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ARTICLE | NOV 2024 | NACD

Technology Oversight and the Role of the Compensation Committee

Editor's Note: Pearl Meyer is a strategic content partner for the National Association of Corporate Directors (NACD). Pearl Meyer is an active participant each year on the NACD Blue Ribbon Commission (BRC) and a contributor to its annual BRC reports—signature publications that propose new principles and practices to address the most critical boardroom issues. The following article was published in the director's toolkit for adopting recommendations in the 2024 BRC report Technology Leadership in the Boardroom: Driving Trust and Value.

It's easy to see how the compensation and human capital committee of any given board could believe technology and data are central to their company's future, and at the same time, judge that it's too early for this shift to impact its core committee responsibilities. As a surprising amount of the compensation committee's work still looks back, not forward, committee members may feel insulated from the coming impacts of disruptive technology and new innovations.

For example, financial measures by their nature must reflect what has already happened, and CEO succession planning—even when proactive—likely considers existing required characteristics and experiences, rather than what will be needed in a future leader. However, forward-looking compensation committees need to consider how to integrate proficiency in technology into their core committee oversight responsibilities of executive compensation design and succession planning.

One way to begin infusing technology into the fabric of the organization includes an automatic consideration of it within each of the core responsibilities of the compensation committee. Below are three practical guides for integrating technology into the committee's work:

- Identifying your organization's technology value drivers that can serve as goals within executive compensation incentive plans;
- Developing incentive plans with goals that align to technology and data strategy; and
- Infusing ongoing succession planning with an eye to future-state leadership needs.

Identifying Your Technology and Data Value Drivers

Understanding value drivers is an important component for identifying specific goals that can be leveraged in incentive plans that align the organization's focus and behaviors around its technology strategy. Value drivers also help the board understand the skills and attributes required in leadership to continue delivering value from technology.

Complicating this task are the hundreds of potential technology factors a compensation committee could consider linking to executive goals and incentives.

To help compensation committee members evaluate these factors and effectively pinpoint areas that can drive value and serve as goals in executive incentive plans, we recommend a value-driver analysis. Each company could start by approaching technology and data through the lens of its business model and culture, evaluating which technology factors are clearly linked to the business strategy, and further narrowing the set based on which have the most impact in the near term and which might drive long-term value creation. This narrowed list can then be the basis for crafting goals which are included in executive compensation and incentive plans.

Value-Driver Analysis and Links to Compensation: Key Considerations

Building on past best practices, companies can consider the following to identify specific technology and data value drivers:

- Balance the leading and lagging metrics that matter when choosing financial performance metrics. This can be done by using the same methodology used to determine the nonfinancial metrics linked to technology and data.
- Design your pay programs to align with your value drivers and clearly outline to plan participants how they can get from point A to point B.
- Finally, don't underestimate the role compensation can play in communicating priorities. Including incentives based on technology and data in your compensation plan signals its importance and can spur the process of embedding it into the business and the culture.

Corporate Value-Driver Analysis with Technology-Focused Goals

Economic Profit	**Net Income**	Revenues	• **New product development/new market penetration** • Increase penetration of economically profitable products • Optimize customer price/value	• **Evaluate and reallocate funds to digitally focused products and services**
		Operating Expenses	• **Improve utilization of employees** • **Reduce warranty expenses through product quality control** • Lower operating expenses and cost of goods sold • Explore outsourcing opportunities	• **Deploy AI-based productivity tools** • **Implement AI-driven continual improvement processes**
		General and Administrative Expenses	• **Upgrade skill mix of employees** • Reduce insurance and legal costs • Control benefits expense • Optimize management information system opportunities	• **Develop internal training and development programs to increase digital proficiency**
	Capital Charge	Working Capital	• **Manage inventory levels** • **Collect receivables within terms** • **Extend vendor payments** • **Reduce supply expenses**	• **Ensure enterprise resource planning is operating cross-functionally**
		Invested Capital	• Improve asset utilization and operation • Take advantage of operating synergies across and within divisions • Dispose of nonproductive equipment	
		Weighted Average Cost of Capital	• Optimize capital structure • Explore alternative financing options	

