

Selection of Data Sources

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A thorough evaluation of available market data sources is critical to ensuring that market data results reviewed by the compensation committee are credible and meet the objectives established at the beginning of the benchmarking process. In some situations, a single market data source may be all that is needed to meet a company's benchmarking objective. In other cases, it may be more appropriate to use multiple data sources to provide credible market results. Peer groups used for compensation decisions must be disclosed in the annual proxy statement

This article provides a high-level overview of the two most relevant market data sources for conducting compensation benchmarking analysis: proxy-reported data and compensation surveys.

Proxy-Reported Data

We find that most companies use proxy-reported executive compensation data for evaluating the pay levels of the most senior executives, either on a stand-alone basis or in combination with other market data surveys. The use of proxy data requires careful review, analysis and synthesis of data to ensure that the highest quality results are presented to the compensation committee.

The use of proxy data has many advantages:

- Allows companies to create custom peer groups of publicly traded companies (see Meridian's article, "Developing Effective Peer Groups")
- Line-by-line pay levels can be shown at the incumbent level as well as summary market statistics
- Allows for the reporting of all components of executive pay using any valuation methodology desired by the target company
- Data is reported not only on pay levels, but also includes detailed information on program design, practices, and the decision-making process for executive compensation

The drawbacks to proxy data include the following:

- Data is generally only available for the CEO, CFO, and three other most highly paid executive officers of the company
- Much of the data reported in proxy statements is already dated, since it is largely reflective of prior year compensation
- Generally, there is limited data on executives below the corporate level beyond the top business unit head executive

Compensation Surveys

Compensation surveys, including compensation databases, can be an important tool in compensation benchmarking. Whereas proxy statements provide an insight into only the top five executives, compensation surveys can provide ready access to market data on hundreds of positions at hundreds of companies, both public and private. All of the major HR consultancies maintain compensation surveys, and smaller firms can be a useful source for industry-specific market data.

The following are some key advantages of using compensation surveys:

- Typically provide data on executive positions beyond the top five executives reported in proxy filings
- Often provide data that can be scoped based on company size and industry, allowing users to easily compare multiple data cuts
- Some data providers provide useful online tools allowing users to create custom peer groups and refine survey results using other techniques
- Can be a time- and cost-effective alternative to providing a quick turn-around snapshot of executive pay levels
- Compensation surveys tend to contain more current information than what is reported in public filings

Some of the drawbacks to using compensation surveys include the following:

- In order to protect the confidentiality of participants' data, users cannot review line-by-line data and are limited to using only summary market statistics
- The valuation methodologies may be different from survey to survey, and this can make it difficult when attempting to create consistency across data sources
- Surveys tend to provide less detailed information on companies' programs and practices and focus more on actual pay levels

Surveys may be focused on a particular industry or cover multiple industries. They may be available to purchase or require company participation to obtain results. In short, there can be significant differences among various surveys, and it is critical to carefully evaluate available data sources against the company's benchmarking objectives.

Below is a sample check list of some of the key areas to consider when evaluating the appropriateness and quality of a survey market data source.

- Does the data come from a reputable survey provider?
- Does the survey provide a thorough description of all data collection and valuation methodologies?
- How many participants are included and from what industries?
- What positions are covered?
- What is the timing of the data?
- Which components of pay are reported?
- What market percentiles are reported?
- Is the data organized and presented in a clear and useful manner?
- Is the data reported in useful size cuts? Can it be size adjusted using regression analysis?
- Can custom cuts for selected participants be obtained?
- What is the cost of the data?