



ORGANIZATIONAL RESPONSES TO SAY-ON-PAY VOTES

Results of the 2021
HR@Moore Survey of CHROs

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EXECUTIVE SUMMARY

Since the passage of the Dodd-Frank Act in 2010, US publicly traded companies subject to proxy rules must allow shareholders to submit an advisory vote on the compensation of their most highly compensated executives at least every three years (known as Say-on-Pay votes), and on how often shareholders would like to be presented with Say-on-Pay votes. Given the potential interplay between executive compensation and succession planning, as illustrated in recent Center for Executive Succession research that shows executive compensation and executive succession decisions appear to be related when it comes to the selection of internal CEO appointments, we sought to better understand how firms develop executive compensation plans and respond to say-on-pay votes.

Respondents first indicated that boards sometimes consider succession plans when setting executive compensation. Additionally, executive compensation incentives are rarely tied to succession planning metrics, though this is unlikely to be a problem. In the end, however, results suggest that some boards do co-manage executive compensation and succession planning. Results also indicated that board members are perceived to be concerned with the potential for negative say-on-pay votes or negative recommendations from proxy advisory firms. This is concerning as it potentially suggests that executive compensation decisions are being driven more by the considerations of outside agencies rather than internal concerns regarding talent management or company strategy.

We then sought to understand what might raise concerns regarding say-on-pay voting thresholds and how companies would likely respond to negative say-on-pay votes.

Respondents most often noted that say-on-pay approval of less than 80% would be concerning, though the threshold distribution was widely dispersed. If this threshold were to be crossed, respondents indicated that changes in executive incentives would be most likely (27 instances), followed by reviews of the compensation program (19 instances), shareholder outreach (16 mentions), and compensation consultant changes (7 instances).

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 requires US publicly traded companies subject to proxy reporting rules to submit to shareholder advisory votes regarding the compensation of the company's Named Executive Officers at least once every three years. These votes have subsequently been termed say-on-pay. The rise in say-on-pay, as well as growth in general shareholder activism, have also given rise to proxy advisory firms who provide data analysis, insights, and recommendations to investors regarding company policies, such as the appropriateness of executive compensation.

Recent research from the Center for Executive Succession illustrates the interplay between executive compensation and executive succession planning. This research shows that when the pay disparity between the CEO and the company's second highest paid executive officer was lower, companies were more likely to promote an inside executive to be the next CEO. Furthermore, this research found that when an inside executive was chosen, the second highest paid executive was more likely to be named CEO when the pay gap between the second highest paid executive and third highest paid executive was greater. These findings were in line with proxy advisory firms' belief that larger pay gaps between the CEO and other executives are evidence of ineffective succession planning and an increased likelihood of having to hire the next CEO from outside the firm. They also provide an indication that executive compensation and succession planning decisions may go hand in hand in meaningful fashion, increasing the importance of managing the efforts jointly.

Given the central importance of executive compensation overall, its apparent linkages to effective executive succession planning, and the growing role and power of proxy advisory firms, the 2021 HR@Moore Survey of Chief Human Resource Officers (CHROs) sought to explore issues related to say-on-pay votes and executive compensation and succession. We surveyed approximately 375 CHROs and 105 of them completed these questions for a 28% response rate.



EXECUTIVE COMPENSATION AND SUCCESSION PLANNING

Executive compensation authority lies with the board's compensation committee who reviews and approves compensation packages presented by management. The compensation committee typically uses a compensation consultant, while in some (albeit rarer) cases management uses its own separate compensation consultant. We began the survey by asking CHROs questions about the links between compensation and succession plans, as well as perceptions of the board's concerns when setting executive compensation as illustrated in **Figure 1**.

39% of CHROs indicated that the board considers talent management or succession plans when setting executive compensation, while only 20% of respondents either agreed (or strongly agreed) that executive compensation incentives are tied to formal succession planning metrics. The former finding seems to suggest the earlier CES research findings discussed may be unintentional signals that companies are sending to shareholders, proxy

advisory firms, and other stakeholders regarding evaluation of executive talent; however, it is important that compensation committee members are aware of how these decisions are evaluated by these groups. At the same time, the low agreement rate is surprising given discussions with CHROs that often indicate compensation considerations are integral in talent management and retention discussions. It is less surprising that formal compensation metrics rarely relate to succession planning considerations, given that managing effective succession planning is likely an important consideration of both the CEO and CHRO's roles; however, it is interesting that 1 in 5 respondents did note some level of agreement that their companies have begun using succession considerations in compensation plans.

