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Aligning the CEO and Board Through Compensation

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 2025 BRC report Unlock the Value of the Board-CEO Relationship.

Aligning the CEO and Board Through Compensation

Discussions around compensation should serve to clarify what the board expects the CEO and the management team to achieve and the appropriate measurements of success. Put differently, these conversations should answer the question: What is the CEO getting paid to do?

Clear conversations will avoid missteps in expectations or unspoken assumptions between the board, the CEO, and the management team. It can also help ensure that the board members are on the same page with each other.

Absent such conversations, compensation can easily become a source of tension between the board and CEO in these dynamic times. Avoiding that tension requires discipline and thoughtful collaboration on the part of the CEO and the board. The compensation committee and the CEO must manage potential hot button issues on two fronts, in particular:

- CEO as Compensation Plan Participant. **Managing the negotiations for the CEO’s own compensation and development throughout the CEO’s tenure**
- CEO as Compensation Plan Manager. **Making compensation decisions for the management team and the organization as a whole**

CEO as Plan Participant

Negotiation of their compensation package is often the first meaningful interaction a new CEO has with the board—it is critical to start off the relationship on the right track. While most boards expect executives to be strong advocates for their own interests, protracted "hardball" negotiations can create lingering bad feelings.

It can be helpful for all parties if the board and/or compensation committee identifies up front which elements of the new-hire offer are nonnegotiable.

New CEO Contract

Key Provisions

Employment Terms

- **Contract length and auto-renewal clauses**
- **Duties and expectations**
- **Board seat: automatic versus subject to vote**

Termination and Severance Provisions

- *Conditions:*
  - **Involuntary for cause**
  - **Voluntary resignation**
  - **Retirement (with definition)/disability/death**
  - **Without cause/good reason**
  - **Change-in-control (with definition)**
- *Payments:*
  - **Cash severance**
  - **Equity vesting**
  - **Change-in-control: single- or double-trigger**
- *Restrictive Covenants:*
  - **Noncompete, non-solicitation, and confidentiality**

Considerations

Board Chair Designation

- **An experienced CEO may negotiate to also be given the chair title. The board should retain flexibility to separate the roles in future without triggering "good reason" severance.**

Weak or Onerous Termination Provisions

- **Overly generous severance or single-trigger change-in-control payouts can spark shareholder criticism.**
- **On the flip side, overly restrictive covenants or low protection may deter strong candidates.**

Total Compensation

- *Base Salary:*
  - **Reflect experience, company size, and industry**
- *Short-Term Incentive/Bonus:*
  - **Define metrics (financial, strategic, operational) and weighting; consider discretion and caps**
- *Long-Term Incentives:*
  - **Mix (e.g., performance shares, restricted stock units, stock options)**
  - **Performance criteria and time-based vesting**
  - **Shareholder value creation alignment**

Overpaying Due to Inadequate Benchmarking

- **Do not rely solely on anecdotal data or overinflate for recruitment. Use peer group analysis and independent advisor input.**

Unbalanced Risk-Reward Structures

- **Avoid disproportionate short-term incentives that could encourage risk-taking.**
- **Ensure that long-term incentives are tied to sustainable value creation.**

Lack of Performance Clarity

- **Vague or discretionary performance metrics can lead to disputes and misalignment. Make goals specific, measurable, and transparent.**

Perquisites and Benefits

- **Health benefits, financial planning, club memberships, personal security**
- **Relocation and housing allowances, if applicable**
- **Retirement plan participation or supplemental executive retirement plans**

Equity Ownership Guidelines

- **Promote alignment with shareholders**
- **Enforce minimum holding levels over time**

Governance Missteps

- **Failing to document rationale and compensation philosophy**
- **Overlooking shareholder optics and Institutional Shareholder Services/Glass Lewis positions**

Of course, the issues and sensitivities for a new CEO pay package vary significantly depending on whether the CEO is an internal promotion or an external hire. For an internal promotion, there tends to be less negotiation over the pay structure, since the executive is already a participant in the company's executive-pay programs. But the magnitude of pay increase required to achieve market pay levels for the new position can

create unease among board members.

In the latter case, the premium required to entice a candidate to leave their current position can result in a disconnect between the new CEO and the rest of the management team.

