



GLASS LEWIS

Peer Groups for U.S. Executive Pay-Setting

Market Practice & Analysis

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About Glass Lewis

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Our customers include the majority of the world's largest pension plans, mutual funds, and asset managers, collectively managing over \$40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

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The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

Join the Conversation

Glass Lewis is committed to ongoing engagement with all market participants.

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Introduction

Peer groups have a crucial role in developing, administering and assessing executive pay programs. They are guideposts. Referencing a specially formed and relevant group of companies helps the board in establishing pay levels, structures, and governance standards – and in demonstrating to shareholders how a company’s pay programs address the need to be competitive in the market for executive talent.

This approach can create an echo chamber, reflecting the conformity bias inherent in setting pay based on peer group pay levels. That isn’t necessarily problematic when competitors use the same well-constructed peer groups and benchmark to median. In some markets, the standards and expectations that apply to compensation structures and quantum are reinforced through a transparent and consistent benchmarking process. The peer group establishes the norm.

But in the United States, it often seems that peer groups are constructed to support an executive pay decision, as opposed to helping to inform the decision-making process itself. Many companies select overly aspirational peers to demonstrate their ambitious plans for growth, and/or set pay levels above the median for their chosen group to demonstrate their executives’ relative worth. Companies are especially adept at using their selected peer groups to indicate they face retention risks that need to be addressed with more compensation.

What ensues is essentially an aggressive bidding war to protect talent regardless of actual attrition risk. That can result in a consistent “ratcheting up” of pay, even in a stable environment. And when the pay environment is unstable – e.g., in a period where previously exceptional “mega-grants” of more than \$100 million become increasingly common – the effect can be significant. Indeed, the marked increase in the number of mega-grants over the past three years can largely be attributed to companies seeing other companies bestowing these awards to their executives, and following suit. As one general counsel of an S&P 500 company speaking at a conference for corporate directors put it, “When’s my turn?”

As a result, North American executive pay quantum has consistently gone up at a rate that investors and market watchers have found alarming – resulting in heightened scrutiny of the benchmarking process, and the use of alternative and independent peer groups to gain a different perspective. Glass Lewis’ peer group methodology represents one such alternative, based on a “proven-peer” approach that serves to reduce the echo chamber effect.

In the discussion that follows, we review the key metrics companies consider in setting peer groups and present data on the most popular companies selected for inclusion. We also summarize the differences between company-selected peers and the Glass Lewis peer group used for its pay-for-performance analysis and why such differences exist.

