

# ViewPoints

## The Compensation Committee 2008 Agenda: Back to Business

The members of the Compensation Committee Leadership Network (CCLN) met on January 9 and 10, 2008, in Washington, DC to share thoughts on their executive compensation agendas for 2008 and the work that lies ahead this year. These discussions were informed and enlivened by special guest and former SEC Commissioner Roel C. Campos.

The following members<sup>1</sup> participated in the meeting:

- Michael J. Critelli, Eaton Corporation
- Thomas J. Donohue, Union Pacific Corporation
- Dina Dublon, Microsoft Corporation
- Robert J. Lawless, Constellation Energy Group
- Stephen W. Sanger, Wells Fargo
- Daniel H. Schulman, Symantec
- Samuel C. Scott, III, Motorola
- Jonathan P. Ward, Sara Lee Corporation
- John Anderson, Hewitt Associates
- Michael Powers, Hewitt Associates

The following members took part in pre-meeting discussions but were not able to attend the meeting:

- Bonnie Guiton Hill, Home Depot
- Arthur C. Martinez, ABN AMRO and PepsiCo
- William A. Osborn, Caterpillar
- Hugh W. Sloan Jr., Manulife Financial
- John T. Dillon, DuPont

### *Executive Summary*

Members of the Compensation Committee Leadership Network agree that they are eager to return to the “core responsibilities” of the compensation committee – designing and delivering compensation programs that will meet business and shareholder objectives, and working on succession planning and leadership development<sup>2</sup> – after several busy years filled with SEC disclosure compliance activity. They appreciated the opportunity to exchange views with Commissioner Campos on executive compensation, proxy access, and corporate governance more broadly.

Specifically, the CCLN members considered:

- **Setting the 2008 compensation committee agenda.** Members devoted great time and energy to crafting the new CD&A’s last year but expect to spend considerably less time on this activity in 2008. However, it is worth noting that these sentiments were expressed before the very recent critical response by the SEC to corporate replies to its 2007 Comment Letters. More work than

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<sup>1</sup> The compensation committee chairs are identified by their board membership. John Anderson and Michael Powers participated in their capacity as compensation experts.

<sup>2</sup> Some compensation committee charters refer to *leadership development*; others, to *management development*. *ViewPoints* uses the terms interchangeably to refer to committee responsibilities below the CEO level.

previously anticipated may be necessary. Setting performance metrics, redesigning some aspects of the plans, reviewing leadership development and succession plans, and responding to the shareholder concerns will take precedence.

- **Engineering structural changes to compensation plan.** Using in-depth examples of several members' experiences as the basis for discussion, the CCLN explored a range of design parameters, including changing equity components of LTIPs, setting specific goals (operational vs. financial), and balancing corporate vs. divisional targets,
- **Planning for leadership development and succession.** Agreeing that leadership development was more of an art than a science, members discussed the role of management vs. the board, using consultants to benchmark talent, approaches to managing board exposure to senior executives, and the time and leadership required to make a difference.

### Setting 2008 Compensation Committee Agendas

Members are less focused on the SEC's 2007 proxy comment letters than they are on "getting back to business" in 2008. As one compensation committee chair told us before the meeting: *"I figure if we have a good compensation plan and a good rationale, then I trust we'll be able to translate that into a document. We'll make a few tweaks to our compensation disclosure [in 2008], but my real focus is on improving the overall plan."* Another added: *"We had a lot of comments in our SEC comment letter on long-term goals. We're still wrestling with that with no resolution but we're leaning towards saying 'drop dead.'"*

Despite some lingering frustration, most members are looking beyond the comment letters to 2008 and the important compensation committee work that lies ahead. They are developing their committee agendas around internal matters while carefully monitoring external pressures from shareholders and shareholder advocates.