Including Technology Impacts in Incentive Plan Goals and Metrics

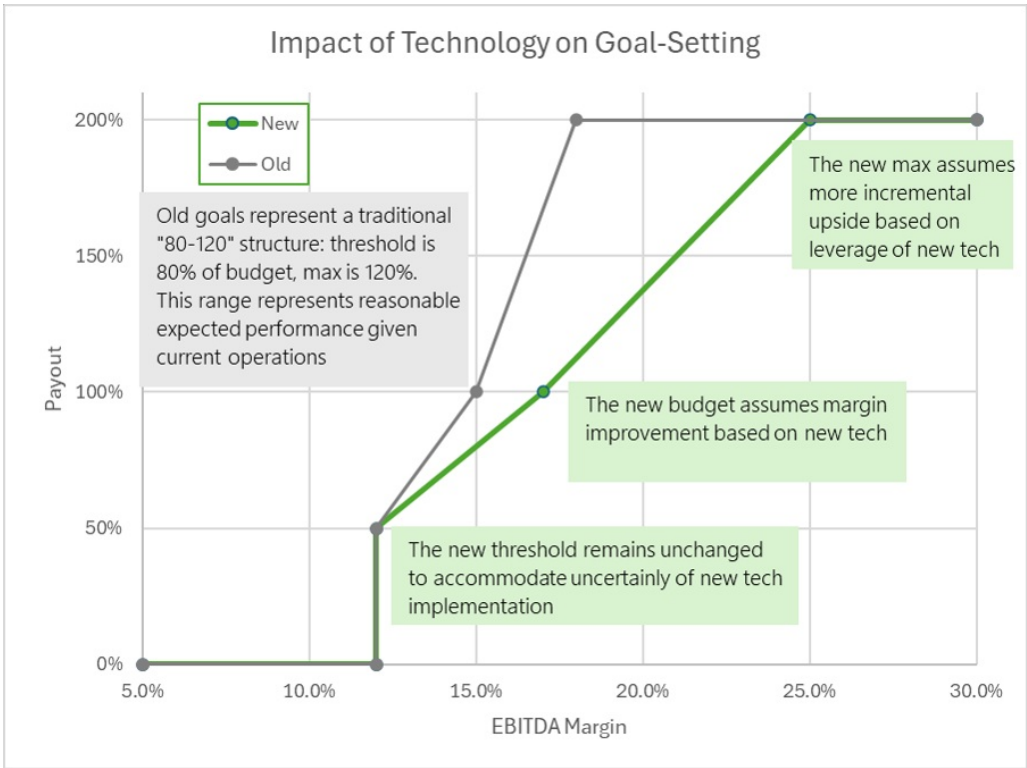
As technology and data capabilities become key drivers of value, they will change both *what*

some companies do and *how* all companies operate. As this shift takes place, compensation committees will need to change the way they set goals to appropriately focus attention on new and promising technology value drivers. To begin, it may change the goals themselves. For example, in recognition of its critical role in the technology ecosystem and the launch of a new security initiative, Microsoft (MSFT) recently changed its executive compensation plan so that it holds executives responsible for cybersecurity.

Implementing Technology-Based Incentive Metrics		
Design Element	**Considerations**	**Examples**
Should metrics be quantitative or qualitative?	Implementing quantitative metrics requires sufficient information to be able to set expected level(s) of performance, which can be challenging with new metrics/processes. On the other hand, qualitative metrics can be viewed by participants as too vague and by investors as insufficiently rigorous.	Quantitative metrics could be financial (e.g., cost savings, revenue growth) or operational (e.g., decreased production errors). Qualitative metrics tend to be more directional (e.g., "successful" software implementation, "improvement" in employee productivity).
Should metrics be intentionally temporary?	When companies go through operational transformation, a temporary focus on required process changes can reinforce new behaviors until the organization's "muscle memory" is developed.	A metric like employee training could be included until the desired adoption rate is achieved (e.g., 95% of employees have completed training programs), then dropped. Alternatively, the 95 percent adoption rate could be implemented as a onetime "milestone" incentive metric to be paid upon achievement.
Should metrics be corporate-wide, departmental, or individual?	Establishing corporate-wide metrics can send a strong signal about the organization's priorities. However, departmental and/or individual goals can provide more direct line-of-sight for participants.	A corporate-wide goal might be a certain percent improvement in revenue-per-employee. Departmental/individual goals would be more targeted (e.g., implementation of a training program for the HR department, or successful rollout of AI software for the IT department).

