

LER 590EC Executive Compensation

University of Illinois at Urbana-Champaign

Fall 2019

Time: Wednesdays, 2 PM – 4:50 PM
Location:
Instructor: Jiwook Jung, Assistant Professor
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Course Description

Designing an efficient and equitable compensation system for executive managers has strategic importance with an implication for a broad set of stakeholders. The main objective of this course is to introduce to HR/IR students fundamental concepts and issues about executive compensation and corporate governance. The discussion will focus on the context of publicly traded companies, but the implications will also be relevant to compensation systems for leadership positions in other kinds of organizations. The course will review opposing views on the nature of executive compensation and examine the evidence for each view. The course will also discuss ethical issues, societal concerns, and international comparisons about executive compensation.

To balance theoretical understanding and practical skills, students will examine actual compensation contracts from public corporations and analyze their strategic effectiveness.

Course Requirements

Readings:

This is a reading-intensive course. It is extremely important to come prepared for each class session. Assignments should be read and given some thought in advance of class. You will not be able to successfully complete the course without full understanding of the readings. Exams and other assignments are designed to ensure that you complete the readings and understand the concepts in them thoroughly.

Each week's readings typically consist of one or two conceptual pieces, one or two newspaper articles, and one business case (except for Week 1). The cases are carefully chosen to illustrate core concepts that are introduced in the conceptual pieces. The cases are intended to help you understand the concepts in a real-world setting and to provide the basis for class discussion.

Some information may seem dated, but consider it as relevant information that helps us

understand historical background of the organization. The cases are not intended to provide up-to-date information about the companies or regulatory policies. Keep in mind that our goal is to learn the underlying concepts rather than to know more about the specific companies featured in the cases.

Attendance and Participation:

Attendance is required at all class sessions. Attendance includes arriving on time and remaining until the end of the session. If you know ahead of time that you cannot attend class due to illness or civic duty (court appearance, jury duty, etc.), please notify the instructor immediately. Each student is allowed to miss no more than **TWO** classes in the semester. In addition, active student participation is essential to successful class sessions. Your ability to contribute comments that are relevant and insightful is highly valued in this course. You will be cold-called to contribute to the class discussion (**10 percent** of the total grade).

Group Case Discussion and Summary:

Every week, there will be group discussion about a selected business case and related discussion questions. To facilitate constructive and meaningful discussion, each group will be asked to provide a short summary of discussion by the end of each class. After group discussion is done, each group will be given 20 minutes to summarize their discussion and highlight main conclusions, and submit the summary via **Compass**. Grading of discussion summary will be done on a **three-point scale—fail, pass (good), and pass (very good)**.

After the first class of the semester, the instructor will assign students to discussion groups of 3-4 students. Students will work with the group members throughout the semester for case discussion and the final group project. Group assignment will be done in a way to maximize diversity of group members.

Mid-term Examination:

The exam will be at **2:00 PM - 4:50 PM** on **October 23, 2019**. The exam will cover all topics of the first half of the course. It will be open book, open notes. **The exam will be administered through the course website (compass 2g) during the class meeting in the classroom.** So you need to bring your laptop to do the test. Detailed guidelines for the exam will be provided in class. The exam will be worth **30 percent** of the total grade.

Group Project: Final Paper and Presentation

The purpose of this group project is to give students an opportunity to apply their knowledge about executive compensation to a real-world example. Each group will conduct research on CEO compensation practices of a company they choose from the lists of Fortune 500 or Global Fortune 500 companies, using the company's annual reports and proxy statements over the last several years. Then, based on their research, students will decide how effective the company's executive

compensation is and whether there are critical issues. In the last part, students will provide a set of recommendations so that the company can improve its executive compensation design and practices. **Preliminary outline** of the group project is due on **November 13, 2019, Wednesday at 2 pm**. The **group project report** is due on **December 11, Wednesday by 5 pm**. More details about the report will be provided after the Spring break.

In addition to the final report, there will be group presentations in Week 14 (April 18).