### Defining the Right Performance Metrics

Members acknowledge that one of the benefits of the SEC's increased scrutiny of the proxy filings is that it has focused them on performance metrics. As one member shared: *"Everything we're doing now we ask ourselves: 'What is performance? How do we measure it? How do you document it?' We're trying to look at it quantitatively and qualitatively."* Members also shared that they have been struggling to find a way to reward good performance and communicate the linkage: *"The greatest problem is that there are so many people banging away at the compensation committees that everyone's getting risk-averse. Well, I've got some news for people: That's not happening in other places around the world, and you have to wise up. You have to say, 'This guy just knocked the cover off the ball and we're going to reward it.' It's hard to explain why a CEO got what he did, but it's not hard to explain why athletes, movie stars, and doctors are making what they do. We need to figure that out."* Another member echoed that sentiment, remarking: *"Any business is going to say it's not good enough to give management that kind of money. How do I know what a good number is and how do you justify the target if they've knocked the cover off the ball?"*

Many members expressed deep concern about revealing performance metrics. In particular, compensation committee chairs are wary of the competitive harm that could potentially result from sharing performance targets. As one member said: *"If you come down to a very detailed description of what your performance targets are, you are giving away competitive information. Everyone on one side of a deal has a heads-up, and everyone else will find out."* To this one participant responded: *"What they'll tell you is that if you're*

*trying to keep a performance metric confidential then it is very difficult to make the case that it should be kept confidential. They will buy it if it's an operational target, though. That is competitive information."*

In general, members agreed with the compensation committee chair who said: *"This is what we do. We set numbers and wait for others to come in and say the targets are unacceptable after they have had about a nano-second of information but you have to respond. It comes with the territory."* Despite their frustration, members are optimistic that focusing on performance metrics in 2008 will strengthen and help clarify the CD&A in this year's proxy statement.

### **Plan Redesign**

Some members told us that they also will be *"taking a fresh look"* at their compensation plans in 2008. Said one: *"I think a lot of the [prior] redesign was done very quickly and this time around, I think management should be more involved, and the whole board should review it."* Said another: *"Sometimes [management] can be entrenched in how it has always been. I think we do have a responsibility to take them on and be fresh eyes."* Another member remarked, *"I see too much consistency [among compensation plans], and I think that customization is extremely important."*

### **Leadership Development and Succession Planning**

CCLN members unanimously agreed that one of their top priorities in 2008 will be leadership development, succession planning, and retention: *"What we're really focused on this year is succession planning. Our CEO has been with us for some time. We have to think of a number of different strategies and we have to think of a number of different scenarios."* Another meeting participant remarked: *"This is a serious item that should take up considerable time of the board and the compensation committee."*

In addition to succession, members are focused on retaining their companies' top talent: *"We're looking at the attraction and retention of people. We're working very hard at that because we have a whole lot of people getting close to retirement, and we're going to have to have a plan."* Echoed another member: *"We have a group of people who are 56 to 60 years old, and we really need them for another two years. In addition to worrying about them going down the street, some of them want to go down to the beach. The fight for talent is going to be getting worse every day for a long time."*

Members also discussed the dilemma of retaining top people after a company goes through a difficult time. Questioned one member: *"How do you create that performance base that enables us to put out aggressive goals and yet, if bad things happen, we don't lose the team? That's really my struggle."* Another member commented: *"What I find the most difficult is when companies are going through a bad spell. You've got pressure from the outside not to pay, but those guys are really at risk, and I've seen a lot of them just ultimately jump ship."*

As members discussed various approaches to these challenges, it became clear that pay strategies needed to be highly tailored, novel, and generous in certain circumstances. Wisdom from closely engaged board members is essential.

### **Incremental Improvement to the CD&A**

With their attention now turning to the 2008 proxy disclosures, most members agree that their primary focus will be on simplifying and clarifying their CD&A. Stated one member: *"Our goal this year is to shorten our CD&A. We want to have good clarity, and we want to make it simple."* Another member

shared: *“We will focus on streamlining and trying to look and see if we’ve taken too much of a legalistic approach. We want to make sure we’ve complied with the SEC’s requests as opposed to us being more creative and providing more explanation.”*

Members will be particularly focused on the disclosure of the role of the independent consultant. *“I think there will be an increasing pressure on compensation committees to make it clear that your advisors are independent based on a specific formula.”*

Despite the occasional modifications and improvements, most members agreed with the compensation committee chair who said: *“We’re going to do much of the same thing we did last year. We’re going to look to management to bring us the data we need; we’re going to consult with our lawyers; we’ll bring in an outside guru to give us advice; and we’re going to try and learn from last year without giving away the store. We’ll see how it goes. We’re going to refine our proxy, but we’re not going to drastically change it.”*