Fifty percent of CHROs agreed that compensation consultants have significant influence over executive compensation policies and decisions. At the same time, CHROs perceive board members to be particularly concerned with

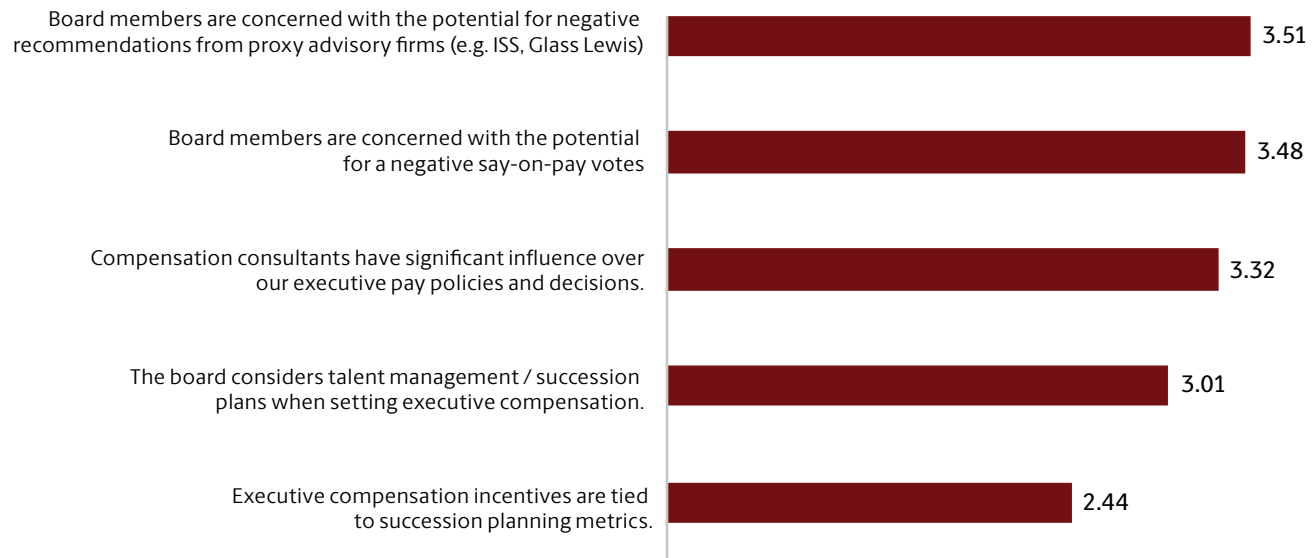


FIGURE 1

Board Concerns When Setting Executive Compensation

negative say-on-pay results (61%) or negative recommendations from proxy advisory firms (61%). These results suggest that board members are concerned about external perceptions of the compensation arrangements and it is unclear how these concerns are weighted compared with how well the compensation arrangements are aligned with effective succession or to strategic considerations, both of which are key board responsibilities.

To better understand the potential links between executive compensation philosophies and executive succession planning practices, we evaluated correlations. We found a correlation of 0.57 between boards who tie executive compensation metrics and incentives to succession planning (tying compensation to managerial behaviors in planning succession) and boards who consider succession plans when setting executive compensation levels (board consideration of succession plans and talent management when evaluating compensation levels). **Figure 2** illustrates this relationship. This

result suggests that there is a subset of boards who are intentional in co-managing executive compensation and executive succession planning, such that those in the top quartile of setting incentive metrics related to succession planning are also much more likely to consider succession plans when setting executive compensation levels. Consistent with our prior research, co-managing executive succession and executive compensation in such a way is likely to produce more effective succession planning.