Another, perhaps less obvious, shift could be much larger deltas in goal ranges (e.g., the incremental difference between threshold, target, and maximum performance goals) for existing incentive metrics. The uncertainties of technology implementation may require additional downside leeway for threshold goals.

Likewise, there may be an exponential upside to a goal enabled by technology that isn't feasible today. For example, in the illustration below, a company with an EBITDA Margin metric might extend the performance range to accommodate the anticipated impact—and uncertainty—of technology enhancements to operations.



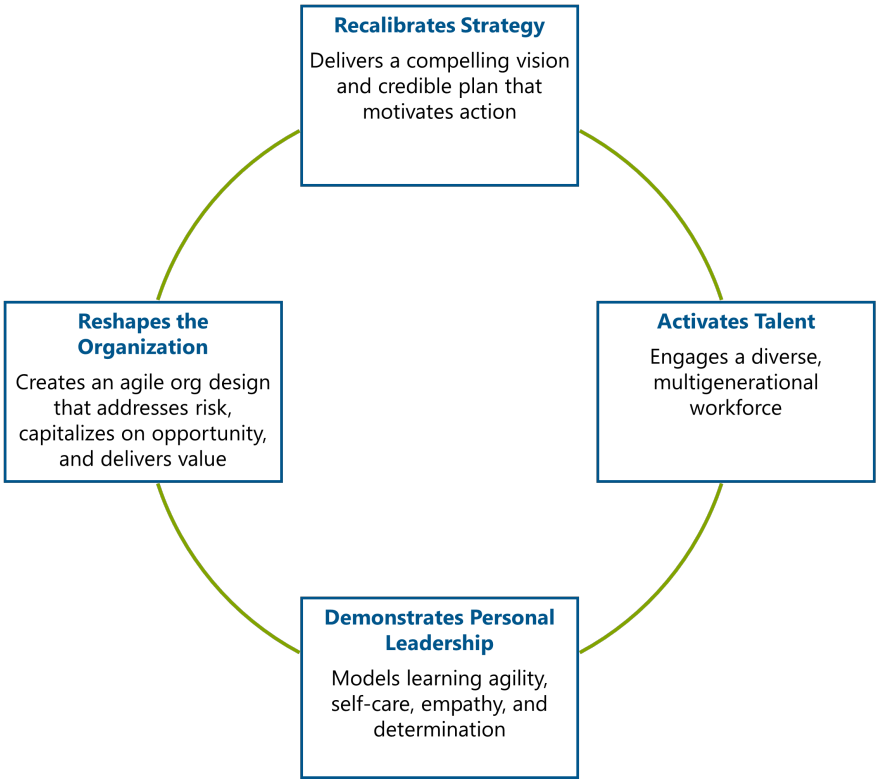
Framework for Future-Proofing Your Leadership and Succession Planning

For the most diligent and effective human capital and compensation committees, succession planning is a priority, and in the best cases, it is an ongoing exercise—one that continually refines the identified skills and experiences needed in the organization's future CEO.

New innovations and the speed of technology change now make exceptional leadership, the ability to plan for the unexpected, and the courage to act swiftly and decisively prerequisites for executives and board success. And the value of an open approach to continuous learning, particularly in emerging technologies, cannot be underestimated.

There are two particularly important areas in a future-proof, technology-centered leadership model: emerging strategic and organizational attributes. Compensation and human capital committees, as well as nominating and governance committees, can incorporate these characteristics into their current CEO performance evaluations and skills matrices for future CEOs.

