

PAY-FOR-PERFORMANCE

Glass Lewis' view on executive compensation is based on the premise that management's primary duty is to maximize shareholder value and the performance of the company. In our opinion, compensation practices should align management's interests with those of shareholders. We thus believe that executive compensation should be closely tied to company and stock performance.

We recognize that many of the factors that affect a given company's performance will also affect the rest of the industry. Thus, in our view, executive compensation should be closely tied not to absolute or overall performance but rather to the company's track record of performance relative to its peers. That is, management should be especially rewarded for directing the company in a manner that out-performs the peers.

This relationship between relative executive compensation and relatively performance is thus the basis of Glass Lewis' proprietary pay-for-performance model. Our model evaluates compensation of the top five executives by benchmarking that compensation against the compensation of the top five officers at peer companies. The model then compares the company's performance to that of those same peers.

In comparing the outcome of these analyses, Glass Lewis is able to evaluate whether the company's executives have been paid in line with the company's relative performance.

The Glass Lewis pay-for-performance model examines seven indicators of shareholder wealth and business performance: stock price change, change in book value per share, change in operating cash flow, EPS growth, total shareholder return, return on equity; and return on assets. These performance data points are calculated based on a weighted average of one-, two-, and three-year data, with the larger weighting given to the annualized three-year performance data.

The model also analyzes two compensation data points: the chief executive's total compensation and the top five executives' total compensation. The model compares each of these nine metrics (seven performance metrics and two compensation metrics) against those of the company's peers, which are grouped into four applicable peer groups: industry peers, sector peers of similar size, companies of similar market capitalization and companies in the same geographic regions. Each of these peer groups is assigned a weight in the analysis, based principally on the market capitalization of the subject company. In most instances, geographic peer groups play a very small role in the overall calculation and industry peers of similar size play a large role in the calculations.

In the end, the model calculates a weighted-average executive compensation percentile (i.e. compensation relative to peers) and a weighted-average performance percentile. For example, a company might be in the 85th percentile in executive compensation and in the 65th percentile in performance. These two percentile rankings are compared to determine how closely the compensation tracks the relative performance of the company.

A final numeric score is calculated for each company based on these weighted-average percentile scores. We refer to this in the model as the “pay-for-performance gap”. In the example noted above, the “gap” is 20, representing the difference between the compensation percentile and the performance percentile. These “gap” scores are then placed on a forced curve, so that the companies with the largest “gap” can be identified as companies that have done a poor job of linking compensation with performance. Each company is assigned a school-letter grade (i.e. “A”, “B”, “F”, etc.), based on a forced grading curve, with 10% of the companies receiving an “A” and 10% receiving an “F”.

Glass Lewis uses the analysis to inform its research and recommendations on the compensation committee members and executive compensation matters that arise on proxies for US-based companies.