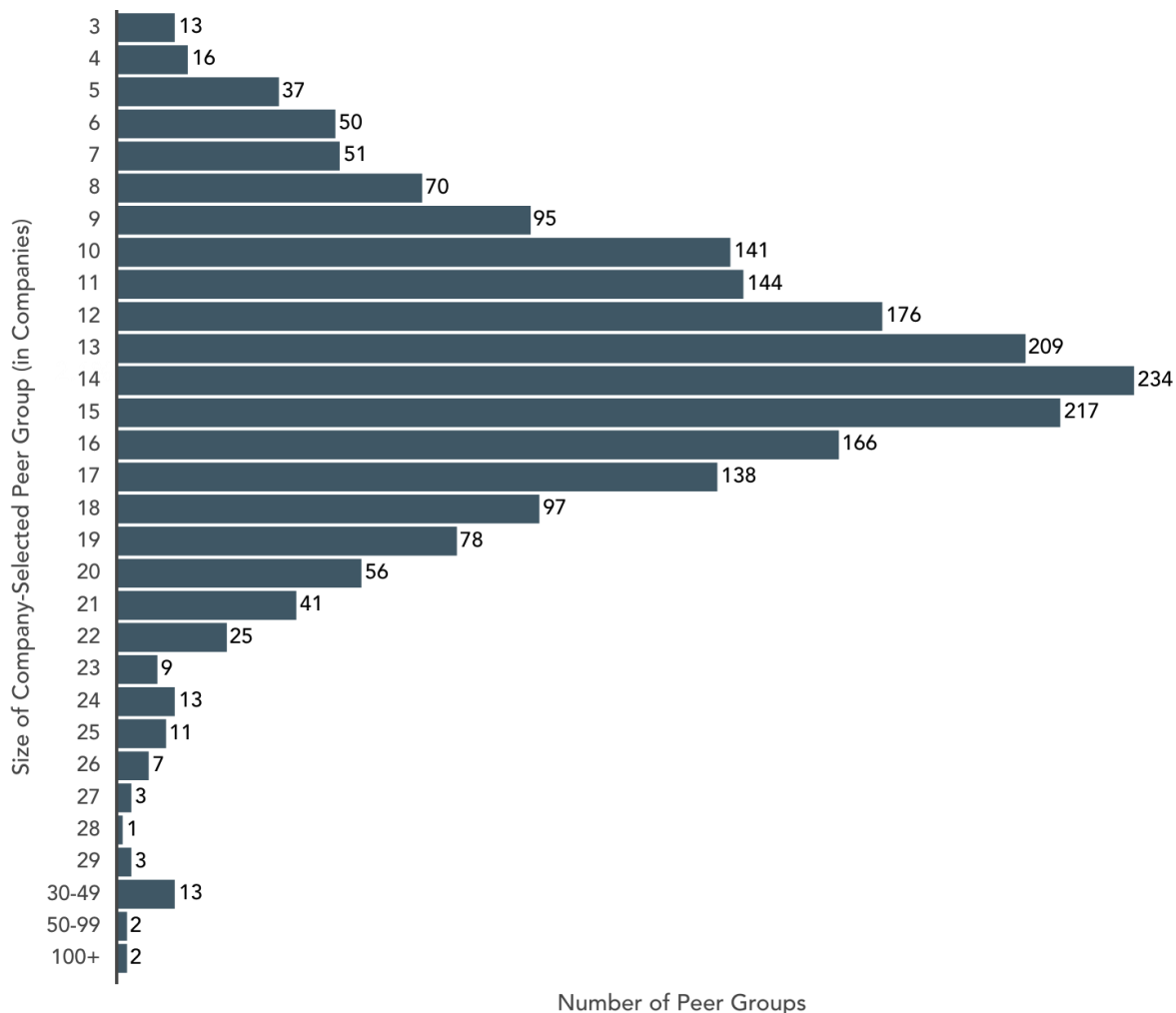
Peer Group Usage in the U.S. Market

How Company Peer Groups Are Selected

The size of the group is typically less than 20 companies; both the average and median number in a sample of over 2,500 U.S. and Canadian companies is 15. There are notable exceptions: the diversified consumer services firm, Service Corporation International, sports the largest bespoke compensation peer group at 173 companies, followed by Sempra with 139 and Archer-Daniels-Midland Company with 98 companies in its peer group.

Approximately 454 companies in the Russell 3000 Index that have been publicly traded for more than a few years still do not have bespoke peer groups, typically on the basis that there are not enough companies in the same industry and/or of the same size for comparison. A small number of this cohort instead reference large “survey peer groups” created by compensation consultants for special studies and not specifically for a particular client company.

Peer Group Size Distribution



In creating peer groups, companies (or as is often the case, their external compensation consultants) may incorporate factors from a wide-ranging list of criteria. The list of considerations can include market capitalization, revenue and assets; or similar business models, industry classification, brand recognition and complexity of operations, amongst others. The actual list of factors varies from company to company, reflecting their unique circumstances.

Industry and company size are the most common considerations. The prevalence of direct rivals in company-selected peer groups indicates that companies usually see their chief competition for talent within their own sector of the economy. That may reflect specific pay practices that complicate cross-sector comparisons, a unique skillset that limits recruitment, or simply convenience. Where industry is a common primary filter, size is often used as a guardrail, with market capitalization and revenue serving as proxies to protect against the inclusion of companies at different developmental stages with materially different scopes of business.