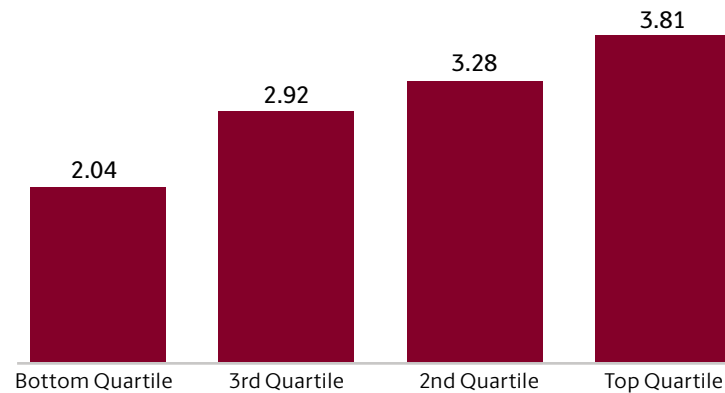


FIGURE 2

Incorporating Incentives for Succession Planning and Considering Succession Plans when Determining Compensation

We also found a positive correlation ($r=0.21$) between companies whose CEO also serves as board chair and boards who tie executive compensation metrics to succession planning. This is particularly true for those companies who have a lead independent director ($r=0.22$). This relationship is illustrated in **Figure 3**, where scores are broken down by different board leadership structures. As seen in **Figure 3**, companies are more likely to have compensation metrics tied to succession planning when the CEO is also the board's chair. Outside observers and regulatory bodies are often concerned that CEO duality, whereby the CEO is also the board's chair (or leader), leads to the CEO co-opting the board's power and can reduce the board's effectiveness. This finding, however, is interesting as it suggests that one way boards are ensuring they effectively fulfill their succession planning responsibilities while allowing for unity of command at the top is to tie the CEO's compensation directly to succession planning.

At the same time, we find a negative relationship between boards who have both a dual CEO and lead independent director and the compensation consultant's influence over compensation ($r=-0.25$), as shown in **Figure 4**. This is likely because boards with a non-management chair operate at greater arms-length from the CEO, increasing the reliance on the compensation consultant for perceived objectivity. Alternatively, boards whose chair is also the CEO require greater cooperation between the CEO and lead director and may reduce the need for outside actors in the compensation setting process.

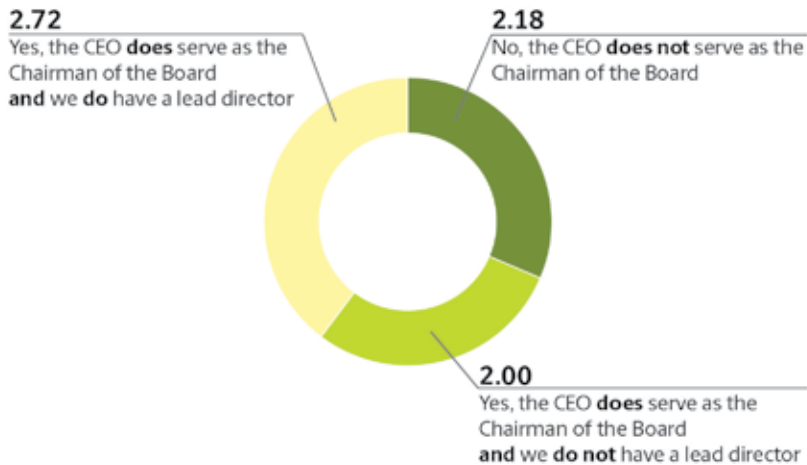


FIGURE 3
Board Leadership Structure and Executive Compensation Metrics for Succession Planning



FIGURE 4
Board Leadership Structure and Executive Compensation Influence

Finally, we found that CHROs who perceive compensation consultants have greater influence over executive compensation are also significantly more likely to believe board members are worried about negative say-on-pay votes ($r=0.39$) and recommendations from proxy advisory firms ($r=0.33$). These findings are again illustrated in **Figure 5**. Compensation consultants influence in the top half of the distribution was highly related to perceptions of directors' concerns regarding negative say-on-pay votes or proxy advisor recommendations. The figure suggests that boards may more heavily rely upon compensation consultants as a means to maintain their reputation and legitimacy with external audiences. This finding would be concerning if such a reliance leads to executive compensation packages that are less aligned to the company's specific needs, strategy, or talent management objectives.

