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Overseeing Executive Compensation and Leadership Development Should Be the Role of the Compensation Committee

The market has seen a powerful trend developing over the past few years, which many welcome: Company boards spending more time and resources aligning executive pay with business strategies and leadership development.

While all compensation committees manage executive pay, the pressure is increasing to ensure this significant “cost of doing business” supports corporate strategy and ultimately performance. Many compensation committees have expanded their charters to include leadership development in this equation, but not all boards have taken this approach or plan to soon. In fact, it is still common to see the compensation committees handle executive pay while the nominating and governance committee, or the full board, oversees leadership development. Some boards schedule committee meetings that don't overlap, allowing all board members to stay current on committee discussions by attending all sessions, and this approach supports the argument for keeping pay and leadership development oversight in different committees.

However, this structure may ultimately hinder a company’s ability to create long-term value through an integrated approach to pay and leadership management. This blog will explain why I believe the most effective way to ensure executive compensation is aligned with long-term value creation is to include leadership development in the compensation committee charter.

First, take a brief look at what are often considered the traditional aspects of the job. Although practices vary, most compensation committee charters have these key responsibilities:

- Setting CEO compensation;
- Setting senior leadership target pay levels;
- Designing annual and long-term incentive programs and overseeing award levels;
- Aligning pay and performance; and
- Reviewing and approving the compensation, discussion, and analysis disclosure, which now includes reporting on executive pay against corporate performance.

Managing executive compensation can be complex, and the challenge only grows when we propose adding leadership development to the agenda. Stepping back, however, and noting exactly what we are trying to accomplish with executive pay makes the rationale for a combined approach clear.

Executive pay programs have appropriately moved away from externally driven compliance exercises, and most compensation committees will say they are working to incentivize a management team to execute on the organization's long-term business strategy. Practically speaking, "long-term" is likely to span 10 years or more and involve multiple CEOs and direct reports. Therefore, an executive pay philosophy that is intended to drive corporate strategies must account for multiple individuals. The experiences, skill sets, and leadership characteristics of those executives cannot be left to chance. So, it only makes sense that integration of executive pay and leadership development is the most optimal way for a compensation committee to effectively execute its duties.

The following text is an edited excerpt from a public company charter outlining the compensation committee's broad human capital development responsibilities:

Oversee the development, implementation, and effectiveness of the corporation's practices, policies, and strategies relating to human capital management as they relate to the corporation's workforce generally, including but not limited to policies and strategies regarding recruiting, selection, talent development and progression, corporate culture, and diversity and inclusion.

Based on this example, let's examine these specifically outlined responsibilities to illustrate why the compensation committee is in the best position to oversee leadership development:

- Recruiting: The compensation committee understands how to structure an offer consistent with the company's executive compensation philosophy and pay practices. And it has immediate access to outside advisors to support the recruiting process.
- Selection: Compensation committees work closely with human resource (HR) heads and can rely on the company's HR professionals to identify potential candidates that are a cultural fit either as outside hires or internal promotions.
- Talent Development and Progression: Aside from approving expanded responsibilities to high-performing executives, compensation committees have the opportunity to design incentive programs that support the performance and rapid progression of high-performing, diverse executives.
- Corporate Culture: A compensation program can be a tool that supports a company's culture. For example, it is not unusual to adjust bonuses through discretion when assessing individual performance. The personal component of the annual incentive award enables committees to raise or lower awards depending on how well an executive supports the company's culture.
- Diversity and Inclusion: Attracting, motivating, and retaining diverse candidates may have compensation implications, especially if diverse candidates are on a fast track to more senior roles within the company—or at risk of being recruited away. Compensation committees can design pay programs that actively support diversity

and inclusion goals consistent with their pay philosophy.

There are many synergistic benefits to expanding the compensation committee's responsibilities and formally aligning business-driving compensation with long-term leadership development. As board and committee responsibilities evolve, it may not be simple to expand a compensation committee's charter quickly to include all aspects of human capital management. Still, boards can consider adjusting charters over time to ensure that the linkage between executive compensation, corporate strategy, and leadership development supports value creation.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.