

Outperform

The Power of Pay for Performance

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PREFACE

THE RELUCTANT CONSULTANT

No boy dreams of becoming a compensation consultant. I certainly didn't. I wanted to become a rally car driver. I wanted to build dams. I wanted to run a factory. None of that happened. What happened instead was a career in executive pay: plenty of struggles, enough triumphs to keep going, countless lessons, and a growing confidence in how to make executive compensation deliver what so many expect of it. All of it culminates in this book. Along the way, I have accepted my destiny. Executive compensation is one of the most effective tools of corporate governance, and executives are among the most important stakeholders of any business.

My path to executive pay was an unlikely one. In 2001, after the dot-com bubble burst, I found myself with a decade of tech experience that nobody wanted. So I started consulting, supporting clients with financial expertise, and that soon turned into advising them on how to pay their executives. Four years later, the many problems in executive pay had discouraged me so much that I quit compensation consulting in 2005. I turned Obermatt, the pay consultancy, into the CFO Intelligence Force, which provided CFOs with financial market intelligence from the then-new financial databases on the internet. Finance and strategy experts wanted my visualizations of market trends and of their own position in their market, all based purely on numbers. By 2009, the credit crisis had wiped out those data budgets. So, four years after my first disillusionment, I returned to the compensation business. Otherwise, my company would have run out of money.

By then, I had combined what I had learned in pay practice with what I had learned in financial intelligence to develop a new methodology of relative performance measurement. By 2010, customers were lining up at my door. Nobody believed they would ever emerge from the worst contraction since the Great Depression. Nobody wanted pay linked to targets, because nobody believed the targets could still be met. We sold the first batch of indexed pay solutions. By 2012, however, the tide had turned and the tailwinds were back. Executives wanted to be paid for the speed of the recovery, and measuring relative performance would have lowered many of their paychecks.

So I quietly left the compensation arena for the second time. With plenty of time on my hands, I learned to program in Python and built a stock-rating system based on our approach to relative performance assessment, which is still available today at obermatt.com. The approach made a stock's financials easy to understand: every metric received the same scale, from 1 to 100. I built it mostly for our family, and we have invested with this method ever since. By 2019, however, it was clear that the stock-rating system would not generate the income Obermatt needed. People just don't pay for information. We had spent more than a million Swiss francs over a decade, while monthly revenue lingered at half of monthly costs and the accumulated loss grew steadily.

For the third time, I felt the need to reinvent the business. I attended ISEP, the leading social entrepreneurship program at INSEAD business school in Fontainebleau. I left the course with a surprising realization: executive pay matters to me, and I do care about it, when non-financial performance is included too. Why? I don't want the CEO of a company that destroys the environment to earn the same as a CEO who cares for people and the planet. I called it plural incentives. It later became ESG pay (environmental, social, and governance), because that was the popular term at the time. We enjoyed fantastic growth until that business evaporated completely in 2023. I then wrote a short account of the difficulties of entrepreneurship. It became part of a book on academic entrepreneurs and is the backbone of the essay "Pay, Peace and Passion" in this book. Obermatt was still carried primarily by our Pay Index business, long-running contracts that supported my long-serving employees. But there was not much left for me to do.

My fourth exit followed. This time it was gradual, prompted not by a new business idea but by a wish to document what I had learned. In late 2023, I began publishing my vision for executive pay in a LinkedIn newsletter every two weeks, so that others could benefit from my lessons. I thought I would be done in six months. I kept going for nearly three years. On August 18, 2026, my 60th birthday, the 80th and final article appeared and the pre-edition of this book went to print.

With that, I entered my fifth and final act. I set up a performance share plan so that my employees could become Obermatt owners themselves, and I accepted my election to the city council (Gemeinderat) of Zollikon, near Zürich, my start in community engagement.

Why did I keep returning to executive pay? Maybe that's life, and maybe that's my personal story on earth. My metaphysical belief is that we are here for a purpose we must find and fulfill. Mine may well be compensation, despite my attempts to leave it time and again. Perhaps I kept coming back over the past 25 years because I had not yet found the perfect pay-for-performance plan. Now I have, and it has a name: Outperformance Pay. I believe it is the right way to reliably reward long-term outperformance at significant organizations.