This approach relies on the availability of a sufficiently large sample of potential peers. When there are insufficient numbers of direct business competitors or appropriately sized competitors, identifying peers can get more complicated. In cases where it is necessary to branch out to other sectors of the economy, the size and complexity of peer candidates become important filters in the initial selection process.

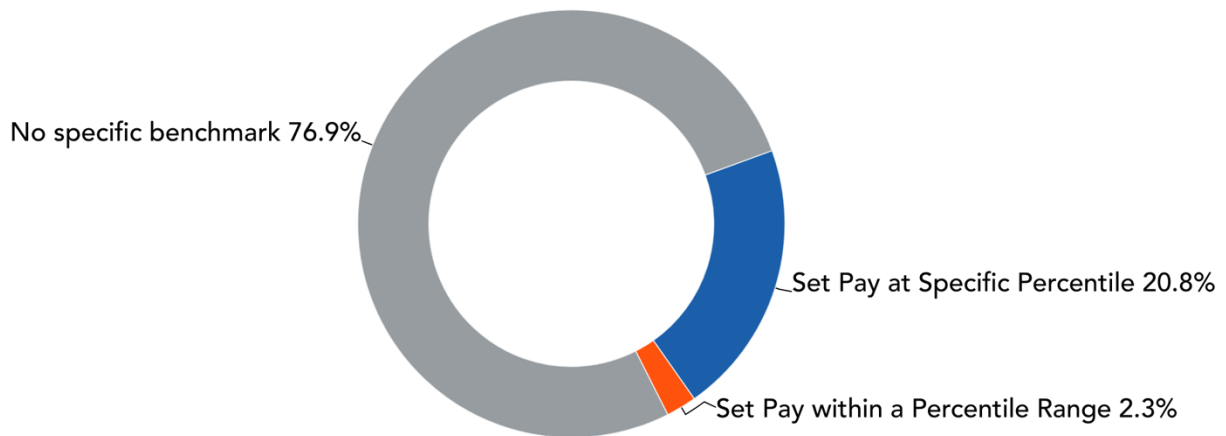
The passenger airlines group, for instance, has a small number of large players (Delta Airlines, Inc., American Airlines Group, Southwest Airlines Co and United Airlines Holdings, Inc.) that dwarf a larger number of smaller providers. In building its peer group, Delta includes the other members of the big four airlines but not its smaller competitors. Instead, companies in the hotel/leisure, transportation/distribution, machinery/aerospace/defense and retail sectors round out its peer group. To explain why the likes of Best Buy Co., Inc., Target Corporation and PepsiCo. Inc., are included, Delta notes that it selected companies with “business characteristics that are similar to Delta’s, including revenue size, market capitalization, number of employees, operating margin and global presence.”

How Companies Use Peer Groups to Set Pay

While often used to situate a company’s compensation within a reasonable network of companies with similar size and value, outright benchmarking of executive pay to a certain percentile rank in the peer group is not as widely practiced as it had been in the past. Peer pay levels are most often used as general reference points as opposed to specific benchmarks, allowing compensation committees the flexibility to set target pay below or, more often, above peer levels after considering individual performance and retention risks, among other factors.

Among S&P 500 companies that held a say on pay during the main 2024 proxy season, more than half (52%) provided their CEOs with total pay that was above the median of their respective peer groups. Among a group of 548 companies comprising the S&P 500 along with other large caps, approximately 60% reported CEO total pay above the 67th percentile of its peer group. The latter represents an increase from 2017, when only 46% of an equivalent group paid their CEOs above the 67th percentile of their peer groups. The historical trend underscores significant growth in executive pay over the past several years and shareholder concerns regarding relative pay setting practices.

