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Relative Performance Evaluation Incentives in CEO Compensation Contracts

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What is Relative Performance Evaluation?

- RPE compares performance to that of peer group
- Incentive earned not based on absolute performance
 - E.g., EPS greater than median of peer group

Findings

- For 338 firm years:
 - 45.6% use long-term RPE
 - 87.4% of RPE users have total shareholder return as perf. Measure
 - 4.8% use short-term RPE
 - 76.9% of RPE users have accounting-based performance measures
- Peer groups
 - 39.0% use an existing index
 - 54.1% use handpicked companies
 - 6.9% use both

Why would companies use RPE?

- Reduces risk for company and employees
 - Employees: Earn incentive even if poor performance as long as beat peer group
 - Company: No payment for luck in good economies
- Often perceived as more fair

Long-Term RPE Use by Year

Year	% of Use		Year	% of Use
1995	8.89%		2005	17.57%
1996	9.71%		2006	19.35%
1997	12.26%		2007	23.18%
1998	13.68%		2008	22.82%
1999	13.11%		2009	24.32%
2000	13.71%		2010	42.35%
2001	14.89%		2011	43.52%
2002	16.22%		2012	46.43%
2003	15.13%		2013	53.01%
2004	19.05%			

Data Collection Approach

- Analysis of 89 companies from 2010-2013
- Use of Securities and Exchange Commission website
- Collect on incentive benchmarks, performance measures, peer groups

Research Questions to Explore

- Why do companies use RPE?
 - Theory or to avoid criticism?
 - Has there been a change over time?
- How are peer groups chosen?
 - Similarity or easy to beat?
- Is RPE associated with management decisions?
 - Risk-taking, cost control, etc.?