It is not a method for every company. It may not suit private equity, which is built for the exit. It certainly doesn't work for venture capital, where companies must grow far faster than the field. It is not for nonprofits, because there is no commercial outperformance in doing good. It is a plan for companies that separate owners from managers, at least partly, and need to reward those managers for what the owners want from them.

I feel a real sense of accomplishment, especially now, as I fine-tune the charts and text of this book. It comforts me to know that the lessons I have learned over a quarter century can now be adopted by anyone, simply by reading this book. That makes me happy.

Zollikon, December 2026
Hermann Josef Stern

CONTENTS

PREFACE

THE RELUCTANT COMPENSATION CONSULTANT

INTRODUCTION

HOW TO READ THE BOOK

PROBLEMS

CHAPTER 1

THE MOTIVATION ILLUSION	1
Lack of Correlation	1
Performance Pay Is Not in the Interest of the Company	3
Fixed Pay Isn't the Solution Either	4
Pay-to-Stay Wins Hands Down	4
In the Beginning, Pay Was Linked to Profits	5
Then, Pay Was Linked to Stock Prices	6
Pay-to-Stay: Market Pay Is the Minimum	6
Executives Are Not Athletes	7
The Pay-for-Motivation Confusion	8
Less Motivation with Variable Pay	8
High Risk with High Variable Pay	8
Why Pay-for-Motivation Research Is Irrelevant	9
Cash Is King? The Science of Gifting	12
What Boards Should Do	14

CHAPTER 2

THE GREED ILLUSION	15
The \$450,000 Question	15
The Wage Anchor Effect	16
The Smarter the Participant, the Worse the Spiral	18

Women Anchor Less	18
Pay as a Signal	19
Pay = Performance	20
The Twist:	
A Better Solution Than Minimum Wage	20

CHAPTER 3

THE PERFORMANCE TRAPS

We Can't Agree on Good	24
The Profit Paradox	24
The Return Riddle	26
Low-Margin Is Not Bad	27
The Boardroom Blindspot	27
The Depreciation Trap	28
Economic Profit Doesn't Save You	29
Pay-to-Downsize	30

CHAPTER 4

THE TARGET TRAPS

The Budget Trap	33
The Risk Trap	34
The Intuition Trap	37
The Overconfidence Trap	38

CHAPTER 5

THE STOCK PRICE PROBLEM

How We Think Stock Prices Work	41
When the Company Beats the Market	42
When the Company Lags	43
How Long Until the Stock Tells the Truth	43
The One Case Where the Stock Price Tells the Truth	43
The Stock Price Risk	44
The Stock Option Roulette	45

CHAPTER 6	
THE RELATIVE STOCK PRICE PROBLEM	49
The Index Comparison That Wasn't a Fix	49
The Credit Suisse Detonation	52
Alpha Is an Option Plan in Disguise	53
The Cure: Rank, Don't Average	55
Why Not Just Hand Out Stock?	55

CHAPTER 7	
THE ESG FAIRYTALES	59
Fairytale One: ESG Makes You Rich	59
Fairytale Two: The "S" Is Social	60
Fairytale Three: The Ratings Mean Something	60

SOLUTIONS

CHAPTER 8	
INDEXING OPERATING PERFORMANCE	67
Should We Abandon Pay-for-Performance?	67
Subtracting the Weather	68
A Universal Currency of Performance	70
Comparing Like for Like	72
Pay Without Targets	74

CHAPTER 9	
PERFORMANCE INDEXING TOOLS	77
The Operating Index	78
The Operating Trend	79
The Operating Alpha	81
Growth and Delta	82
The Operating Rank	83
Universal Performance Assessments	84
The Operating Radar	85

The Operating Contribution	87
The Operating Position	89

CHAPTER 10

THE PAY INDEX METHOD 91

From Messy Results to One Number	91
Step 1 — Choose the Metrics	91
Step 2 — Build the Peer Field	91
Step 3 — Draw the Operating Index	92
Step 4 — Convert to the Operating Rank	92
Step 5 — Combine the Ranks	93
Step 6 — Turn the Rank into a Payout	94
Step 7 — Smooth It Over the Plan Period	96
Step 8 — Prove It Before You Sign It	96
The Payout Risk Analysis	98
Getting Everyone on Board	100