### **Proxy Resolutions**

Proxy access will undoubtedly be a key issue in 2008. Although members do not anticipate much proxy access legislation in the coming year, one informed meeting participant shared: *“This year it looks as if you are going to see about 70 proposals having to do with shareholder access and putting the compensation package to an advisory vote. I thought some of that had run its course but it looks like it is still very much alive.”*

In general, members are skeptical about proxy access and its repercussions for the compensation committee: *“There’s a beauty to getting shareholders involved, and then there’s the reality. What do you take from that advisory? That, to me, is the most difficult part of it. On the surface, it is hard to argue with, and you look like the bad guy but the truth is: I don’t know what it does for us or if it just creates a no-good-deed-goes-unpunished situation.”* Despite this skepticism, one meeting participant was optimistic about the future of proxy access and executive compensation: *“Hearing this is hugely encouraging. If there is scrutiny by an investor group the fact that you’re being as careful as you are will hold you in good stead and will be a very defensible situation. Not that you should approach this from a defensive posture. You’re there to work out the right compensation to get the best for the investors of the company.”*

### **Boards will Stabilize Relationships with Investors**

Most members concurred with the compensation committee chair who said that despite increased regulation, at the end of the day *“I’m more concerned about my investors and communicating with them than I am about the SEC. I’m much more concerned about what they think.”* Indeed, most members share the view that *“generally having a conversation with those in conflict with you is better than no conversation”* As one member pointed out: *“I think everyone has a huge investment in having a stable relationship with investors. Maybe it didn’t have to be that way in the fifties, seventies, ten years ago, even five years ago... but I don’t think it’s going to go away.”*

Members also agreed that what most investors are looking for is *“clarity in the explanation.”* In particular, members believe that communication around compensation is needed after a difficult year. As one participant pointed out: *“There are times when a company goes through a bad time and the CEO does great things to keep the company together, and that’s not communicated, and I think that is where a lot of problems end up happening.”*

Indeed, members already are taking steps towards improving communication in 2008. Explained one member: *“We are inviting the top 20 shareholders to talk to us about compensation at our company. We don’t think they will want to do it, but I think it’s better to engage in the discussion.”*

### **The SEC and Executive Compensation in 2008**

After an eventful 2007, most members predict that 2008 will be a relatively stable year for the SEC and its involvement with executive compensation. When asked if the CCLN should be prepared for any major proxy access legislation, meeting guest Roel Campos replied: “I think it is unlikely that the SEC this year will put out any shareholder access proposal.” Campos then went on to add, “This is an election year so all focus is on the nominees. My prediction is that the three Republican [commissioners] will not put up a proxy access proposal and that there won’t be one until a new Commission is in place. I can’t see into [SEC Chief Commissioner] Chris [Cox’s] heart but I don’t see the Commission being motivated.”

When asked what the CCLN should be focusing its attention on, Campos responded: “Right now the fight is with disclosure about performance targets and CD&As, and that is where it is going to stay.”

Members agreed that *“you have to give [SEC Commissioner] Cox a lot of credit.”* One member went so far as to remark: *“Until all of this came out, how many people could say what happened after a CEO’s retirement? [All of this regulation] allowed compensation committees to see the light of day.”*

Indeed, Campos reminded members that executive compensation will be a major part of Commissioner Cox’s legacy, and therefore he really wants to get it right. Therefore, Cox would be interested to hear proposals for improving procedures. On the vexing topic of the single number that purportedly captures CEO pay, Campos remarked that: “Cox really wanted to come up with one figure. It’s a stake in the ground and there’s a big circle around it. Cox was really the one who drove it and he cares about this issue a great deal.”