Peer Benchmarking Practices



When Target Quantum Drives Peer Group Selection

Regardless of the specific criteria, peer groups can serve to illuminate and provide useful context, or to distort the pay environment and construct an artificial gap. Throughout the last eight years of Glass Lewis' North American issuer engagement program, there have been many conversations where companies have demonstrated a thoroughly thoughtful process for their peer group selections. This is particularly true of Canadian companies with large numbers of U.S. companies in their peer groups -- the onus is on the Canadian company to justify peers from a market that is notorious for excessive pay, and many do so cogently. However, in reviewing thousands of Say on Pay and equity grant proposals, we have also identified many instances where the peer group appears to have been constructed expressly to justify excessive quantum.

Axon Enterprise, Inc. justified its 2023 proposal for a special CEO grant of nearly \$400,000,000 by pointing to a list of other companies that granted their founders similar awards. The list even included companies that had granted the awards just prior to their initial public offerings. By contrast, Axon, an S&P 500 Index member, has been a publicly traded company for 22 years. In this way, Axon's only consideration in choosing comparator companies appears to have been the presence of founder mega-grants, even if the resulting "peers" bore little resemblance in size, sector or maturity. After receiving pushback from shareholders, the company canceled the proposal and replaced it in 2024 with a smaller CEO mega-grant of \$175 million, along with awards ranging from \$37 million to \$123 million for other named executive officers. In justifying the CEO's grant, the company continued to cite grants to founders of companies that (apart from being publicly traded, and having a founder) appear fundamentally unlike. At the 2024 AGM, the CEO's grant was approved by the slimmest of margins, receiving 50.01% support.

In its 2022 proxy statement, The Trade Desk, Inc. said it granted a target award of 16,000,000 shares to CEO Jeff Green, with a value of approximately \$818 million. Prior to the disclosure, this Russell 3000 company with \$44 billion in market capitalization appeared only 14 times in other companies' selected peer groups. Despite its market capitalization subsequently halving to only \$22 billion, its popularity as a peer doubled, to 28 instances. That group includes only 11 companies that had listed The Trade Desk, Inc. in their peer groups prior to the

announced grant. Of the 17 new companies that added The Trade Desk, Inc. to their selected peer group following the announcement, 13 had excessive granting practices that raised concerns at Glass Lewis, and four did not fit into the same size bracket in terms of market capitalization, asset base, revenue and/or employee count. The Trade Desk, Inc.'s rising popularity as a peer is strong indication of opportunistic peer selection to justify large pay quantum at other companies.

Situations like these fuel shareholder skepticism of the role of peer comparisons within the pay setting process. Suspicions of target pay driving peer group selection are not new, but take on additional urgency in the context of \$100 million-plus 'mega-grants' to executives. This practice has become increasingly common since shareholders' initial approval of Elon Musk's \$3 billion grant in 2018, in part because companies have begun comparing themselves to a whole new peer group: private equity firms, which since 2019 have been increasingly identified as competitors for talent. Even where the CEO has not received any actual employment offers, we have seen the purely hypothetical retention risk posed by private equity firms presented to shareholders as acceptable rationale for massive awards -- for example by Palo Alto Networks, which said in a Form 8-K filing that its \$113.6 million award to CEO Nikesch Arora was granted in part to mitigate the risk of potential employment offers from competitors and private equity firms.

Of course, genuine retention concerns exist, and pose real problems for companies and their boards. However, since the beginning of the COVID-19 pandemic, the slew of special one-off grants justified on the basis of staying competitive against peers has made it difficult for shareholders to distinguish real flight risks from pay one-upmanship.

Glass Lewis Peer Group Selection

Over the last eight years of Glass Lewis' extensive engagement with companies and investors, we have gained a deep understanding of investor and issuer sentiments on peer groups. We found that:

- Public companies tend to prefer their self-selected peers, stemming from the unique position they feel they hold in the marketplace
- Investors prefer peer candidates that represent competition for their investment dollars, and look for complementary peer groups to provide a different perspective from those constructed by public companies.

After listening to investors and issuers, we developed a peer group methodology based on a **“proven peer”** approach in 2020. Under this methodology, we begin with the company's self-disclosed peers and run multiple tests against the independent views of other companies, investors and fundamental analysis, before ranking peers based on proven consensus across these views.

