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# Relative Performance Evaluation Incentives in CEO Compensation Contracts

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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

## 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

## 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

## 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

### 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% | | | |

## 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.?