### **Boards and Business have to Market Executive Compensation**

Members of the CCLN agreed with Commissioner Campos that compensation committees, and boards in general, could and should be doing a better job at marketing executive compensation. As one member noted: *“At its most basic level executive compensation has an ‘optics’ problem and we struggle to justify the sheer numbers.”* Indeed, another meeting participant pointed out that *“there are good arguments for why CEOs make this money, but that case hasn’t been made well. Bankers are making \$1 billion, but it’s more justifiable because there is a metric there.”*

Once the problem was identified, members talked about ways to effectively market executive compensation. One member asked: *“Is there a way of working this stuff through and simplifying it so everyone understands it?”* In response, another member offered: *“I like the idea [of] putting another page in the CD&A that says what really happened in that year in terms of CEO pay rather than just focusing on that lower-right-hand number.”* Regardless of how compensation committee chairs approach the issue of marketing, most members agree that *“compensation is an optics issue that needs to be addressed and how it is ultimately resolved is a company-to-company issue.”*

### **Shareholder Activism: Playing “Five Moves Ahead”**

Members believe say-on-pay will continue to be a significant issue in 2008. Moreover, they believe that this issue plays into the much larger discussion of investor activism. As one member said: *“You have to play this chess game five moves ahead. It’s not only about say-on-pay. It’s a long process.”*

Several members reported that they find it difficult to prioritize investors and their issues. One compensation committee chair remarked: *“I think one of the important things to ask is: Who are the investors who are raising all of these questions? Are they major investors we should be cognizant of or are they some unions who have other axes to grind?”* Indeed, another member asked: *“Who are the constituencies that are causing us all these headaches? It’s not the shareholders, it’s not the management teams—it’s the unions. It’s CalPERS. We have to ask ourselves: Who is the audience we’re trying to respond to?”*

Despite their frustration, some members are still optimistic about the outcome of shareholder activism, specifically say-on-pay: *“I think the most positive thing is that it has brought about a much closer dialog between boards and management. The mere fact that there is a say-on-pay has led companies to more communication.”*

### **Engineering Structural Changes to the Compensation Model**

At the meeting, CCLN members engaged in a lively discussion of major structural changes to executive pay at large companies. Typically, it is the practice of the CCLN to capture and distribute insights that include specific details from such member discussions. However, members advised against extended treatment of particular items from this discussion, suggesting instead a broad summary of the conversation’s themes and points of interest.<sup>3</sup>

### **Events That Trigger Significant Compensation Review**

Members pointed out that a major review of the compensation plan can be triggered by any number of internal and external events, including CEO and leadership changes, company performance and maturation, broader market and economic forces, a merger or acquisition, a company crisis or scandal, a regulatory change, or shareholder pressure. CCLN member examples suggest that a major compensation review or redesign is just as likely, if not more so, to take place as a result of internal efforts to align pay with performance or simply *“because it is time to do it.”*

### **Responsibilities of Management and the Board**

Specific examples of compensation plan reviews and changes revealed significant differences in the roles played by the board, the compensation committee, and management in assessing and designing compensation structures:

- In some cases, the compensation committee and its chair serve as the driving force behind the plan review and restructuring, working closely with the head of human resources and others to deliver

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<sup>3</sup> At the request of members, no quotations have been included in this section. For participants, it is intended to serve as a reminder of the discussion; and for other readers as a reference on working with senior executives and the rest of the board to review and restructure compensation plans.

the new plan for board approval. In these cases, the committee chair invests significant time and energy in the program review, works on the new plan on a weekly (or even daily) basis, and may elect to retain a compensation consultant or other outside expert.

- In other cases, the compensation committee and the board rely heavily on HR/management to review the operational drivers of the current plan, to revise the drivers for the current business environment, and structure a compensation program that will reward performance commensurate with those drivers. The board and compensation committee focus more on the targeted payout of the new plan and its alignment with performance.
- Finally, in other cases, management initiates a review of the compensation plan, in light of internal and external forces that have substantially changed the real or perceived value of performance incentives. Although the review may be triggered by retention or other concerns, the compensation committee still takes a leadership role in ensuring that the compensation program is tightly aligned with shareholders' value creation over time.

### **Shifting Equity Component of LTI**

In keeping with broader trends in the market, a number of CCLN members companies have shifted away from traditional time-vested stock option grants to time-restricted stock units, performance-restricted stock units, and performance share units. Generally, these shifts have been motivated by a commitment to more effectively pay for performance and to strengthen the alignment between shareholder and executive interests. These changes also offer additional, company-specific benefits ranging from bringing equity burn-rates and overhang, in line with industry norms, to retaining and rewarding key executives, to better balancing the actual cost of an incentive with its perceived value to the recipient.