CHAPTER 11

THE HOLY GRAIL: PEERS 103

Same Tide, Not Same Boat	103
The Consumer-Basket Principle	104
The Peer Group You Must Not Reuse	106
Reporting Frequency Matters for Indexing	108
Mutual Agreement Key	109
Keeping the Field Alive	109

CHAPTER 12

THE CURRENCY CONUNDRUM 111

A 10% Return Is Not 10%	111
The Constant-Currency Smokescreen	113
The Tripartite Trap	115
Constant Currency Rewards Weakness	116

CHAPTER 13	
THE TRIPLE BOTTOM LINE	119
The P&L Tells Half the Story	120
The Triple Bottom Line, Done Wrong	121
The Triple Bottom Line, Done Right	121
The Triple Bottom Line Index	123
Short Term or Long Term?	126
 CHAPTER 14	
TOTAL SHAREHOLDER RETURN	
TOTALLY RIGHT	129
Alpha or Rank	129
The Alpha Method Runs a Lottery	131
The Rank Method Pays a Wage	133
When the Proxies Object	135
Measure Often, Then Add It Up	140
More Than One Metric	143
 CHAPTER 15	
WEIGHTING IS STRATEGY	147
A Set of Weights Is a Strategy	147
Let the Strategy Choose the Weights	148
Weight the Strategy, Not the Noise	149
 CHAPTER 16	
OUTPERFORMANCE PAY	151
The Pattern in the Wreckage	151
Part I — Why Familiar Systems Fail	152
Part II — The One Move, and the Tools It Needs	154
Part III — Proof in Practice	160
Before Your Next Remuneration Committee Meeting	163
The Decision Is Yours	165

CASES

CASE 1

THE PLANSEE SUCCESS STORY 169

The Private Company's Blind Spot 169

A Stock Market of Its Own 170

Burned Fingers 171

A 100-Year Entanglement 172

Why It Matters Beyond Plansee 172

CASE 2

THE ZUMTOBEL PIONEER STORY 175

They Cut the Cord Between Bonus and Budget 175

But a Target Is Still a Target 176

Three Things the New Plan Had to Do 177

Long-Term Orientation 178

Decoupled from the Budget 178

Simplicity and Fairness 180

Building the Index 180

Fair, Sustainable, and Independent 183

The Questions Every Board Asks 184

The Pioneer's Lesson 185

CASE 3

THE SIKA OUTPERFORMER STORY 187

The Success Penalty 187

The CEO Who Proposed His Own Reform 188

Earning the Board's Trust 189

Drawing the Pay Curve 190

Sika's Choice 192

CASE 4	
THE ACID TEST: TRANE TECHNOLOGIES	195
About Trane Technologies	195
The LTIP Target-Setting Challenge	195
The Overconfidence Trap: When Ambition Backfires	196
Overcoming Overconfidence	198
Building the Peer Field	199
No Targets, No Caps, No Floors	200
One Number from Many Metrics	203
The Payoff	206
The EBITDA Target Trap	207

ESSAYS

ESSAY 1	
PAY, PEACE AND PASSION	213
Plural Incentives	228
The Indexing Operating Performance Solution	229
An Afterword	231

ESSAY 2	
THE POWER OF AGREEMENT	233

ESSAY 3	
THE TECH CURSE	237
Are Digital Monopolies the New Curse of Oil?	237
How the Resource Curse Works	237
The Tech Monopoly Parallel	238
The Tech Curse Hypothesis	240

ESSAY 4	
THE PROSPERITY GATE	241
Political Inclusion and Prosperity	241
The Prosperity Gate Model	242
Riding the Prosperity Gate Wealth Wave	243
The Autocrat Penalty	247
Cases: Ex-Soviet Republics — Russia, Belarus, and the Baltics	248
Cases: BRICS	249
Cases: China–Taiwan Reunification	250
The Nobel Prize Supports the Prosperity Gate Model	251
What Boards Can Do About Low Political Inclusion	252
Political Inclusion Ranking	252
ENDNOTES	255
GLOSSARY & INDEX	261
BIBLIOGRAPHY	267
ABOUT THE AUTHOR	271

INTRODUCTION

HOW TO READ THE BOOK

This is a book about how pay-for-performance should be done. It is my view, and I stand by it. This is not a consultant asking what you want while holding out a menu of alternatives. Nor is it a textbook on everything people have tried over the years. There are enough books on pay, with enough ideas. I am a practitioner, writer, and teacher with 25 years of experience in this field. I have seen every kind of problem, and I have thought and taught hard about how to make pay-for-performance better.

