Video Transcript: Leading Minds of Compensation – Leadership Development

Chris Clark: Dave, imagine that you're Bob Herz on the Morgan Stanley board and I'm an active shareholder very interested in all sorts of your strategies and I'm asking you the question, “Does your executive comp program support the development of strong leaders over time?”

David Swinford: Yes, it does.

Chris: Could you give me a little more?

David: So the question I think as a comp committee member you have to ask yourself is does our executive compensation program support the acquisition, growth, maintenance of a strong leadership team over the long run. We have a compensation structure that is consistent from the bottom of the organization to the top, so that as people move up the structure, how their compensation opportunities will reward their growth and development is very clear to them. Most of us, by the way, don't have that. We've gotten so say-on-pay focused and so ISS focused that there is this disconnect between the design of our named executive officer compensation program and how we treat people below that. I think it's an issue that a good compensation committee is going to focus on.

The second thing that I think you need to provide for in that, as we've mentioned a couple of times already, is a focus on the increase in the executive wealth that is tied to the company's stock as they move up the ladder in the organization. Think about it at the levels below which they are going to become subject to the stock ownership guidelines, and think beyond the stock ownership guidelines. If your CEO's guideline is six times base salary, it's typical for a Fortune 500 CEO who's been in place for a while to have 10, 20, 50 times base salary. You know that they're thinking about the investor's perspective when they're making strategic decisions and even key operating decisions, and you know they're going to worry about managing risk. They've got too much to lose. Just make sure they don't have so much to lose that they're paralyzed and won't take any risks.

Think about growing your executives’ skills as well as their investment in the company over time. Think about your ability to transfer executives across the operation in order to grow them over time. Don't put them in a position where they have to take a pay cut to do a different job, or worse yet, you've got to red circle them because they really need to move in to this lower graded job in your structure for two years to acquire a particular skill. Now, Charles Elson at the University of Delaware would argue based upon his research that you shouldn't be using peer groups because it's going to cause you to mark to market rather than focusing on an appropriate internal hierarchy of pay. Getting a new person to market median in three years is a common goal, but it is not necessarily what that person is looking for. They're looking for signals that they are succeeding and they are looking for the next step. "What are my increased opportunities and am I being effectively rewarded for my accomplishments, and how do I know that if I keep growing over time I have a real opportunity to get that top job?"

Those are the principles that, besides paying competitively against the marketplace, I think Bob should be discussing with his investors.