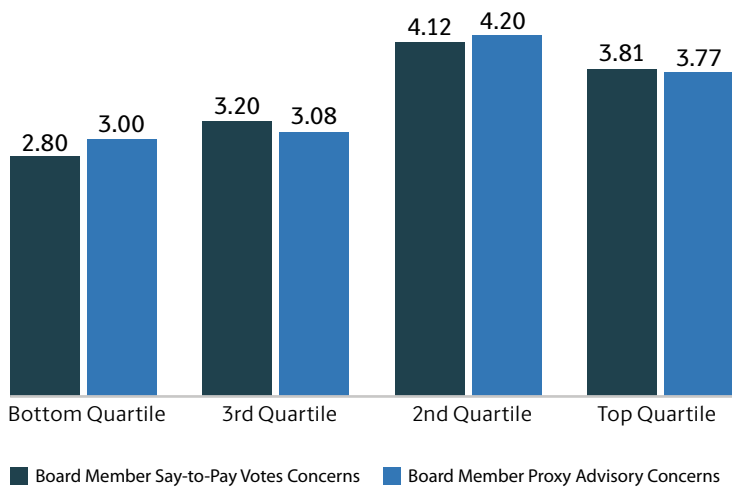


FIGURE 5

Board Leadership Structure and Compensation Consultant Influence





ORGANIZATIONAL RESPONSES TO SAY-ON-PAY VOTES

While understanding how companies consider executive compensation in relation to succession planning was important, our results and prior conversations with CHROs indicated there is significant concern about potential say-on-pay votes and the impact of proxy advisory firms on compensation policies and practices. To better understand how companies evaluate their compensation programs and attend to say-on-pay votes given the fundamental importance of executive compensation, we first asked CHROs about the threshold level of say-on-pay approval that would lead the board to take action (see **Figure 6** for distribution of responses). As seen in **Figure 6**, the most common threshold that would lead to action was between 70 and 79 percent (most respondents in this category indicated 70 or 75 percent). Of the 91 respondents who indicated a number, 40 indicated a threshold below 70 percent, while 18 indicated thresholds greater than 80 percent. In short, the data largely suggest that boards would likely expect say-on-pay approval ratings to be at least 75 percent; however, there is clearly a group of companies that are less concerned with potential low say-on-pay approvals.

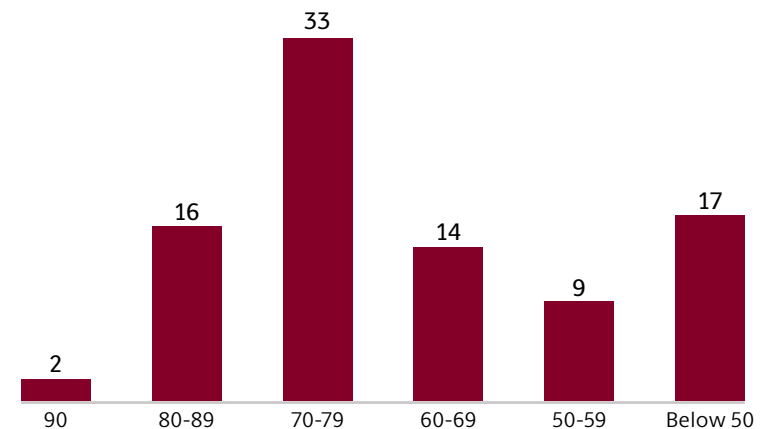


FIGURE 6

Threshold Level of Say-on-Pay Approval that Would Lead the Board to Take Action

We then assessed the correlations between the minimum threshold for approval and board's approach toward and consideration of compensation asked previously. In particular, we found that the minimum approval threshold is higher for boards who appear more sensitive to negative say-on-pay votes ($r=0.28$) and recommendations from proxy advisory firms ($r=0.28$).

As a follow-up, we then asked CHROs whether the board would likely undertake four commonly proposed responses to low say-on-pay approval (**Figure 7**). Interestingly, CHROs most agreed with the notion that the board would first change executive incentives (45 of 102 CHROs). CHROs believe the board would be least likely to change membership over low say-on-pay approval (12 of 100 respondents), while they were relatively split on whether there would be changes in compensation levels (25 of 102) or compensation

consultants (45 of 102). Further, we found large, positive correlations between the minimum approval threshold noted earlier and each of these actions (board membership changes = 0.21; executive compensation levels = 0.22; executive incentives = 0.43; compensation consultant changes = 0.42). This suggests that companies whose concerns would be raised at smaller levels of non-approval (e.g. high minimum thresholds) would also be more likely to respond to negative votes. Correlations between these potential actions were also all highly positive, suggesting that these actions in response to negative votes would likely be taken in tandem. This is further indication that those companies who are clearly concerned with even a small number of negative say-on-pay votes as a signal are also more likely to be responsive to negative say-on-pay votes, while those who seem less concerned with negative say-on-pay votes would also be less likely to respond.

