

Investors and a Study on the Use of Peer Group Benchmarking

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Given say-on-pay votes, companies are interested in understanding how their shareholders view executive compensation. At the always informative NASPP conference, Michelle Edkins from BlackRock and Ann Chapman from Capital Research both mentioned a recent [paper](#) from Charles Elson of the Weinberg Center for Corporate Governance, titled “Executive Superstars, Peer Groups and Over-Compensation ? Cause, Effect and Solution.”

The paper argues that tying CEO compensation to external peer group benchmarking is unnecessary at best because the practice is based on a faulty premise of easily transferable executive talent. Citing various other studies, they question the frequency of CEO turnover, in particular, movements by public company CEOs to another public company.

The authors believe that targeting compensation levels to either the 50th, 75th or 90th percentile of this peer benchmark has led to rising executive pay. This then creates a “leapfrog effect” through networks formed by the peer grouping process, as one company’s “overpayment” then ripples through other companies for which they are a peer.

Instead, the authors advocate for a complex process of diminishing the focus on external benchmarking and developing instead internally created standards based on the specific nature of individual organizations.

It’s an interesting time to discuss peer benchmarking, as we’ve seen the influence in the past year of proxy advisory firms relying and evaluating companies’ performance against their own formulated peer groups. The use of peer groups by those firms and companies are unlikely to go away, so perhaps the important point here is not so much whether companies find the paper’s conclusions to be persuasive, but that it is useful to be aware that key institutional investors are reviewing these types of studies about compensation-setting. The paper’s arguments, and other similar external criticisms, may factor into investors’ assessment of companies’ compensation practices as they make voting decisions.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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