

Looming GICS Code Changes To Affect Many Technology Companies

Changes to the Global Industry Classification Standard (“GICS”) structure announced late last year to better reflect modern communication activities are set to take effect at the end of September 2018. These changes, which represent the biggest reclassification of companies in the history of GICS, will affect numerous Internet and e-commerce companies, including Google, Netflix, and Facebook. For technology companies, the changes may prompt a reassessment of their compensation peer group, as well as their understanding of how their executive compensation program will be evaluated by Institutional Shareholder Services (“ISS”), the major proxy advisory firm. This Thoughtful Pay Alert describes the pending changes and provides our initial observations on their potential implications in the months ahead.

Background

The Global Industry Classification Standard (“GICS”) structure is an industry taxonomy developed in 1999 by S&P Dow Jones Indices and MSCI, Inc. for use by the global financial community. The GICS structure currently consists of 11 sectors, 24 industry groups, 68 industries, and 157 sub-industries into which Standard & Poor’s has categorized all major public companies. The GICS structure is used as a basis for Standard & Poor’s and MSCI’s financial market indexes in which each company is assigned to a sub-industry, and to a corresponding industry, industry group, and sector, according to the definition of its principal business activity.

In addition, the major proxy advisory firms, particularly Institutional Shareholder Services, Inc. (“ISS”), use the GICS structure in their modeling analytics when formulating their voting recommendations on matters to be submitted for shareholder action at a company’s annual meeting of shareholders.

Changes to the GICS Structure

On November 17, 2017, S&P Dow Jones and MSCI announced revisions to the GICS structure “to reflect the evolution in the mode in which people communicate and access entertainment, content and other information.” Citing this evolution as a result

of the integration between telecommunications, media, and internet companies, the proposed revisions are as follows:

- The “Telecommunication Services” sector will be broadened and renamed the “Communication Services” sector;
- Media companies will move from the “Consumer Discretionary” sector to the “Communication Services” sector;
- Internet services companies will move from the “Information Technology” sector to the “Communication Services” sector; and
- E-commerce companies will move from the “Information Technology” sector to the “Consumer Discretionary” sector.

These changes are to be effective on September 28, 2018.

Implications for ISS Analyses

ISS uses the GICS structure classifications to construct compensation peer groups that are used in formulating its voting recommendations on compensation-related proposals submitted for shareholder action at companies’ annual meeting of shareholders, including the “Say-on-Pay” and employee stock plan proposals.

Although it is difficult to predict how the pending reclassifications will affect the analysis of a given company’s specific situation, we envision that changes could occur in these areas of ISS focus:

- Summary of a company’s total shareholder return performance (on a one-, three-, and five-year basis) relative to companies with similar GICS classifications;
- Construction of peer groups for purposes of pay benchmarking and relative “pay-for-performance” comparisons;
- Review of the relative alignment of the compensation of a company’s CEO as part of its quantitative screen for evaluating an executive compensation program in connection with formulating Say-on-Pay proposal voting recommendations;

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- Review of the compensation arrangements for the non-employee members of a company's Board of Directors relative to the competitive market for purposes of identifying "excessive compensation" practices;
- Review of new or amended employee stock plans to determine the shareholder value transfer and gross burn rate relative to companies with similar GICS classifications; and
- Calculation of a company's "QualityScore," which considers specific corporate governance and executive compensation-related policies and practices relative to GICS-based industry norms.

Initial Observations

While some of the changes that will result from the GICS structure reclassification will be nominal (for example, grouping internet software and other software companies together), other changes may have significant ramifications for how companies will be evaluated for comparative purposes (for example, moving internet retail companies from the "Information Technology" sector to the "Consumer Discretionary" sector). The most prominent technology companies affected by the changes, along with their new proposed classifications, are listed on Exhibit A to this article.

About the Authors

The authors of this Thoughtful Pay Alert are Mark Borges and Jason Borrevik, principals at Compensia. If you have any questions about this Thoughtful Pay Alert or the implications of the changes to the GICS structures generally, Mark can be reached at 415.462.2995 or mborges@compensia.com and Jason can be reached at 408.876.4035 or jborrevik@compensia.com.

Need Assistance?

Compensia has significant experience in helping companies understand and address ISS' corporate governance and executive compensation policies. If you have any questions on the topics covered in this Thoughtful Pay Alert or would like assistance in assessing how the policies are likely to affect your executive compensation program, please feel free to contact Jason Borrevik or Mark A. Borges. ■

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Exhibit A

(as disclosed as of August 2018)

Company	Existing GICS Sector	Existing GICS Sub-Industry	New GICS Sector	New GICS Sub-Industry
Netflix	Consumer Discretionary	Internet and Direct Marketing Retail	Communication Services	Movies and Entertainment Interactive Media and Services
TripAdvisor	Consumer Discretionary	Internet and Direct Marketing Retail	Communication Services	Movies and Entertainment Interactive Media and Services
2U	Information Technology	Internet Software and Services	Information Technology	Application Software
Activision Blizzard	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Akami Technologies	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Alarm.com Holdings	Information Technology	Internet Software and Services	Information Technology	Application Software
Alphabet	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Angi Homeservices	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Box	Information Technology	Internet Software and Services	Information Technology	Application Software
Cloudera	Information Technology	Internet Software and Services	Information Technology	Application Software
Cornerstone OnDemand	Information Technology	Internet Software and Services	Information Technology	Application Software
Electronic Arts	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Investnet	Information Technology	Internet Software and Services	Information Technology	Application Software
eBay	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Etsy	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Facebook	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Godaddy	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Grubhub	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
IAC Interactive	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
J2 Global	Information Technology	Internet Software and Services	Information Technology	Application Software
LogMeIn	Information Technology	Internet Software and Services	Information Technology	Application Software
Match Group	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
New Relic	Information Technology	Internet Software and Services	Information Technology	Application Software
Nutanix	Information Technology	Internet Software and Services	Information Technology	Application Software
Rightmove	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Shopify	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Snap	Information Technology	Application Software	Communication Services	Interactive Media and Services
Stamps.com	Information Technology	Internet Software and Services	Consumer Discretionary	Internet and Direct Marketing Retail
Take-Two Interactive	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment
Trade Desk	Information Technology	Internet Software and Services	Information Technology	Application Software
Twilio	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Twitter	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
VeriSign	Information Technology	Internet Software and Services	Information Technology	Internet Services and Infrastructure
Yelp	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Zillow	Information Technology	Internet Software and Services	Communication Services	Interactive Media and Services
Zynga	Information Technology	Home Entertainment Software	Communication Services	Interactive Home Entertainment

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About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

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