Although we recognise the importance of the company's self-selected peers and peer-of-peers when evaluating pay, we believe a truly independent and robust comparison should also consider investor views of factors such as industry, country, and company size. By incorporating the investor view, we can reduce the “echo-chamber” effect and market-wide ratcheting on executive compensation levels encouraged by peer-of-peers methodologies that rely exclusively on how companies reference one another in their disclosures.

Our peer methodology addresses these issues in a measured way. By beginning with a company's self-disclosed peers, our approach incorporates important factors that cannot be adequately reflected in a straightforward GICS- or industry-based methodology, such as unique headwinds and business models or misclassification of the company's industry. But this is only a starting point. We then move beyond the company-selected peers to include investor views on both industry-based and country-based peers, in addition to the company's peers-of-peers. The methodology then scrutinizes this larger pool of potential peers by introducing additional screens based on corporate revenue, market capitalization, and assets; weightings also consider the source and frequency of confirmation, and peer rankings are based on a strength-of-connection approach that considers all potential peers, not just those resulting from the network effects of corporate disclosures.

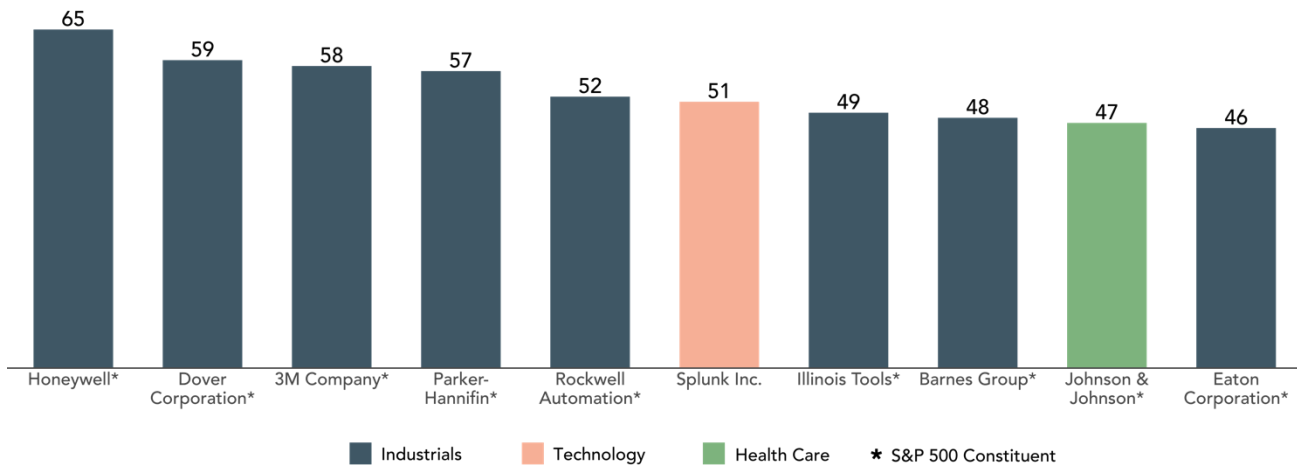
Glass Lewis peer groups are updated twice a year in August and February; [see here](#) for a comprehensive overview.

Peer Group Analysis

Popular Peers Among Company-Selected Peer Groups

Despite the variety in each company's peer group selection process, there are certain companies that appear more commonly in self-selected peer groups than others. On average, each of the 2189 companies in our data set was selected as a peer by another company 13.9 times. However, as shown below, the most popular companies were cited more than three times as frequently, with Honeywell International included in 65 companies' peer groups.

Most Popular Companies in Company-Selected Peer Groups



The data illustrates the potential for overconcentration and groupthink. Eight of these ten companies belong to the S&P 500, and eight reside within the Industrials sector. The remaining two are in Information Technology sectors.

