EXECUTIVE COMPENSATION
HONORS

Group Challenge #1: Reimagining Executive Pay

At the beginning of our session, we reviewed the various laws, regulations and rules that have helped shape the prevailing structure of executive compensation programs among large publicly traded companies. In many ways, the legislative, regulatory, accounting and tax influences have resulted in an overall lack of creativity and new ideas from the executive compensation firms. While not all the ideas promoted by consultants have been as helpful as hoped (think junior stock and reload options), the current state of practice, due in part ot the influence of proxy advisory firms, has led to increasing homogenization of incentive practices.

In view of prevailing “best practices” (orthodoxy), we want to challenge ourselves and explore potential new thinking and alternative ways (heresy) to structure executive pay. Given the newly introduced pay-for-performance disclosure mandated by the SEC, the complex and burdensome calculations corresponding to the valuation of long-term incentive awards, and the recent decline in favorable say on pay votes which may reflect decreased support of shareholders for the current structure of pay, the time may be ripe for new thinking and experimentation in the design of executive incentives.

You’ll be divided into three groups to provide your analysis, recommendations and rationale relating to the current and alternative approaches to the design of executive compensation. Once you’ve developed your recommendations and supporting arguments, the groups will reconvene and take turns presenting their ideas. After each group’s presentation, we’ll discuss the pros and cons of the recommended approach. Once all three groups have presented, we’ll consider all the ideas discussed and identify potential new ways to structure executive pay that may warrant further research and development by the Center.

Instructions for each Group are presented on the following pages.

Group 1:” I like what we have, if it isn’t broken, don’t try to fix it.”

The prevailing executive compensation model is typically comprised of:

- Salary (10% to 15% of CEO pay)
- Short-term incentives (15% to 25% of CEO pay), based on performance metrics representing a mix of financial and non-financial objectives.
- Long-term incentives (60% to 70% of CEO pay), based on a combination of market metrics (such as relative TSR) and financial metrics over a three-year performance period.

We think the prevailing structure of executive compensation should not change because:

1.

2.

3.

4.

5.

However, there are aspects of the current structure that are subject to criticism:

1.

2.

3.

To help mitigate these criticisms, potential changes to the design of executive pay that may be warranted include:

1.

2.

3.

Group 2:” While the structure of executive compensation is not totally broken, there are some changes we think should be explored.”

The prevailing executive compensation model is typically comprised of:

- Salary (10% to 15% of CEO pay)
- Short-term incentives (15% to 25% of CEO pay), based on performance metrics representing a mix of financial and non-financial objectives.
- Long-term incentives (60% to 70% of CEO pay), based on a combination of market metrics (such as relative TSR) and financial metrics over a three-year performance period.

We think there are aspects of the prevailing structure of executive compensation that should be changed because:

1.
2.
3.
4.
5.

The specific changes we would suggest companies explore include:

1.
2.
3.

While the suggested areas of change are worth exploring, criticism of such changes may include:

1.
2.
3.

Assuming companies are willing to adopt the changes suggested, potential ways to help mitigate criticism may include:

1.
2.
3.

Group 3:” The prevailing structure of executive compensation is flawed and needs a total rethinking. Tinkering around the edges is a waste of time and now is the perfect time to start with a blank sheet of paper.”

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- Salary (10% to 15% of CEO pay)
- Short-term incentives (15% to 25% of CEO pay), based on performance metrics representing a mix of financial and non-financial objectives.
- Long-term incentives (60% to 70% of CEO pay), based on a combination of market metrics (such as relative TSR) and financial metrics over a three-year performance period.

We think the current approach to designing executive compensation is outdated and is not helpful to serving the interests of investors and other stakeholders because:

1.
2.
3.
4.
5.

Starting from scratch, we would recommend the following structure of executive pay:

1.
2.
3.

While these seemingly radical changes to the executive pay model are overdue, such chnges may generate criticisms, including:

1.
2.
3.

Assuming companies are willing to push the envelope in executive compensation design, potential ways to help mitigate the resulting criticism may include:

1.
2.
3.