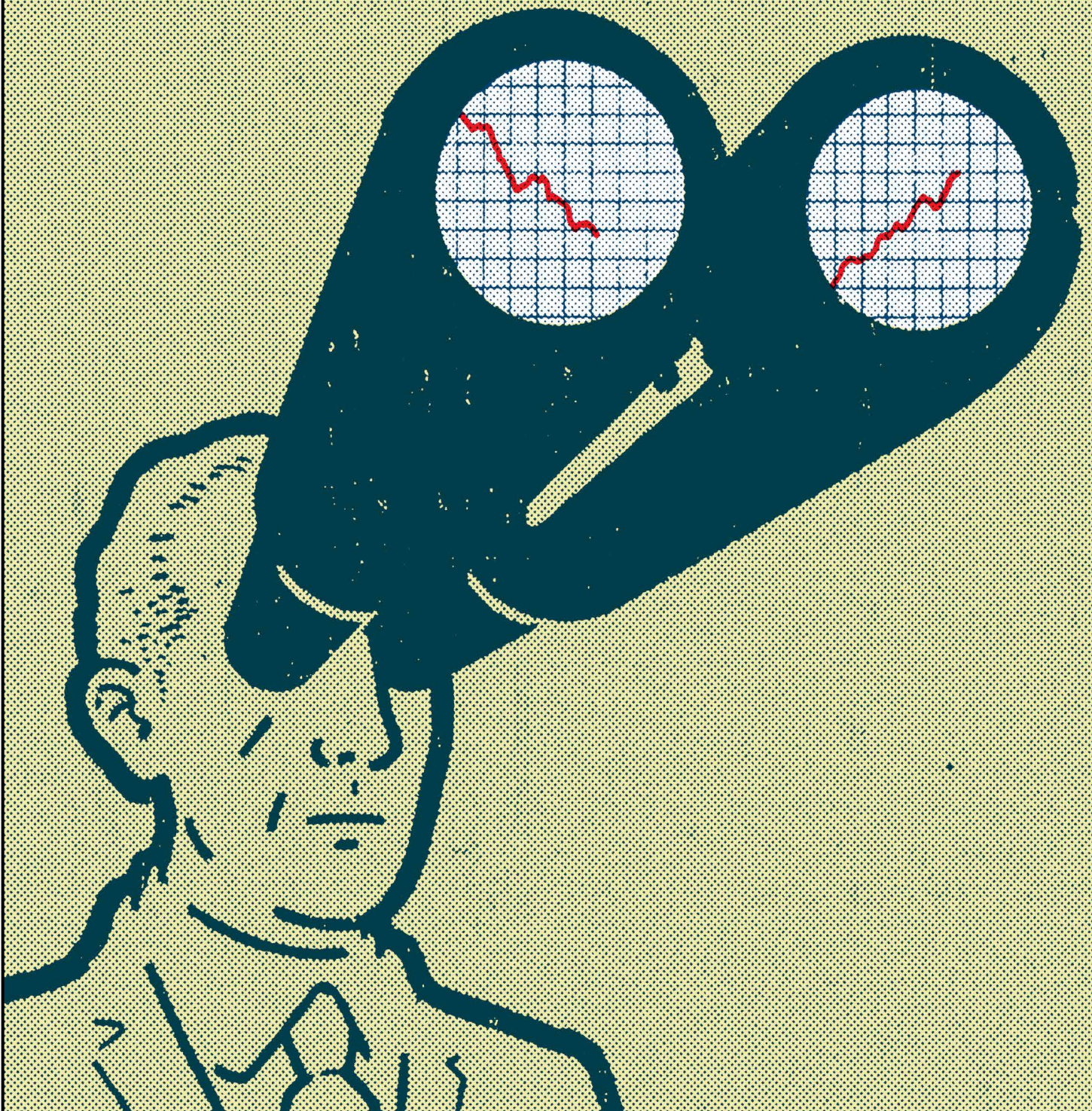


DO YOU HAVE THE RIGHT COMPENSATION PEER GROUP?



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GIVEN THE HEIGHTENED SCRUTINY on executive compensation, it is increasingly important for compensation committees to ensure that they have an appropriate peer group for comparison purposes. A carefully selected and assembled peer group can provide information that is critical to decision making on compensation—both the level of compensation and the underpinnings for short- and long-term pay program design.