Future-Proof Leadership Attributes



Resilient strategic attributes result in an ability to steer the organization with purpose through heightened and protracted uncertainty.	
Attributes	**Examples**
Purpose-Driven	Focuses on strategies and road maps in a way that supports the organization's purpose and is reinforced by its culture
Agile and Opportunistic	Pivots with grit and persistence to manage today while deciphering and leveraging opportunities for tomorrow amid uncertainty
Courageous	Cultivates candor, encourages rich dialogue, decides with conviction, builds alignment, and acts swiftly

Resilient organizational attributes result in agile designs that address risk while capitalizing on opportunity and delivering value.	
Attributes	**Examples**
Inspires Innovation	Creates policies, decision-making processes, and talent priorities that empower employees to innovate, solve problems, and respond swiftly to external realities
Transformative	Develops a culture that brings ongoing value by readily adopting emerging technologies and a digitization in products, services, and customer experience
Works Within an Agile Operating Model	Aligns leadership, clarifies incentives, defines efficient management processes, and establishes systems and resources that will enable the organization to adapt and respond amid challenges

Incorporating the Commissions 10 Recommendations into Your Compensation Committee Agenda

10 Blue Ribbon Commission Recommendations	
Commission Recommendations	**Strategies to Integrate the 10 Recommendations into Compensation and Human Capital Committee Governance**
Innovate Oversight	
Ensure trustworthy technology use by aligning it with the organization's purpose and values	• Examine the annual compensation risk assessment to determine if incentive plans, especially with respect to technology, may inadvertently drive undesirable behaviors inconsistent with the organization's values • As part of the responsibility to human capital, ensure technology advancements (particularly AI) have appropriate and adequate human oversight
Upgrade board structures for technology governance	• Incorporate the expanded responsibility for technology governance as appropriate to the compensation and human capital committee charter • Include digital expertise in the human capital risk assessment • Establish areas of intersection and common concern among compensation and other committees for ongoing technology risk and opportunity exploration • Include established levels of technology proficiency in board, committee, and director assessments • Ensure board compensation aligns with the need for technology-proficient directors
Clearly define the board's role in data oversight	• Maintain line of sight into how the leadership team is allocating data management responsibility, including data protection
Define decision-making authorities for technology at board and management	• Leverage short- and long-term incentive plans to establish clear expectations for management's achievement of strategic, technology-based milestones

levels	
Deepen Insight	
Establish and maintain necessary technology proficiency among the board	• Adjust required talent attributes to include continuous learning and agility, followed by technology and digital acumen • Identify a plan for addressing gaps in experience • Ensure director compensation structures encourage—and do not stifle—board refreshment and the potential recruitment of directors with complementary technology proficiency
Evaluate director and board technology proficiency	• Move from board assessment to individual director assessment, with an expectation that the assessment process specifically references a learning mindset and ongoing director and technology-specific education • Include the ability to grow and change as a result of assessments and recommendations
Ensure appropriate and clear metrics for technology oversight	• Deploy value-driver analyses to highlight technology-focused opportunities within existing, strategically aligned compensation design
Develop Foresight	
Recognize technology as a core element of long-term strategy	• For organizations that are not technology pure plays, structure compensation to ensure there isn't technology pursuit and adoption for its own sake; rather, it's used as a tool that allows for growth and the optimal execution of the core lines of business • From the human capital perspective, focus on ongoing, multilevel succession planning to build a continual pipeline, emphasizing technology talent as part of the process
Enable exploratory board and management technology discussions	• Take advantage of the sophisticated modeling of compensation and succession plans that technology enables to engage in robust conversations about potential outcomes, both risks and opportunities • Encourage a leadership mindset and culture that broadly considers technology within and across functions, not just IT
Design board calendars and agendas to ensure appropriate focus on forward-looking discussions	• Evolve the compensation and human capital committee calendar to account for annual reviews of leadership and pipeline development with a focus on building technology proficiency • Reallocate a portion of the time spent on look-back reporting, structuring the agenda to focus on driving compensation and leadership strategies inclusive of technology

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.