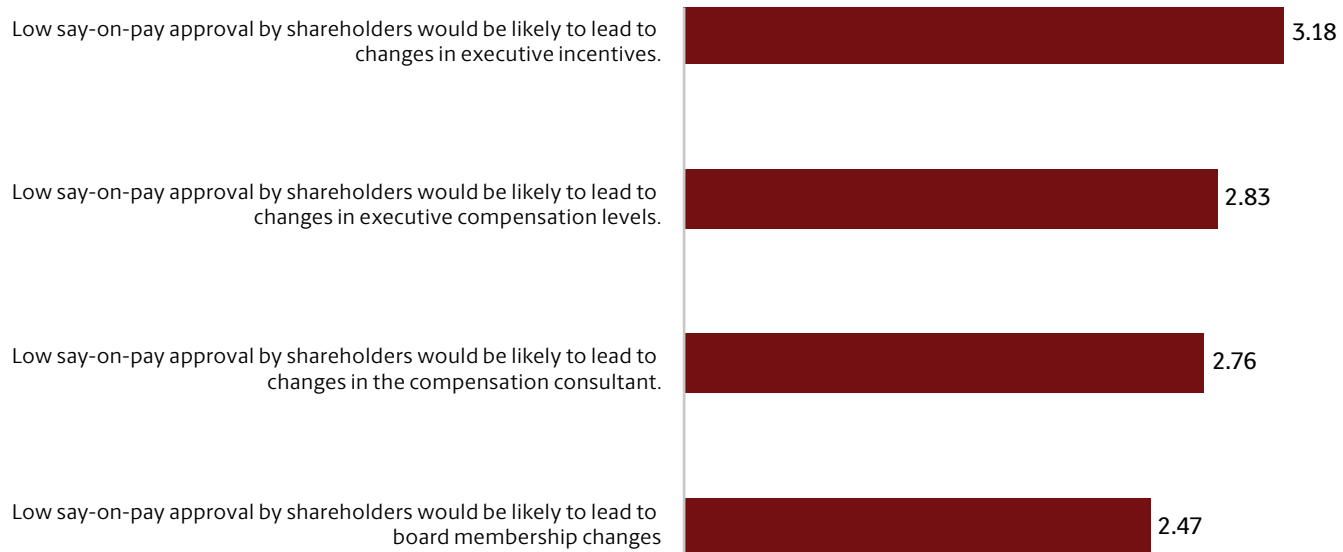


FIGURE 7

Likely Responses to Low Say-on-Pay Approval

To understand further approaches that companies might take to low say-on-pay votes, we specifically asked CHROs what actions they believe would be most likely if say-on-pay approval fell below the acceptable threshold. We coded these responses based on a variety of themes, which are illustrated in **Table 1**. Specific quotes from CHROs are reported in **Table 2**. The most common response, mentioned 27 times, was an expectation there would be changes in the design of the compensation program. These changes included the mix of incentives, changes to both short-term and long-term incentives, or changes to the metrics that were used. These comments are consistent with the growing use of non-financial, non-profit related metrics that are increasingly used in compensation programs, such as those tied to sustainability or succession planning.

Most Likely Actions in Response to Below Threshold Say-on-Pay Approval	Count
Change compensation program design	27
Compensation reviews	19
Shareholder outreach / engagement	16
Compensation consultant changes	7
Compensation committee changes	3
Comprehensive overall review	3
Review proxy language on pay	2
Engage proxy advisory service / outside consultant	2
Benchmarking against competitors	1
Meet with proxy advisory firms	1
Discussion with compensation consultant	1
New CHRO	1
Discussion with compensation committee	1
Nothing	2

TABLE 1



The second most common tactic mentioned was an expectation the compensation plan would be reviewed (19 respondents). Such reviews were often coupled with mentions of shareholder outreach (16 respondents). CHROs noted it would be important to listen to the concerns of shareholders and then use feedback received to consider changes that likely were to be necessary. Finally, 7 CHROs noted that a low approval rating would likely result in changes to the compensation consultant.