Given the wide-ranging scope of the U.S. market, the dominant popularity of Industrials in company-selected peer groups warrants examination. Something akin to critical mass appears to be a factor -- industrials make up approximately 15% of the Russell 3000 and it is the largest segment of the S&P 500 companies. With most companies relying primarily on their own sector, it stands to reason that the largest sector will be well represented.

In addition to that industry boost, the popularity of companies like Honeywell appears to be further amplified by their relative size. Abbott Laboratories, Accenture plc, Pfizer Inc., Microsoft Corporation and HP Inc. are examples of companies with large capitalizations that selected industrials like Honeywell despite the incongruity of their industries. Accenture plc noted that one of its criteria was global scale -- typically S&P 100 companies with strong brand recognition. Pfizer and Microsoft each maintain two peer groups including a general industry peer group made up of multi-national companies of similar size and complexity.

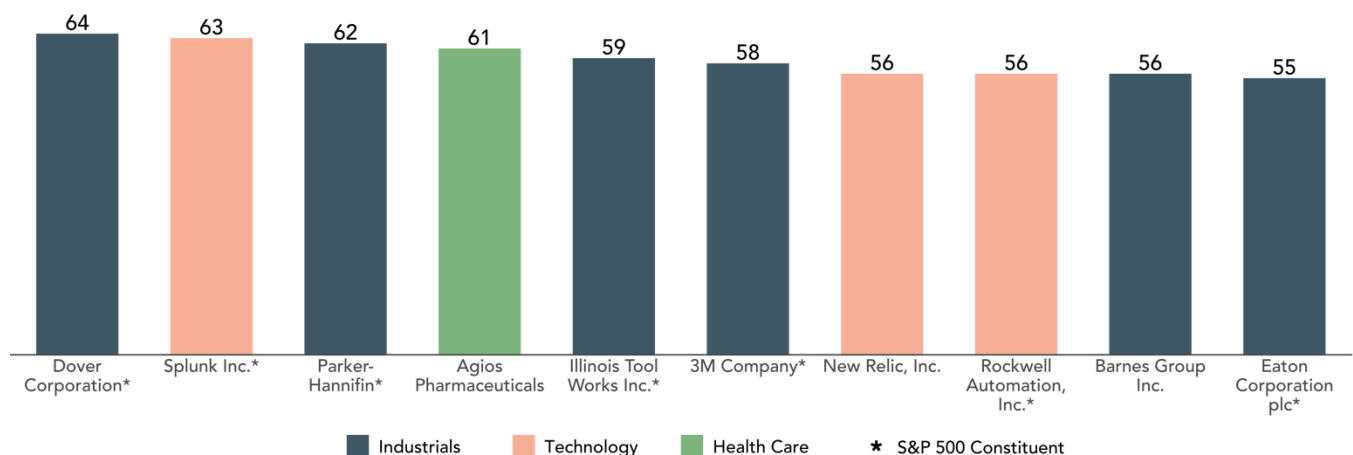
Skeptics may conclude that Honeywell is a popular peer due to its pay level -- the company has received an “F” grade for the last two years under Glass Lewis’ pay-for-performance analysis because it pays executives more than its peers while performing moderately worse than them. However, this is not the case for Dover Corporation, which pays its CEO only moderately more than the median of his peers; or 3M Company, which actually paid former CEO Michael Roman less than the median.

Glass Lewis Peers versus Company-Selected Peers

By taking an independent, nuanced approach that involves a larger sample of potential peers and a wider range of screens and filters, Glass Lewis’ proven-peer methodology provides a complementary, but distinctly different, perspective compared to company-selected peer groups.