Considerations for Internal Promotions Versus External Hires

Issue Area	Internal Promotion	External Hire
Compensation Level	▪ **Often viewed as part of a continuum** ▪ **May start below peer median with structured progression**	▪ **Typically requires a premium to attract and compensate for change or risk**
Expectations Setting	▪ **High familiarity can lead to inflated or ambiguous expectations**	▪ **External optics may provide a "honeymoon" period with clear performance expectations**
Negotiation Leverage	▪ **Limited leverage unless multiple opportunities exist** ▪ **Loyalty and culture alignment are implicit**	▪ **Greater leverage, and often multiple offers or buyouts are in play**
Cultural Fit	▪ **Known entity with proven cultural integration**	▪ **Cultural integration and leadership style alignment can be risky**
Retention Concerns	▪ **Can cause tension with bypassed internal peers** ▪ **Needs clear messaging and retention strategies**	▪ **May demoralize internal candidates if seen as a missed opportunity**
Equity/Ownership Stake	▪ **May already hold significant equity** ▪ **Consider impact of incremental grants**	▪ **Needs alignment via ownership guidelines and a significant initial equity package**

Sign-on Bonus/Buyouts	▪ **Uncommon unless adjusting to CEO-level compensation quickly**	▪ **Commonly used to offset lost equity or unvested compensation from previous employer**
Perceptions and Governance	▪ **Shareholders may appreciate leadership continuity, but may question the new CEO's ability to be a "change agent"**	▪ **Depending on the circumstances, the need to hire externally can call into question the organization's succession planning process.** ▪ **External hires may trigger scrutiny over costs, rationale, and alignment with strategy.** ▪ **On the other hand, some shareholders may welcome the new perspectives that an outsider brings.**

Beyond the initial onboarding, CEO pay sets the tone for the rest of the organization. Pay design and philosophy often start at the top of the house and cascade down to the senior management team and throughout the rest of the company. Boards and CEOs consequently must navigate multiple compensation issues throughout the CEO's tenure. Of particular importance is understanding what changes are required in compensation as the company itself goes through changes. If compensation management is allowed to go on autopilot during these times, it can quickly become a flashpoint, creating conflict for CEOs and boards.

Some typical events that might signal the need for pay-program changes include acquisitions or divestitures, an internal restructuring, or a significant change in the competitive landscape.

Finally, the board must be prepared for the eventual retirement or departure of the incumbent CEO. Starting two to three years before an anticipated transition, the board and the CEO should begin discussions about what, if any, changes to the compensation package might facilitate the exit "glide path" for both the CEO and the company.

Executive Compensation and Development Throughout the CEO Life Cycle

Onboarding the New CEO (Timeframe: 60-90 days)

Key Issues

- **Ensure that signing bonuses and equity awards do not create motivations different from the rest of the executive team.**
- **If there are multiple internal candidates, consider creative strategies for retaining and optimizing contributions from unsuccessful internal candidates, e.g., creating a new position or additional responsibilities.**
- **Schedule time for the CEO to meet with the compensation committee chair and the committee's outside advisor(s) to understand the structure and rationale for the company's executive compensation programs.**

Managing Through Change (Timeframe: Year One through Exit Year)

Key Issues

- **Formalize an annual review process of CEO performance and pay.**
  - **At the beginning of the year, the process should focus on targets and goal setting. Is target compensation market-competitive? Do we have the right balance of salary, short-term incentives, and long-term incentives? Do the CEO's performance metrics align with the key goals and objectives of the company? Do we have the appropriate mix of financial, operational, and strategic measures?**
  - **At the end of the year, the process should focus on results and development. Is actual pay relative to market well-aligned with the company's relative performance? How did the CEO perform against expectations—both financial outcomes and leadership results? This performance review process should include feedback from both board members and direct reports.**
- **Any meaningful change in the company's operating plan (e.g., acquisition, divestiture, change in business model or focus) should trigger a discussion with the committee regarding the pay-program design—for the CEO and the organization as a whole.**

Preparing for a CEO Transition (Timeframe: Exit Year Three Through Transition)

Key Issues

- **Planned transition: Ideally, the CEO transition is the result of a planned succession. From a compensation perspective, companies should consider several issues:**
  - **As retirement approaches, how should awards with multi-year vesting be adjusted?**
  - **Should awards continue to vest post-retirement as a way to ensure that the exiting CEO is invested in the success of their successor?**
  - **Will the CEO take on any kind of transition role (e.g., executive or nonexecutive board chair, temporary advisor, or consultant arrangement)? If yes, what will be the terms and conditions of the new role?**

- **When the transition is unplanned, the board and CEO confront different potential issues. The board will be managing both internal and external fallout, so it should seek to minimize the conflict over the exiting CEO's package:**
    - **While the employment contract or severance agreement generally outlines the potential payments to the departing CEO under various termination conditions, companies often negotiate "around the edges" of the formal agreement. However, be wary of**
        - **extending equity vesting beyond the provisions of the grant agreement, which can result in additional accounting expense; and**
        - **allowing the executive to "save face" by publicly characterizing the parting as a voluntary termination, while still paying severance—both Institutional Shareholder Services and Glass Lewis are increasingly critical of the practice, often resulting in negative vote recommendations.**

CEO's Role in Executive Compensation Design

The CEO is in the unique position within the management team of being able to put their "fingerprints" on compensation program direction and design and ensure it aligns to the organizational goals. To do this effectively, the CEO must develop a different, deeper understanding of compensation design and structure than can be acquired simply from being a participant in the programs—or even managing the implementation and oversight of programs that have been designed by others.