Specific Comments Related to Likely Actions to be Taken in Case of Low Say-on-Pay Approval
Deep dive review of CEO and other Section 16 officer compensation plans and results in comparison with competitors.
We do a significant amount of shareholder outreach now but we would listen to the concerns of shareholders to understand their concern and then take appropriate action.
There is opportunity to change the structure of the compensation committee to give it a bit more latitude than it currently has.
More conservative and restrictive comp actions in following year
A negative (below 80%) say on pay would result in a deep review of the current status and a change in the approach. We would connect with our larger investors to determine the root cause of the concern and adjust accordingly.
Stepped up shareholder outreach; Look to consider changes/make changes to program based on that feedback; Review consultant and obtain additional resources; Consider refreshment of committee chair, but would not have the chair suffer sole accountability
Comprehensive review of business plans and performance, compensation plan designs, payouts and market. Longitudinal view and context of internal and external environment. May consider a change in the independent compensation consultant.
If we fell below the self imposed threshold, there would be a (1) detailed analysis on why we fell below our historical average; (2) identification of which shareholders voted against the SOP proposal along with potential discussions; (3) discussions with the independent consultant on what we can do to improve our results; (4) review of our exec comp programs to ensure pay is not exorbitant, our short-term and long-term targets are stretch targets; and (5) analysis of proxy language on our pay philosophy and decisions made.
Changes to CEO pay and compensation program structure.
Most likely rigor on performance goals
Assess the areas of concern and make changes in the compensation structure.
Engage in outreach with large investors, solicit inputs from consultant to the Board's Comp Committee, possible adjustments to pay design (framework, quantum or particular rules/policies), and ramp up of proxy and other communications going in to the next proxy season. Likely also need to do internal change management with covered executives as they don't appreciate the external considerations to the same degree as the Board.
We would do a shareholder outreach program and then would take feed back into account in design of plans.

TABLE 2

SUMMARY AND CONCLUSION

Research suggests there are links between executive compensation and executive succession planning, while at the same time there is an increasing focus on executive compensation programs related to say-on-pay advisory votes. This focus has yielded concerns that outside influences have led companies to create more homogeneous compensation practices. The data from our survey of CHROs suggest that such concerns may arise due to influence by compensation consultants in setting pay, as well as concerns from board members regarding negative say-on-pay results or recommendations by proxy advisory firms. Our results suggest that say-on-pay votes are often taken seriously by board members. Concerns arise when approval falls below high thresholds and is expected to lead to specific actions, including compensation reviews and changes and increased shareholder engagement. Finally, despite the importance of executive compensation to talent management and therefore succession planning, there does not seem to be a disclosure and connection between how compensation is reflected in succession planning.

A recent report from the Center on Executive Compensation notes that the role of Compensation Committees are being expanded greatly. With this expansion and a greater focus on talent, there is an opportunity for CHROs and boards of directors to strengthen the linkage between executive compensation and succession planning. Such a linkage can not only enhance succession planning, but can also provide a rationale for pay practices when engaging shareholders.

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The Center for Executive Succession serves as an independent, objective source of knowledge regarding C-suite succession practices. The center provides a forum for corporate leaders to shape the future direction of succession practices, which are increasingly one of the board's top governance priorities. Our partners have the opportunity to contribute to cutting-edge research that challenges the status quo and is empirically driven to further success in C-suite succession planning. For more information or to inquire about potential membership, please visit our website or contact us at sc.edu/moore/ces.

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Founded in 1919, the Moore School has a history of innovative educational leadership, blending academic preparation with real-world experience through internships, consulting projects, study abroad programs and entrepreneurial opportunities. The Moore School has grown into a thriving site of academic excellence with an enrollment of more than 5,300 undergraduate students and more than 700 graduate students. The school offers a wide range of programs in nine undergraduate concentrations, seven master's degrees and two Ph.D. degrees as well as executive education programs and consulting services to the business community.

In 1998, the school was named for South Carolina native Darla Moore, making the University of South Carolina the first major university to name its business school after a woman.

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