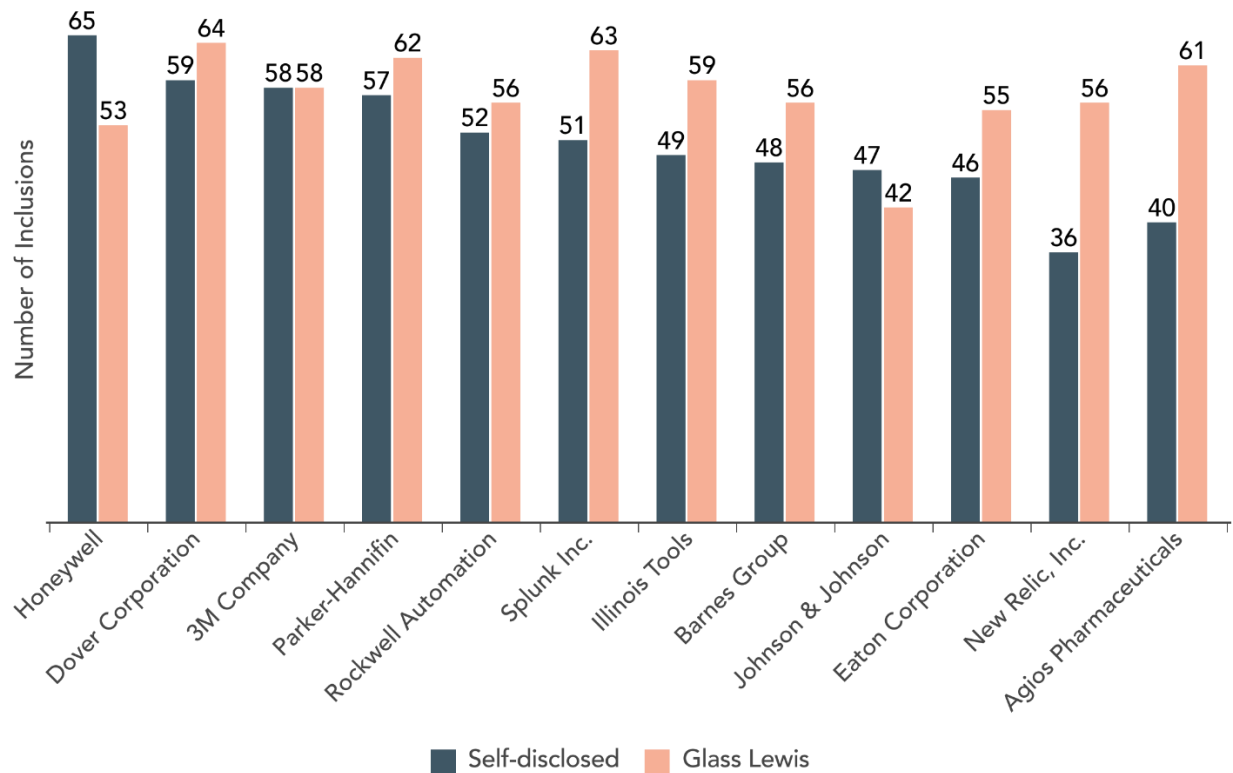
Amongst the top ten most popular self-disclosed peers and top ten most popular Glass Lewis peers, there are eight companies in common. Given that Glass Lewis’ peer selection begins by looking at self-disclosed peers before applying additional filters, this level of overlap is unsurprising.

Most Popular Companies in Glass Lewis Peer Groups



The independence of Glass Lewis’ approach is evident in the frequency in which peers are selected (see below). The most popular among company-selected peers, Honeywell, was excluded from the most popular Glass Lewis peers while smaller companies like Agios Pharmaceuticals with only \$1.2 billion in market capitalization and \$27 million in revenue saw higher instances of being selected.

Most Popular Peers: Company-Selected vs Glass Lewis Peer Groups



Glass Lewis peer groups comprise 15 companies. For companies with similarly sized peer groups, on average, the difference between the number of times a given peer is selected by the company itself and by Glass Lewis is 5.6 times. There is a median difference of five times. In other words, roughly one-third of the average peer group is made up of different companies, illustrating the independence of Glass Lewis' approach.