### **LTI Payouts Over Time**

Members also considered the very practical question: What should be the range of LTI payout over, for example, a ten year period? What if the LTI is not paid out even once in that period? What if the LTI is paid out at maximum levels almost every year in that period? Members advise that the award no longer impacts behavior in either case. In conducting a major structural review of the plan, some members suggested that a target distribution of LTI payout is appropriate. For example, in a 10 year period, it may be appropriate to pay the LTI at target levels six or seven years, maximum levels one or two years, and to make no award one or two years. Of course, members point out, that there is no one-size-fits-all approach to LTI awards, and that LTI payouts will vary by industry, company, and time period.

### **Operational vs. Financial Goals**

Members identified at least three broad areas of executive performance that they believe are critical to the redesign of a compensation plan: bottom-line financial performance, operational impact, and leadership effectiveness. The first two areas were the focus of much discussion; the third was addressed in the context of leadership development and succession planning.

Compensation committee chairs fully recognize that share price appreciation and dividends are the ultimate measure of performance and have to figure prominently in determining executive pay. But, they ask, how should the compensation plan be structured when even exceptional, company-wide financial performance is not reflected in share price growth? What if the model for share price growth is predicated on operational outcomes that will produce future revenue, margins, and returns? The consensus: In this kind of

environment, effective compensation plans may tilt away from financial metrics, in favor of operational metrics.

### **Corporate and Divisional Metrics and Pay**

Members considered the relative weight that should be given to divisional or business unit performance metrics versus the weight given to corporate performance measures. This balance is particularly sensitive when divisional or business unit performance is dramatically different from overall corporate performance. Members expressed concern that a corporate component, if weighted too heavily, could conceal unit performance, reduce awards to well below target levels, and create retention challenges. This possibility seems more likely in large established companies with diversified lines of business whose performance plans rely on a series of corporate threshold performance levels or “cliffs.”

### **The Target Is The Thing**

Assuming that the board is confident about the mix of pay elements and their alignment with performance drivers, the compensation committee still must oversee the specific numerical targets set by management. CCLN members recognize that even the most carefully constructed compensation plan can be “gamed” if performance thresholds are set too low, or rendered ineffective if those thresholds are set beyond reach. Member examples suggest that effective committees embrace the notion that “the target is the thing,” and work diligently to calibrate and refine performance targets on an ongoing basis.

### **Pacing and Rate of Change in the Compensation Plan**

Members who have undertaken a major compensation plan redesign have sought rapid, steady progress without excessive disruption. Regardless of the nature of the plan change, members advise that new plans be given time to work. Some practices that minimize disruption include executive and employee participation in compensation focus groups and planning sessions, a carefully constructed communications plan, and individual discussions between compensation committee members and executives. Steady progress was achieved by implementing a more comprehensive set of plan changes over a multi-year period. This approach had the benefit of interregnum periods in which payout models could be tested and refined, plan elements could be fine-tuned, and employees could better plan for changes in their personal compensation.

### **A Plan that Both Drives and Communicates Executive Performance**

As members point out, no one complains about executive compensation when share price is rising steadily. However, when share price goes flat or falls, the executive compensation plan must not only withstand shareholder and public pressure but effectively communicate the board’s assessment of executive performance and its ability to hold executives accountable for company performance. In light of this, the redesign of a plan must consider not only the best ways to satisfy both shareholder and business objectives but also to communicate executive accountability to shareholders.

Member examples suggest that this responsibility carries unique challenges in some companies. For example, if a senior executive has already attained very large amounts of personal wealth, the executive may seek relatively limited incentive compensation. While this approach relieves the executive and board from certain pressures (accusations of greed or egregious pay packages), it provides very little structural basis upon which to recognize performance – either positively or negatively. None the less, the compensation

committee strives for meaningful performance evaluation processes and appropriate vehicles for communicating the results of these processes.