Course Materials

1. **Compass.** Some readings in PDF are available on the Illinois Compass 2g website for this course. See the section “Course Website” below for more information.
2. **Harvard Business Publishing website.** All cases are available for purchase on the Harvard Business Publishing website at: <https://hbr.org/store/case-studies>.

On the course schedule below, each reading has its source noted in the brackets (e.g., [Compass]). You do not need to purchase any textbook for this course.

Evaluation

	%
Attendance and Participation	10%
Case Discussion and Summary	20%
Mid-Term Exam	30%
Final Group Paper/Presentation	30%/10%
Total	100%

Calculation of Course Grades

The final letter grade will be “generally” based on the following scale:

<u>LETTER GRADE</u>	<u>TOTAL SCORE</u>
A	100-94
A-	93-87
B+	86-80
B	79-70
B-	71-74
C+	63-55
C	54-46
C-	45-37
D+	36-28
D	27-

Course Website

A website for this course (LER 590EC) is set up at Illinois Compass 2g at <https://compass2g.illinois.edu/>. Required readings, PowerPoint slides, case memo questions, and useful resources will be posted there. Please check frequently for updates. When the level of class attendance declines, the instructor may reduce the amount of information contained in the PowerPoint slides posted on Compass in order to encourage attendance.

Academic Integrity

In order to maintain a vigorous and healthy learning environment in the classroom, it is critical that no member of the class engage in or tolerate academic fraud, such as cheating or plagiarism. We believe strongly in giving certain liberties to students, and in return we expect honest and honorable conduct, including compliance with the University of Illinois' Student Code (see <http://admin.illinois.edu/policy/code> for details).

Since our reading materials and discussion topics include examples from well-known companies, it is often the case that relevant information can be found in the sources other than designated course materials (for example, the Internet, magazines, newspaper, etc.). Whereas referring to external sources is fine and encouraged, it may be tempting to use or copy information from such sources in your course assignment *without proper acknowledgement of the sources*. Such action is considered **plagiarism** and strictly prohibited. Brief guidelines about what constitutes plagiarism and how to avoid it will be provided during the class, but it is ultimately the students' responsibility to educate themselves about the risk of plagiarism and avoid committing it. Carefully review the University policy governing academic integrity and plagiarism, including the Student Code Article 1, Part 4, §1-402 "Infractions of Academic Integrity" (http://admin.illinois.edu/policy/code/article1_part4_1-402.html). Not knowing the policy is not an excuse.

This policy applies to **all** written assignments of this course, including case memos and exam answers. Any incidence of plagiarism will be handled according to the official University policies and reported to the University administration.

Course Schedule

Week 1 (August 28): Introduction

Week 2 (September 4): Corporate Governance

- Margaret M. Blair. 1995. Ownership and Control. Washington, DC: Brookings Institution. Chapter 2, pp.17-76 (skip pp.33-44, sections “More on the role of debt and equity,” “The mix of debt and equity matters,” and “How real is the distinction between debt and equity.”) [Compass]
- Case: “Apple: Corporate Governance and Stock Buyback.” Haskayne School of Business, Case #W14736.

Week 3 (September 11): CEO Labor Market

- Rakesh Khurana. 2002. Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs. Princeton, NJ: Princeton University Press. Chapters 2 and 3, pp. 20-80.
- Case: Rakesh Khurana. 2002. Chapter 1 (“Everyone Knew He Was Brilliant: The Wooing of Jamie Dimon”), pp. 1-19.

Week 4 (September 18): A Primer on Executive Compensation

- Kevin J. Murphy. 1999. “2.3. The components of CEO pay,” “2.4. Who sets CEO pay?” from Handbook of Labor Economics, Vol. 3, edited by O. Ashenfelter and D. Card, Elsevier: New York, pp. 2497-2518. [Compass]
- James B. Stewart. 2017. Metaphor for G.E.’s Ills: A Corporate Jet with No Passengers. New York Times, November 2, 2017 [Compass]
- Case: “CEO Compensation at GE: A Decade with Jeff Immelt” Harvard Business School, Case #9-112-003.

