THE ASPEN PRINCIPLES
MODERN PRINCIPLES FOR SENSIBLE AND EFFECTIVE EXECUTIVE PAY

FREQUENTLY ASKED QUESTIONS

WHERE DID THESE ASPEN PRINCIPLES COME FROM?

The Modern Principles for Sensible and Effective Executive Pay are the product of two years of research and constructive dialogue with scores of individuals including board directors, experts in governance and investment, leading executive pay advisors and scholars. Through this process we developed a thorough understanding of the broad spectrum of perspectives about what works well, what doesn't, and where there are opportunities for better design and decision-making about executive pay, especially in public companies.

Aspen staff worked in close partnership with the leaders of Korn Ferry's Executive Pay & Governance team to articulate and define five key principles and to hone questions that boards should ask when evaluating executive pay programs.

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WHAT IS THE GOAL? WHAT WILL BE DIFFERENT IF BOARDS TAKE THESE PRINCIPLES SERIOUSLY?

The goal is to stimulate thoughtful dialogue among those responsible for the design and oversight of executive pay programs, and to elevate the need for clarity, alignment with key goals, integrity, and, especially, to achieve two objectives rarely considered: simplicity (avoiding excessive complexity), and fairness.

By using the Principles to guide the design of pay packages we seek better alignment of pay with key performance metrics and better outcomes for people throughout the organization. We hope to see less of a tendency to mimic the pay programs of other organizations and less fixation on total shareholder return as the main indicator of company and executive success.

WHY NOW?

Public trust in business is at a low ebb; business leaders are rethinking the purpose of their companies. The time is ripe for boards to reexamine assumptions and consider research and new ideas that better align pay and incentives with corporate purpose and the changing role of the CEO. Also, enhanced understanding of human motivation and high-functioning teams is contributing knowledge of what works best when it comes to the design of rewards.

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SHOULD ORGANIZATIONS MAKE GREATER USE OF NON-FINANCIAL METRICS? DO THE PRINCIPLES ENCOURAGE 'ESG' TARGETS?

The first principle is that pay should be clearly tied to the company's purpose and the drivers of its long-term success. When boards consider what is at risk and what needs to be true for the company to flourish over the long-term, social and environmental considerations are illuminated and the need to consider a mix of financial and non-financial drivers of performance becomes more apparent.

On the other hand, too many goals or performance targets leads to complexity and confusion. The Principles strike a balance that starts with the board's own understanding of corporate purpose and key objectives.

HOW ABOUT THE USE OF LONG-TERM INCENTIVES—DO THE PRINCIPLES FAVOR LONG-TERM AWARDS TO ENCOURAGE LONG-TERM THINKING?

Two concerns emerge in the use of long-term incentives.

Rewarding executives with stock that they must hold over a long period is a valid way to ensure their commitment to the company (i.e., assure 'skin in the game'). But when stock grants or other rewards are tied principally to targets for stock price or total shareholder return (TSR), other goals, values, and key constituents might be devalued or the incentives may distract executives from other important areas of performance.

Also, senior executive pay has risen at a faster rate than the pay for other workers—which is largely a function of long-term incentives (including and especially the value of equity-based awards). Shareholder advisory firms place a premium on total shareholder return and as a result, many companies have assigned an even greater percentage of total pay to long-term incentive awards. In a prolonged bull market, these awards have proved highly lucrative for executives—contributing to an increasing gap between top executive pay and the pay for the average worker.

Long-term incentives, properly structured and balanced in the total compensation program are, and will continue to be, an important component of executive pay. The Principles elevate the need to carefully strike a balance in how long-term incentives are designed and used to avoid unintended consequences.

EXTERNAL BENCHMARKING HAS BEEN A STAPLE OF EXECUTIVE PAY ANALYSIS AND REASONABLENESS TESTS FOR YEARS. WHAT ROLE DO YOU SEE IT PLAYING MOVING FORWARD?

Compensation programs need to be externally competitive to enable organizations to attract and retain the talent they need at all levels of the organization. But many organizations have become too focused on precisely targeting executive pay at a certain level of market competitiveness (i.e., median or 75th percentile) when the actual "market rates" are, by definition, imprecise, and sometimes subject to significant year-to-year fluctuations based on factors unrelated to company performance or industry dynamics. What matters more is organization performance (broadly defined) and the contributions of individual executives in driving performance.

External benchmarking should be used as an input and a final check when evaluating pay decisions, not the primary driver of those decisions. And it's important for compensation committees to consider that the decisions they make each year have the most significant impact on year-to-year changes in the market pay rates for CEOs and senior executives.

ARE THE PRINCIPLES REALLY ABOUT KNOCKING DOWN CEO PAY?

No. The Principles recommend shifting from a fixation on external benchmarking to a greater consideration of internal equity when making pay decisions. There is no formula or universal standard for "fairness"; every organization should develop their own criteria for determining what is fair and effective. This involves answering a series of questions: How does the top executive's pay compare to that of other senior executives? How does the pay for the management team compare with that of the general employee population? What's the right balance when deciding how to split profits between returns to shareholders and reinvesting in employees?

WHY NOT PROPOSE SOMETHING EVEN MORE RADICAL GIVEN RECENT CALLS TO RETHINK THE COMPENSATION COMMITTEE'S MANDATE AND TO SHARE MORE VALUE WITH WORKERS?

We believe boards are positioned and motivated to address the most important concerns that are raised today about executive compensation. In fact, there have been many improvements enacted over the past decade. If Compensation Committees carefully consider the questions outlined in the Principles, improved decision-making will result. Boards can achieve greater clarity in how executive programs are structured, align pay with the goals that matter the most for the long-term, and achieve greater fairness and consistency in how executives are paid relative to others in the organization.

Please click here to download your copy of The Aspen Principles, or use the contact details below to speak to one of our team about the Principles in more detail.

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KORN FERRY

The Aspen Institute Business & Society Program

Judy Samuelson
Founder and Executive Director
judy.samuelson@aspeninstitute.org

Miguel Padró
Senior Program Manager
miguel.padro@aspeninstitute.org

Felicia Davis
Program Manager
felicia.davis@aspeninstitute.org

Korn Ferry

Don Lowman
Global Leader of Rewards & Benefits
don.lowman@kornferry.com

Irv Becker
Vice Chairman of Executive Pay & Governance
irv.becker@kornferry.com

Tierney Remick
Vice Chairman of Board & CEO Services
tierney.remick@kornferry.com

David Wise
North America Market Leader - Private Equity
david.wise@kornferry.com