In particular, the compensation committee should quickly address two broad areas:

- **Learn what the new CEO already knows (or does not know) about the structure of the company's compensation plan. (Boards may be surprised to learn that the background rationale, strategy, or historical issues are not always readily apparent to a new CEO, even one who has been promoted from within.)**
- **Effectuate the CEO's involvement beyond simply the background and mechanics of the plan, so that ongoing conversations can be structured around firm-wide priorities.**

The board leader or compensation committee chair should sit down with the CEO within the first 60 to 90 days to establish a good working relationship at the outset and agree on the framework for productively managing compensation for the company. In addition, give thought to who else should be involved at these meetings, such as the chief human resources officer (CHRO) or outside advisors.

CEO Onboarding Materials: Compensation Committee

It is important that the new CEO understands the general "rules of the road" for executive compensation programs, but these vary significantly from company to company. Materials provided to the CEO can cover the following:

Corporate Governance

- **Committee charter**
- **Duties and responsibilities**
- **Annual committee calendar**

External Influencers

- **Legislative and regulatory considerations (US Securities and Exchange Commission, Financial Accounting Standards Board, Internal Revenue Service, etc.)**
- **Institutional Shareholder Services, Glass Lewis, and major institutional shareholder guidelines**

Company Programs

- **Pay philosophy**
- **Current pay programs and recent history/changes**
- **Competitive market/peer information**

Trends

- **Current market issues in executive compensation**

This process should ensure alignment with the committee on compensation philosophy, as well as the value of change (to meet changing conditions) versus consistency (to promote stability and reduce chaos).

Communication must then continue throughout the annual pay cycle (with a goal of no drama, no surprises). The committee and the CEO should remain sensitive to common "pain points" related to compensation and be prepared with potential mitigation steps.

As noted above, the CEO and the committee chair should have an initial conversation as part of the first 90-day onboarding process. It may take a new CEO more time to formulate opinions on areas of the compensation program they may want to change—especially if the CEO is new to the organization. The committee chair, along with the CHRO and the committee's outside advisors, should plan an in-depth follow-up session with the CEO as part of their first annual budget planning cycle to ensure that the company's compensation programs continue to align with and support the new CEO's vision for the organization.

Compensation Philosophy Checklist

The following checklist can serve as a starting point for structuring conversations on compensation philosophy between the CEO and the compensation committee.

Key Activities	Key Questions
Understand positioning against the market.	▪ **What is the market we will use to benchmark compensation levels and practices (e.g., peer companies, survey sources)?** ▪ **Should we use an external compensation consultant?** ▪ **How do we want to position our compensation levels against the market? Should it be above or below the median?** ▪ **What role does our compensation strategy play in our overall corporate strategy?**
Design the right mix for company-specific goals.	▪ **What are the desired compensation goals?** ▪ **How do we determine what takes greater priority: the goal of retention or performance?** ▪ **Which incentives or motivations are provided by different compensation elements?** ▪ **What mix of compensation elements (e.g., base salary, bonus, long-term incentives) makes the most sense for us?**
Link performance to rewards appropriately.	▪ **What is the ideal balance between individual and organizational performance when determining the compensation elements?** ▪ **How should long-term measures differ from short-term?** ▪ **What is the right balance of total company, department, and individual metrics? How should the weighting vary by employee level?** ▪ **How much leverage should be embedded in the pay-for-performance design (i.e., the range of threshold and maximum relative to target/budget)?**
Determine the role of non-direct compensation.	▪ **What is the role of non-direct compensation, such as perquisites and benefits?** ▪ **How can we best avoid excessive perquisites?**
Agree on mutual protections.	▪ **What purpose do mutual protections between employees and the company serve?** ▪ **What form and degree of mutual protections should exist?**

Review the risk assessment.	▪ **Do any of our compensation plans or practices create risk-taking incentives that are reasonably likely to have a material adverse effect on the organization?**
Explicitly outline relationships with outside advisors.	▪ **Which outside advisors do we use, and for what purpose?** ▪ **How involved are outside advisors with the strategic aspects of the compensation plan?** ▪ **Are there areas where we can get more value from outside advisors?** ▪ **Are there areas where we are overly reliant on outside advisors?**

When properly structured and aligned with business strategy, executive compensation can be a powerful tool for the board to reinforce the organization's goals and priorities. Timely and honest communication between the CEO and the management team and the CEO and the board about program objectives and challenges can ensure all parties remain in sync, thereby minimizing potential pay-related conflicts.

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.