Market Data in Context

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When it comes to benchmarking executive pay, it's important to consider market data in context. Here is a look at some best practices for making informed decisions with market data, starting first with process.

Compensation Committees' Decision-Making Process

The compensation cycle starts in the third quarter, typically with a review of the peer group. In the following months, during the fourth quarter, committees start reviewing market data and pay positioning relative to market, and begin having discussions about individual executive and company performance.

Following a robust benchmarking process leads to better decision-making outcomes. This includes reviewing and approving the peer group in advance of the benchmarking, discussing the benchmarking methodology and data source strategy upfront, and providing multiple looks at market data. It enables committees to provide feedback on the process at each step. It also provides the committee with an opportunity to review market data a few times before approving pay decisions.

Best Practices for Making Informed Decisions with Market Data

Market data is inherently imperfect. It's important to avoid the literal application of market data. With market data serving as a backdrop for pay decisions, committees should also:

- **Treat data as a reference point:** Putting less emphasis on the market results leaves greater room to consider other unique factors that impact pay decisions, such as experience, institutional knowledge, individual performance and internal equity.

- **Focus on a competitive range rather than a fixed percentile:** Consider a competitive range around your desired market reference (e.g., +/-15% around market median) rather than fixating on percentiles. Fixating less on a specific percentile gives the committee more flexibility to exercise its informed judgment and tailor pay by individual.

- **Judicious application of regression analyses, premiums and discounts:** Using regression analysis to fit market data to a company's size and applying premiums and discounts to benchmarks can sometimes imply a false level of precision of market data. Instead, think about positioning an executive below or above a market range depending on their unique responsibilities and scope of role or the company's size relative to peers.

- **Monitor trends outside of the industry:** Compensation committee agendas should have at least a semi-annual (if not quarterly) review of compensation trends to understand what's happening in their industry, but also to consider broader trends in executive pay which may influence pay decisions.

- Avoid knee-jerk reactions to market data volatility: Understand the drivers of market data volatility and avoid knee-jerk reactions to match significant increases or decreases in market data. Looking at how the market changed for a constant incumbent sample provides a true sense of how pay has moved. Consider also isolating pay movement by component. Isolating data like this helps the committee better understand underlying trends in the market data.

- Consider multiple sources of market data: Consider a few market sources (e.g., proxy data, industry-specific surveys, and general industry data) and discuss the tradeoffs of each source (e.g., real-time insights in surveys, line-by-line detail in proxies).

- Account for real retention risk: A highly seasoned, high-performing executive might be positioned at the top end of a competitive range of the market median. Executives with real domain expertise in an industry or function may command a premium. Pay increases for someone nearing retirement may not need to be as strong.