### *Planning for Leadership Development and Succession*

The committee charter of virtually every company represented in the CCLN includes language to the effect that the committee will review and approve (1) succession planning and (2) the recruitment, career development, and compensation of senior management. As compensation issues stabilize and the rate of turnover among senior executives continues to accelerate, succession planning and leadership development – already priorities for boards and compensation committees – are rapidly moving up the corporate agenda.<sup>4</sup> As one CCLN member said: *“On an annual basis, I worry about succession planning a whole lot more than I do about Chris Cox’s comments on the proxy.”* At the January meeting, participants agreed that succession planning and leadership development are top priorities in 2008, but many confessed that they are still struggling to adopt a best practice: *“Succession planning is an art, not a science, and we haven’t completely figured it out yet.”*

### **Management’s Role in Developing Human Capital**

Members of the CCLN agree that a crucial first step toward successful succession planning and leadership development in a company is getting management involved: *“It lies with management to make sure that they have a disciplined process for defining succession at all levels.”* One member and former CEO shared an approach that had proved successful: *“At [my company] we made it part of my compensation. A discretionary piece of my compensation was the succession plan for the next five years. It was a very specific process in place and we reviewed it twice a year.”*

If no plan exists, members agree that it falls to the compensation committee chairs to take control and exercise force if necessary: *“At the company where I am compensation committee chair, [management] has nothing in place at all, and I’ve found you have to force yourself on them. It’s the board who is accountable for the next CEO.”*

### **Succession Requires Long Term Planning**

Members agree that having both a long-term and short-term developmental plan in place is crucial to successful succession planning and leadership development in an organization. In particular, members believe it is important to leave enough time: *“You have to plan somewhere between six to ten years out. Five years is not very long if you’ve got a high-potential candidate. You have to create a series of moves... You have to ask yourself: ‘What’s the company going to look like in 5 to 10 years?’ I find determining that timeline is the biggest challenge.”*

By identifying top talent early, members report that it is much easier to monitor and develop high-potential candidates. As one member shared: *“At our company, we have a lot of candidates who are the same age as the CEO and what we’ve done is go down to the next level and look at the sequence of jobs the next level*

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<sup>4</sup> J. Stephen Heinen and Randall S. Cheloha, “Effective Succession Planning: The Board’s Role,” *Executive Remuneration Perspective* 55 (updated July 31, 2006). Available online at <http://www.mercer.com/referencecontent.jhtml?idContent=1235660>.

*has to have to hit CEO after the next six or seven years... you really need to bring someone in seven years out and nurture them”*

In addition to keeping an eye out for the next potential CEO, members also highlighted the importance of attracting and retaining top a Chief Financial Officer (CFO): *“It seems to me that the most mobile and shortest supply are really first-rate CFOs. You can find a lot of CEOs, but finding the right CFO is becoming a unique thing.”* Echoed another member: *“Right now, we’re paying more attention to succession of the CFO job. We have financial people on the board who are saying the CFO is the second most important job in the company... We want to know who we have coming up behind the current CFO.”*

### **Use of External Consultant to Benchmark**

CCLN members were interested to hear about and discuss the use of external consultants to assess and benchmark leadership quality within a company. One member who had implemented the use of a third party shared: *“We brought in an outside firm, and they analyzed our top 30 executives both psychologically and comparatively against a peer group. They did a three-hour psychological assessment session with each individual and then calibrated each individual against the comparable of outside firms based on whatever criteria I set—leadership, technical talent, etc. It tells you what kind of team you have and if this would be a candidate you would put at a top position.”*

Most members agreed that this approach helped address one of the biggest challenges in succession planning and leadership development: *“making sure you have the right evaluation of talent.”* Indeed, an experienced member shared: *“It’s not perfect, but at the very least it’s an outside analysis of what you’ve got. We were surprised because in one instance we had a person we thought was great and the rating came back low. This is an outside calibration that helps.”*

### **Board Exposure—Structuring Quality Interaction with Top Talent**

Although CCLN members unanimously agree that interacting with executive top talent is one of their key roles as both a board member and a compensation committee chair, some members reported that they still struggle to identify the best way to approach this task. As one member questioned: *“How do you really create a quality discussion between high-potential people and boards? How do you really get to know someone? I’d love to get input on that.”*

Members responded by sharing some of their best practices:

