

# Changes to GICS Code Classification System to Take Effect in 2023

Earlier this year, S&P Dow Jones Indices and MSCI, Inc. [announced](#) limited changes to the Global Industry Classification Standard (“GICS”) structure to take place in March 2023. These changes will involve reclassifying companies across five GICS sectors and likely affect many Internet and e-commerce companies, including such companies as Block (formerly Square), PayPal Holdings, and Uber Technologies. For the affected technology companies, the changes may prompt a reassessment of their compensation peer group, as well as their understanding of how their executive, board of directors’, and equity compensation programs will be evaluated by Institutional Shareholder Services (“ISS”), the major proxy advisory firm.

This Thoughtful Pay Alert summarizes the pending changes most likely to affect technology companies and notes where these changes may potentially impact some of the comparison groups that ISS currently uses in its analytical methodologies

## Background

The GICS structure is an industry taxonomy developed in 1999 by S&P Dow Jones Indices (“DJPI”) and MSCI, Inc. for use by the global financial community. Currently, the GICS classification system consists of 11 sectors (based on a two-digit code), 24 industry groups (based on a four-digit code), 69 industries (based on a six-digit code), and 158 sub-industries (based on an eight-digit code) into which all major public companies have been categorized. 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.

Each year, Standard & Poor’s and MSCI conduct an annual review of the GICS structure to ensure that it continues to appropriately represent the global equity markets and, thereby, enable asset owners and managers, as well as investment research specialists, to make consistent global comparisons by industry. This year’s changes are scheduled to go into effect in the GICS Direct and S&P DJI’s indices following the close of business (ET) on **Friday, March 17, 2023**.

## Pending Changes to the GICS Structure

### Classification of Retailers

S&P DJI and MSCI have decided to reclassify retailers in recognition that many of such companies are opting to pursue an omni-channel approach to sell their products (rather than sticking with mainly brick-and-mortar retail or purely online channels), as well as the ongoing blurring of general merchandise stores and department stores with both retailers primarily selling consumer discretionary goods. Further, they have decided to consolidate retailers that generate a majority of their revenue or earnings from consumer staple items, such as food, household, and personal care products, under the “Consumer Staples” sector. Accordingly, the following revisions are being made:

- The “Internet & Direct Marketing Retail” category is being discontinued, with companies being classified according to the nature of goods sold (for example, DoorDash is likely to be moved to “Restaurants,” while Wayfair is likely to be shifted to “Homefurnishing Retail”);
- General Merchandise Stores (such as Amazon and Etsy) and Department Stores are being merged into a new sub-industry called “Broadline Retail”;
- Consumable merchandise sellers are being shifted to the “Consumer Staples” sector; and
- The GICS nomenclature for select Retail classifications is being updated by replacing the word “Stores” with “Retail.”

### Classification of Data Processing & Outsourced Services

Noting that companies classified as “Data Processing & Outsourced Services” offer services either customized for select industries (such as human resources or travel) or to diverse industries, as is the case with transaction and payment processing companies that connect many different consumers, financial institutions, merchants, governments, digital partners, businesses, and other organizations, S&P DJI and MSCI have concluded that these support activities are closely aligned with the business support activities covered under the “Industrials” sector rather than the “Information Technology” sector, and, in the case of payment processors, with the “Financials” sector. Accordingly, the following changes are being made:

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- The "Data Processing & Outsourced Services" sub-industry under the "Information Technology" sector is being moved to the "Industrials" sector with an updated definition;
- Transaction and payment processing companies will be reclassified from "Data Processing & Outsourced Services" to a newly created sub-industry called "Transaction & Payment Processing Services" under the "Financials" sector;
- Payroll processing and human capital management software companies are being moved to the "Industrials" sector under the "Human Resource & Employment Services" sub-industry with an updated definition; and
- Companies offering travel related data processing and outsourced services are being moved to the "Consumer Discretionary" sector under the "Hotels, Resorts & Cruise Lines" sub-industry.

### Additional Noteworthy Reclassifications

S&P DJI and MSCI are making additional changes to the classification of banks and thrift & mortgage finance companies, equity real estate investment trusts ("REITs"), and transportation companies. Of particular interest are the following revisions:

- The "Trucking" sub-industry is being split into two new sub-industries to be called "Passenger Ground Transportation" (which will include Lyft and Uber Technologies) and "Cargo Ground Transportation."
- In recognition of the increased specialization of REITs, which generally focus on distinct property types, several industries and sub-industries are being created, including a "Data Center" sub-industry (which will include companies such as Equinix and Digital Realty).

### Outcome of Changes

As a result of all the planned changes, the new GICS structure will consist of 11 sectors, 25 industry groups, 74 industries, and 163 sub-industries. ***The full list of companies affected by these changes will be made available to clients no later than December 15, 2022.***

### Implications for ISS Analyses

ISS uses the GICS structure classifications for several purposes, including 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" proposal, as part of its assessment of non-employee director compensation (to identify companies with "excessive" non-employee director pay levels), to evaluate and formulate its voting recommendations on employee stock plan proposals (typically to make shareholder value transfer and burn rate comparisons under its Equity Plan Scorecard), and in its QualityScore model (to assess governance-related risk in the areas of audit and risk oversight, board structure, compensation, and shareholder rights).

### Initial Observations

The last time a significant change was made to the GICS structure in 2018, ISS published a white paper which answered the most frequently asked questions regarding how the changes to the GICS structure would impact ISS analyses, and when those changes would be effective. It remains to be seen how - and when - ISS plans to respond to these pending revisions, particularly as they affect shareholder value transfer and burn rate benchmarks.

Undoubtedly, questions will arise in the months ahead as companies begin to assess the impact of the changes on their specific situation. While some of the changes are likely to be nominal, others may have significant ramifications for how companies will be evaluated for comparative purposes (for example, a software company that was moved to the "Interactive Media and Services" sub-industry in 2018 now has a significantly lower burn rate benchmark under the ISS guidelines) – some companies may experience similar or contrasting changes as a result of the pending changes.

### 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 these classification changes are likely to affect your executive compensation program, please feel free to contact Jason Borrevik at 408.876.4035 or [jborrevik@compensia.com](mailto:jborrevik@compensia.com). or Mark A. Borges at 415.462.2995 or [mborges@compensia.com](mailto:mborges@compensia.com).

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## About Compensia

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