Companies must now publicly disclose peer group members, explaining the selection criteria used in developing the peer group, and defending its appropriateness for benchmarking compensation, performance analysis and pay program design.

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Until lately, peer-group composition tended to remain relatively static from year to year. But recent activity involving spin-offs, mergers and acquisitions is changing the landscape and may call for revisions to a company's existing peer-group composition. The critical role of peer groups further increased last year by the SEC's use of relative total shareholder return (TSR) as the performance measure under its proposed rules on the disclosure of executive pay vs. performance.

ONE PEER GROUP MAY NOT MEET ALL NEEDS.

Considering these important developments, compensation committees should focus on reviewing and updating their organization's peer group in today's business and regulatory environment, as peer groups are used for measuring performance as well as evaluating compensation. And one peer group may not meet all needs; committee members should consider when and why it may be appropriate to construct different peer groups for different purposes.

DO YOU HAVE THE RIGHT COMPENSATION PEER GROUP?

When considering whether their current peer group meets new demands, and how they might need to modify it, compensation committees should seek to answer two primary questions:

1 DOES THE PEER GROUP ACCURATELY REFLECT YOUR BUSINESS TODAY?

Did your company recently acquire all or part of another company? Was a division sold or spun off? Mergers, acquisitions and spin-offs may result in significant changes to the company. Compensation committees should consider the impact a transaction may have had on the overall size of the company relative to its peers, whether the industry classification still reflects the company's core business, and whether the organization has become more (or less) complex. The acquisition or divestiture of overseas operations could also have an impact on appropriate peers.

Committee members also should determine whether capital market activities have affected any peer companies. While the loss of peers due to acquisition is not uncommon, simply replacing the peer with its acquirer may not be the answer, since that organization may not be a good fit in terms of size, industry or complexity. A peer company that has made a significant acquisition or divestiture should also be reexamined on those factors.

Keep in mind that each company is unique and there are no "perfect" peer matches. But the closer your peers come to reflecting your company, the easier it is to defend the appropriateness of your peer group and thus the appropriateness of any benchmarking of your company's executive compensation.

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2 SHOULD YOU USE THE SAME PEERS FOR COMPENSATION AND PERFORMANCE MEASUREMENT?

The short answer: probably not. That is not to say that you shouldn't include any (or all) of your compensation-benchmarking peers in your performance-measurement peer group, but the key to appropriate performance-measurement peers is finding the right group (or index)—one that accurately reflects your company.

Benchmarking compensation and measuring performance are separate and distinct initiatives and should remain so. The companies against which you benchmark your executives may be an appropriate fit in terms of size, industry and the core business. However, the performance of your peers over short periods of time may vary wildly. In addition, limiting your performance measurement to a “closed” group may create issues as corporate transactions may affect your performance peers. Creating a broader custom peer group, or measuring your company against an index, is generally a better idea than limiting yourself to your compensation-benchmarking peers.

**BENCHMARKING COMPENSATION
AND MEASURING PERFORMANCE ARE
SEPARATE AND DISTINCT INITIATIVES.**

DO YOU HAVE THE RIGHT COMPENSATION PEER GROUP?

There are a variety of performance peer groups to choose from: published indices, including the broader index in which your company is a component (e.g., the Russell 3000); subindices in which your company is a component (e.g., financial, energy, telecom, etc.); or a custom peer group that includes companies beyond your benchmarking peers. Understanding your company's relative TSR performance, as well as peer performance, may be important when creating a performance peer group.

Over finite periods of time, relative TSR performance results can be extremely volatile; strong performers over long periods may be low performers over finite periods, while the opposite holds for lower performers that may do relatively well over finite periods. Although past performance does not indicate future results, it is important to understand how your company has performed versus an index, subindex or custom peer group.

THE KEY TAKE-AWAY

Static peer groups are a notion of the past. In today's busy, shifting capital markets, it is vital to have an understanding of your peer companies that goes beyond their size, and includes many other facets. To ensure that your benchmark peer group is defensible, you need to know your peers' business nearly as well as your own.