Everything in this book leads to one idea: Outperformance Pay, a solution for companies that need to retain their executives and reward long-term outperformance. It may be of limited value where the goal is a quick and lucrative exit, as with private equity firms and hedge funds, or hypergrowth, as with venture capital. That is why I don't use it at my own firm, Obermatt. We want to double our business several times, not least with the help of this book, so we compensate our team with an approach borrowed from venture capital.

But these are the exceptions. Most companies need to outperform year in, year out. New managers need new plans, again and again. These plans won't make anyone a billionaire, but they can prevent disappointment and keep the team on board even through the most severe downturns. After all, I began this journey with the Pay Index Method in the depths of the Great Recession, when most plans collapsed, as "The Zumtobel Pioneer Story" in chapter 18 documents.

Crisis-resilient, reliable payouts. That is what Outperformance Pay provides.

There are several ways to read this book:

- **If you are a compensation professional** and need to know what this book adds, go straight to chapter 16, “Outperformance Pay.” It summarizes all the errors and the Outperformance Pay solution developed in this book.
- **If you are a skeptical executive**, congratulate yourself: skepticism is the right instinct. Go to chapter 17, “The Plansee Success Story,” to read what a world-leading family firm did and why.
- **If you are an ambitious executive**, go to chapter 19, “The Sika Outperformer Story,” to understand why the outperforming executives at Sika chose this approach as early as 2010.
- **If you are already convinced**, go to the illustrative case in chapter 20, “The Trane Technologies Stress Test Story,” which takes you through the implementation step by step.
- **If you have time**, do what I ask of my students at the University of St. Gallen: go chapter by chapter and discover the many fascinating errors we humans make when we pay others. You may end up where I did after many years as a skeptic, embracing Outperformance Pay wholeheartedly.

Many of the lessons in this book are presented as questions and answers, because that is how I arrived at them. Many chapters open with a fundamental pay question, invite you to answer it from what you know today, and then develop an answer that is usually counterintuitive and took me a long time to learn. I don’t cover the obvious. I don’t explain that a profit-sharing plan pays more when profit rises. I show why a larger profit can be a problem. I don’t explain how stock prices move with enterprise value. I show why they are often out of sync with it, often for too long to support a reliable executive pay design. I don’t explain that executives have a broader mandate than this year’s result. I show why ESG doesn’t solve that problem either, and brings so many other pitfalls that ESG pay is highly toxic.

Why the question-and-answer technique? As a compensation consultant, I often work with clients who are convinced they know better, even though I have worked on this topic for 25 years and they deal with executive pay only irregularly and, at best, as a side issue. They have better things to do; they run a business. For me, compensation is the business, and offending clients by telling them I know better doesn’t help. So I started asking questions, letting executives answer them, and then showing them the Achilles’ heel in their answers, the other side of the coin. It took me a decade to get there. What changed my approach from teaching to questioning was the late, great Daniel Kahneman. In *Thinking, Fast and Slow*, he explains that people don’t learn from being taught.

They keep assuming that the behavioral bias being described happens only to other people. They learn only when they realize that they themselves make the errors. That is the journey you will take as you read this book, page by page. The advantage of this approach is simple. You will never forget.

Why It Matters

Compensation matters far more than we think. It changes what executives do. I sometimes hear in the boardroom that a flaw in the pay system is not a problem, because the managers do the right thing anyway. Speak to the managers and they will tell you otherwise: they do what they are paid for, even when they think it is wrong. If a plan rewards margins, they push the high-margin products, even though the low-margin ones are easier to sell and would bring in more income. Paying fixed salaries instead is no solution either. Then we pay for time, not results, and the executive who bankrupts a company earns the same as the one who makes it prosper. It is far better to learn where pay-for-performance goes wrong and how to fix it. That is what this book is about.