- **Breakfast before a board meeting:** *“Every time we come in for a board meeting, we have high-potential couple of employees have breakfast with the board.”* Another member shared: *“You learn a lot at those meetings. We have scheduled one-on-one meals with high potential individuals.”*
- **Multiple directors with one candidate:** *“At our company we have three directors sit down with one person.”*
- **Director meets candidate off site:** *“I’ve created occasions where individual executives will sit down with directors at their place of business. It’s still a bit staged, but when you do a one-on-one and you’re off the director’s home turf, it creates a different dynamic.”*

- **Director assigned executives:** *“I’ve seen cases where each director was assigned two executives, and they were supposed to get to know them over the next 18 months. When you saw them next, they had a relationship. It helped bridge the gap between the current leadership and the next generation.”*
- **Retreat with both directors and executives:** *“We went away on a strategic retreat with the whole board. At first I thought it was a complete boondoggle but we really got to know the management team.”* Another member added: *“Riding together in a bus is when you get to know someone.”*

Regardless of the approach, members agreed that interacting with management and high-potential candidates is a crucial component of successful leadership development and succession planning: *“You can see the résumés in a book, but being able to interact with people in both formal and informal settings is key.”*

### **Time Commitment by Board**

CCLN members agree that the ratio of time spent on succession planning and leadership development to time spent on compensation is *“shifting,”* and that *“as [interest in] comp dies down, there will be more time to focus on these issues.”* All CCLN members view succession planning and leadership development as critically important activities, but the actual amount of committee and board time spent on them varies widely by company. Overall, members reported that they are devoting anywhere from 20 percent to 33 percent of their agenda to succession planning and leadership development at each compensation committee meeting.

Although compensation committees must constantly focus on their next tier of executives, members reported that the time commitment increases significantly depending on where the company is in the process: *“Normally we devote around 20 to 25 percent of our time to it in the committee. As you get nearer to a CEO succession, it can become 100 percent.”* Another member offered, *“Regardless of where we stand in the process we will always have one meeting each year entirely focused on succession planning in addition to it being a major agenda item year-round.”*

### **Leadership Required**

When it comes to succession planning and leadership development, CCLN members agreed that one thing matters most of all: quality board and compensation committee leadership. As one member remarked: *“One of the things I think boards have missed is that there is no ‘champion’ on the board. No one jumps up and down for the cause of the board. No one challenges the CEO. I don’t know a lot of board members who have a lot of experience going through this process but I think it needs some attention.”* In response, another member commented: *“I think committee charters are making it much more clear who the champion is. [The charter] not only empowers you to take charge of [succession planning and leadership development], but it also forces you to hold to it.”*

Nevertheless, members debated how responsibilities should be allocated. Questioned one member: *“You know where the accountability is, but how do you accomplish everything that needs to get done?”* Another member responded: *“We have the CEO and human resources primarily drive it, and then we respond. You as a board need to start stepping in and saying it’s not good enough.”* Another member remarked, *“At our*

*company, the CEO drives the process, and the board pushes back. Sometimes that works and sometimes it doesn't. I think all of that is healthy because I think boards understand what needs to be done."*

CCLN members discussed one final conflict that can potentially arise between the board and current CEO when the timing of the CEO's departure is in question: *"One of the hardest things is if you've got someone who's ready to come in now and the CEO's not ready to leave. That's a tricky situation. You want people who are ready to go when you're ready."* Members ultimately agreed that it is the compensation committee chair's responsibility to communicate with the CEO and pick a date and stick to it: *"Now that we're losing our [second-tier executives] to other companies, we've started to put stakes in the ground about whether a CEO is staying or going. You have to rally around a date; and unless there's a big transaction, they need to know that this is where everything is going. Still, that's a tough discussion."*

### Conclusion

Compensation committees have been the target of shareholder activists, legislators and the SEC for the past several years and members of the CCLN are now optimistic that 2008 will be a year to get back to the important work of compensation design and delivery. To do this, members are focusing on more forward looking agenda: *"everyone has been looking over the fence rather than where their company is going."*

Members also report a shift in their thinking these issues within the context of the CCLN. *"We've gone from venting to learning. There is a wealth of knowledge amongst these [compensation committee chairs]. And today we learned from our peers."*

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