Difference in Popularity Between Glass Lewis & Company Peer Groups

Average	5.6
Median	5.0

This difference is perhaps most clear in the cases of Honeywell International and New Relic. These are two of the most popular companies seen in self-disclosed peer groups and Glass Lewis selection, respectively, and yet do not crack the top ten of the inverse categories. Honeywell International was seen 65 times in the peer groups selected by companies, and 53 times in Glass Lewis peer groups. This means that the number of instances Honeywell appeared in peer groups was 12 times less following Glass Lewis' methodology than individual

Company selection. Alternatively, New Relic, Inc. was seen 20 more times in Glass Lewis peer groups than in company-selected groups. While they both remain relatively popular, still being cited in either category above 30 times, what companies they are deemed comparable to varies greatly. (Note that New Relic is no longer a publicly traded company.)

Casting a Wider Net

One of the notable aspects of Glass Lewis' methodology is the ability to create peer groups for companies in sectors that do not have or disclose many self-selected peers.

In situations where a company does not provide Glass Lewis guidance on peers through a disclosed peer group, the GICS-based industry peer group and country peer group define the whole of the peer candidate universe for the company. Agios Pharmaceuticals was selected by 40 fellow industry peers while Glass Lewis selected it as a peer 62 times. . Every instance that Agios appeared as a Glass Lewis peer was for biotechnology companies, including ones that did not disclose their own peer groups. In contrast, large companies like Honeywell nearly always provide that disclosure.

Meanwhile, Deciphera Pharmaceuticals was cited 47 times in Glass Lewis peer groups and just 22 times in company-selected peer groups, while Acadia Pharmaceuticals was cited 46 times by Glass Lewis and 35 by companies (combined, 107 vs 57). The disparity illustrates how our approach casts a wider net, with more Glass Lewis peer groups for the biotechnology sector than there are company-select peers in the sector.

Overlap and Exclusions

In addition to the number of times each company is cited as a peer, comparing the composition of a given company's self-selected peer group to Glass Lewis' further illustrates the difference in methodology. In a review of companies with comparable numbers of peers (six to 25 company-selected peers), on average 43% of self-selected peers are excluded from Glass Lewis' peer group. The median is at 40%. This relatively low average overlap with company-selected peers demonstrates the level of independence provided by the proven-peer methodology, which is not present in third-party peer-to-peer approaches.

Where a high level of overlap does exist between Glass Lewis and company peers, it typically involves a company with a very small self-selected peer group composed entirely of companies in the same industry (e.g. The Bank of Nova Scotia's eight member peer group and American Airlines' three member peer group), which helps to increase the percentage. In our August 2023 update, there were 112 companies, representing roughly 5% of our coverage, where the Glass Lewis peer group included 100% of company-selected peers. (Even where this is the case, the Glass Lewis peer group still provides a different perspective by including additional peers that were not selected by the company.)

Conversely, 25 companies had 0% overlap between the two groups. These companies tended to have small, self-selected peer groups made up of companies that are not drawn from a common industry or sector – making the chosen peer company unlikely to perceive the reference company as a competitor for talent. The peer companies are likewise unlikely to acknowledge each other as competitors for talent. Indeed, there were often significant differences between the reference company and company-selected peer companies in terms of size,

scope, maturity and other factors, raising questions about the appropriateness of the company's chosen comparison.

For instance, The RMR Group Inc., which had a market capitalization of \$391 million at the end of its fiscal 2022, included as peers The Carlyle Group Inc. and Ares Management Company, both of which had market capitalizations of over \$10 billion at the end of their fiscal 2022, along with financial behemoths such as Apollo Global Management Inc., Blackstone Inc. and KKR & Co. Inc. – an aspirational group indeed. While The RMR Group's true size may be hidden by its business structure, its selected peers did not consider it as competition for talent.

In another scenario, Nabors Industries Ltd. went to extensive lengths in its proxy statement to explain why larger business competitors like Halliburton, Baker Hughes and Schlumberger belonged in its compensation peer group; meanwhile, none of the three reciprocated the peer selection. These cases where there is low connection strength tend to also exhibit poor pay-for-performance alignment when compared to the Glass Lewis peer groups that are more size-appropriate.

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