Week 5 (September 25): Stock Options and Long-Term Incentive Pay

- Randall A. Heron, Erik Lie, & Tod Perry. 2007. On the use (and abuse) of stock option grants. Financial Analysts Journal, 63(3): 17-27. [Compass]
- Mark Maremont and Charles Forelle. 2006. Bosses’ pay: How stock options became part of the problem. Wall Street Journal, December 27, 2006. [Compass]
- Case: “Executive Compensation at Nabors Industries: Too Much, Too Little, or Just Right?” Stanford Graduate School of Business Case: CG-5.

Week 6 (October 2): The Dark Side of Stock Options

- Wm Gerard Sanders and Donald C. Hambrick. 2007. Swinging for the Fences: The Effects of CEO Stock Options on Company Risk Taking and Performance. *Academy of Management Journal* 50(5):1055-78. [**Compass**]
- Natasha Burns and Simi Kedia. 2006. The Impact of Performance-Based Compensation on Misreporting. *Journal of Financial Economics* 79(1):35-67. [**Compass**]
- Case: “Al Dunlap at Sunbeam.” Harvard Business School, Case #9-899-218.

Week 7 (October 9): Pay for Performance

- Michael C. Jensen and Kevin J. Murphy. 1990 [2010]. CEO incentives: It’s not how much you pay, but how. *Harvard Business Review*, May- June, pp.3-18 (Reprinted in 2010 in the *Journal of Applied Corporate Finance*, 22(1): 64-76). [**Compass**]
- Lucian Bebchuk and Jesse Fried. 2004. *Pay Without Performance: The Unfulfilled Promise of Executive Compensation*. Cambridge, MA: Harvard University Press. Chapter 1, pp.15-22. [**Compass**]
- Case: “General Dynamics: Compensation and Strategy (A)” Harvard Business School, Case #9-494-048.

Week 8 (October 16): Psychological and Political Factors

- Lucian Bebchuk and Jesse Fried. 2004. *Pay Without Performance: The Unfulfilled Promise of Executive Compensation*. Cambridge, MA: Harvard University Press. Chapter 2, pp.23-44; Chapters 5-6, pp.61-86. [**Compass**]
- Peter Whoriskey. 2011. Cozy relationships and ‘peer benchmarking’ send CEOs’ pay soaring. *Washington Post*, October 3, 2011. [**Compass**]
- Case: “AFL-CIO: Office of Investment and Home Depot.” Harvard Business School, Case #9-407-097.

Week 9 (October 23): Mid-Term Exam

Week 10 (October 30): Did Wall Street’s Bonus Culture Cause the Global Financial Crisis of 2008?

- Money, Power, and Wall Street, PBS Documentary available at <https://www.pbs.org/wgbh/frontline/film/money-power-wall-street/#video-4>.
- Case: “Banking on Change: Aligning Culture and Compensation at Morgan Stanley.” Harvard Business School, Case #9-917-402.

Week 11 (November 6): Comparative Analysis of Executive Compensation: Japan

- Sanford M. Jacoby. 2007. Principles and Agents: Calpers and Corporate Governance in Japan. *Corporate Governance* 15(1): 5-15. **[Compass]**
- Luyao Pan and Xianming Zhou. 2018. CEO Compensation in Japan: Why So Different from the United States? *Journal of Financial and Quantitative Analysis* 53(5): 2261-92. **[Compass]**
- Case: “The Rise and Fall of Carlos Ghosn” **[Compass]**

Week 12 (November 13): CEO Compensation in IT Companies

- Case analysis using Oracle and Tesla **[Compass]**
- **Group assignment: outline of the final report due by 2 pm**

Week 13 (November 20): Consultation Meetings for the Final Team Project

Week 14 (November 27): Thanksgiving Break, No Class

Week 15 (December 4): Student Presentations

Week 16 (December 11): Course Overview and Evaluation

- **Final group report due by 5 pm**