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# Pay For Performance Observations
# S&P/TSX Composite Index - 2011

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| June 2012

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## Pay for Performance Observations 2011

In 2009, the Clarkson Centre for Board Effectiveness (CCBE) began observing pay and performance for firms on the S&P/TSX Composite Index (TSX Index).[1] CCBE has continuously tracked pay and performance data since 2004 for over 300 Canadian large public firms. For the purposes of this report, we observe 200 firms who were listed on the TSX Index in 2011 and for which 7 continuous years of pay and performance data are available. The impact of the financial crisis can be seen in our TSR observations for two years (2008-2009) of our sample. The average annual TSR in 2008 is the lowest in our observation period at -31.64% which was followed by the highest average annual TSR of 36.51% in 2009, suggesting an immediate overall rebound. However, despite the negative impact of the financial crisis, overall CEO pay and performance over the 6-year 2005-2010 period were aligned.

## 6-year Observations

The correlation between 6-year performance and 6-year smoothed[2] pay change between 2005 and 2010 was very strong at 0.59. 130 TSX Index firms (65%) had pay and performance moving in the same direction over the 6-year 2005-2010 period (Figure 1). However, there are several firms that had 6-year smoothed pay change far outpacing 6-year performance. For example, European Goldfields Ltd. (EGU) which had a 6-year TSR of 351% and 6-year smoothed pay change of 682%. Almost half (86 firms) had pay rising at a slower rate than performance. The average firm was similar to CIBC (CM) which had a 6-year TSR of 39% and a moderate 6-year smoothed pay change of 10% (Figure 2). Generally, investors have realized positive gains from their investments in TSX Index firms due to the fact that the majority of the firms have positive TSR increases over 6 years. On average, the present value of an investment in TSX Index firms over the last 6 years has increased by 43%[3]. As well, CEOs are receiving more total direct compensation in 2010 than in the last 6 years – pay increased by about one-third since 2004.

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[1] Pay measured as Total Direct Compensation to CEO and performance measured as total shareholder return (TSR)

[2] In order to address the high impact an anomalous year in CEO pay may have on 4- and 6-year CEO pay changes, the CCBE 'smoothes' the change in pay. For Example: 6-year smoothed change in pay =

$$\{(Year\ 4\ Pay + Year\ 5\ Pay + Year\ 6\ Pay) - (Year\ 1\ Pay + Year\ 2\ Pay + Year\ 3\ Pay)\}/(Year\ 1\ Pay + Year\ 2\ Pay + Year\ 3\ Pay)$$

[3] Present value of investment is calculated as: (Starting 30-day average share price) + {(6-year TSR assuming reinvested dividends)*(Starting 30-day average share price)}

