Post #82: The Impact of Consolidation in the Energy Sector on Executive Compensation – Part 1

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Navigating the Shrinking Peer Pool When Evaluating Compensation Peers

As mergers and acquisitions (M&A) reshape the energy sector, selecting relevant peer groups for executive compensation benchmarking has become increasingly complex. This three-part blog post series offers practical recommendations for energy companies and compensation committees adapting to a shrinking peer group in the wake of energy consolidation.

Compensation Benchmarking Peers

Finding comparably sized energy companies to form a compensation benchmarking peer group is getting harder. Although the pay practices of a compensation peer group are not intended to dictate a specific value or design for companies to follow, benchmarking pay to industry peers is a valuable exercise that helps establish a competitive range of pay.

Ideally, a compensation peer group will include 12 to 20 companies in the same energy subsector (e.g., upstream, midstream, downstream, oilfield services), in a similar size range (as defined by enterprise value or other relevant size measures) that represent reasonable competitors for executive talent. As the industry consolidates, companies are finding that there are not enough peers to create a compensation peer group by these “traditional” standards. So, what can companies do?

Presented below are three potential approaches to defining a compensation peer group and gathering and evaluating market data, against the backdrop of energy consolidation.

Cast a Wider Net:

- Expand the scope of potential peers to include broader energy companies. For example, midstream companies may reasonably include upstream companies in their peer group and vice versa.
- Look across the border and include companies in both the U.S. and Canada. This adds complexity because of currency differences but given we have observed examples of cross-border consolidation and cross-border executive movement, your Canadian or U.S. neighbor may represent a credible compensation peer.
- Include local companies, even though they may not be energy companies. Consider companies in your regional headquarters; they may not be in the same industry, but if they represent a competitor for executive talent, particularly corporate roles such as HR, IT, Legal, they may be a reasonable compensation peer.

Broaden Your Market Data Strategy:

- Consider augmenting your industry or sector specific survey data with general industry market data. A broader data source can provide additional market perspective and supplement proxy data from a smaller compensation peer group. Similar to the last point above, this may be most helpful for corporate roles that transfer well across industries (e.g., HR, IT, Legal, Communications).

Evaluate Data with a New Lens:

- When reviewing benchmarking data from the compensation peer group, it can be easy to focus on the aggregated data - the 25th, 50th and 75th percentiles. However, as peer groups shrink, those aggregated statistics are more likely to be skewed by pay practices at individual companies. As compensation peer groups become smaller, consider focusing less on the aggregated statistics and more on the entire array of available data (i.e., the line-by-line company detail).

- Additionally, internal equity of the team (i.e., how one job is compensated or valued in the organization relative to others) is always critical to consider when evaluating competitive positioning and potential pay actions. With smaller peer groups, and therefore fewer data points, internal equity may increase in importance.

As the energy sector continues to consolidate, selecting effective peer groups for executive compensation benchmarking is more challenging -and essential -than ever. By casting a wider net, broadening your data sources, and evaluating data with a new lens, companies can better navigate the complexities of today's shrinking peer landscape.

In parts two and three of this three-part series, we will explore how consolidation affects performance peer group selection and relative Total Shareholder Return (TSR) calculations. Stay tuned!