

COMPENSATION COMMITTEE

See the Forest *and* the Trees

“If you don’t know where you are going, you may wind up someplace else.” – Yogi Berra

For executive compensation, achievement of corporate strategy is the destination; pay levels, pay programs, and metrics provide the route. As inevitably as the Cubs missing the playoffs, the end of the year swiftly approaches, and compensation committees must reflect on the year’s actions and recheck their route. With media scrutiny, regulatory oversight, and the specter of derivative litigation ever increasing, we all need to ask ourselves some pointed questions about compensation strategy.

Consider the environment:

- Executive compensation represents one of the board’s principle responsibilities in executing company strategy. Mistakes are costly. Pay for performance alone is insufficient for driving successful strategy. Investors expect more.
- Derivative litigation continues to plague companies. Even the most specious claims require extensive board time, distract management, and represent wasted profits in the form of direct and indirect legal expense. This growing litigation shark tank feeds on seemingly minor compliance errors, obliging committees to conduct their own independent audits. (If in doubt as to the potential scale of this problem, ask counsel to brief your committee on the *Clorox*¹ case.)
- As executive pay regulation accumulates, such as the expected 2016 CEO pay ratio disclosure, committees need to anticipate public and investor reactions to pay actions through the lens of current disclosure regimen. In 2013, we saw an increase in activism from historically quiet institutional investors. As many large institutional investors have brought their proxy analysis in-house, the relative reach of ISS and Glass Lewis have diminished, also diminishing the assumed “safe harbor” found with the proxy advisers’ formulaic approval process. Committees that overstep expectations may find themselves suddenly initiating investor outreach programs, directly explaining their actions to key institutional investors.

There are no clear-cut answers to every issue and no one-size-fits-all approach that will automatically place a company beyond reproach. Instead, compensation committees must reflect on both the exigencies and opportunities facing their company and act accordingly.

By following a methodical approach to committee compliance, compensation committees will equip themselves to make informed, careful, strategic decisions that will serve their companies well in 2014 and beyond.

We suggest an internal review along three major themes:

Pay Strategy.

How the committee uses pay and employment terms to advance the company’s strategy.

✓ **“The Compensation Story”** – Is there a succinct narrative that can consistently and compellingly be used by each board member and affected management?

✓ **Value Creation** – Is it readily apparent to all that your executive pay plans promote shareholder value creation in a manner consistent with investor presentations and your investors’ expectations?

Pay Effectiveness.

The degree to which the actual value delivered supports the strategy.

✓ **Simplicity** – Are the various plans understood and embraced by executives? How do we know? (“I don’t understand all that stuff” = low ROI.)

✓ **Wise Risk** – Does the overall program encourage appropriate risk? Discourage unwise risk?

✓ **Impactful** – Is it suitably motivational and does it promote retention?

✓ **Defensible** – When described in the media, are you proud or embarrassed?

Compliance.

Safeguarding the company from nuisance litigation through disciplined compliance.

✓ **Achievement** – Did the committee complete all responsibilities laid out in its charter?

✓ **Compliance** – Is the company in full regulatory and exchange compliance with plans and filings?

✓ **Advice** – Are external advisers competent? Do we have sufficient confidential contact with them?

¹ *Mancuso v. The Clorox Co.*, No. RG12-651653 (Cal. Super. Ct. Alameda Cnty.).



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