**Figure 1**

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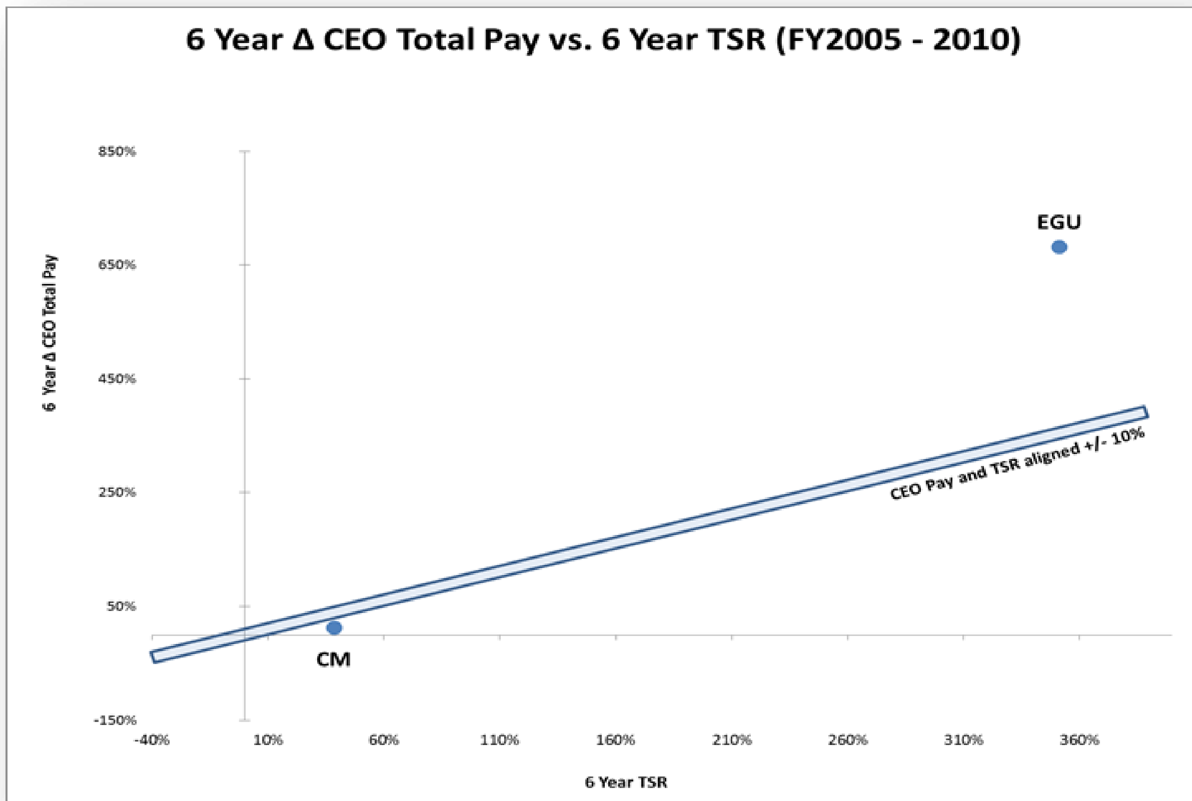
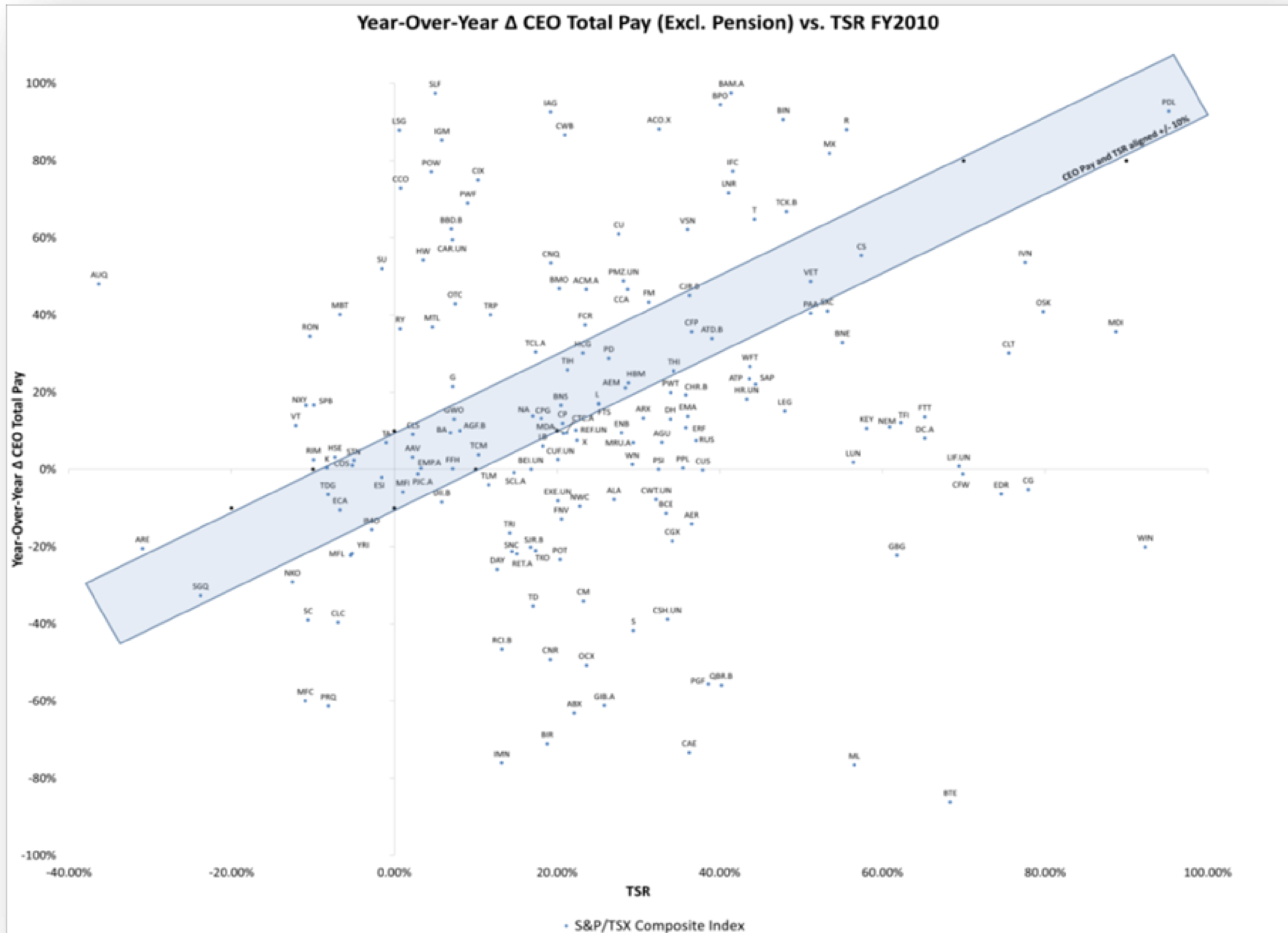
Figure 2




## Other Observations

Analyzing the financial crisis years (2008-2009) more closely, we found that, on average, firms struggled to align pay and performance in 2008 and 2009 compared with other years. The 1-year correlation between pay and performance was very strong in 2007 at 0.63 and in 2008 and 2009 (i.e. during and after the crisis) the correlation between pay and performance was random at -0.06 and 0.06 respectively. However, in 2010 the correlation between pay and performance rebounded slightly to 0.14. Although TSX Index firms seemed to have struggled to align pay and performance during the financial crisis, they have managed to strengthen the relationship between pay and performance post financial crisis (Figure 3).

**Figure 3**




## Conclusion

Although firms listed on the TSX Index in 2011 seemed to struggle more with pay and performance alignment during the financial crisis years, pay and performance were meaningfully aligned in the longer 6-year period between 2005 and 2010. In this period, investors have earned returns of 20% over the past 4 years even while taking the financial crisis into consideration, and CEOs have been rewarded for their good performance.

In the following months, the CCBE will investigate pay trends from 2004-2010 that may have impacted the generally positive alignment between long-term pay and performance.

- What is the relationship between equity and non-equity compensation? Are certain equity/non-equity mixes more likely to result in high pay/performance alignment?
- Is CEO pay higher on long-tenured TSX Index firms compared with short-tenured firms? Does longer tenure on the Index, and thus greater exposure to outside scrutiny, affect pay/performance alignment?
- Does CEO pay behaviour change after a firm is listed on the Composite Index?
- Have long-tenured firms reacted differently to drastic market changes than other Composite Index firms with shorter tenures? If so, is it possible that increased shareholder scrutiny has played a role in the long-tenured firms' reactions?