

LER 590EC Executive Compensation
University of Illinois at Urbana-Champaign

2021 Fall

Time: Tuesday, 8 AM – 10:50 AM, October 19-December 7 (2nd half of semester)
Location: LER 35/43
Instructor: Jiwook Jung, Associate 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. 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).

Weekly Quizzes

In each teaching session you will need to complete a short quiz (5 minutes) on your readings. The quiz includes five questions in the format of the true/false, multiple-choice or filling in the blanks. Each quiz will deal with the chapter(s), articles and cases that I have assigned for that class session. I may administer a quiz at the beginning, middle or end of class. There will be **NO** make-up quizzes. The summing of quiz performance will be done **after dropping the lowest quiz score**.

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 summarize their discussion, highlight main conclusions, and submit the summary via **Canvas**. 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.

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. The **group project report** is due on **December 9, Thursday by 5 pm**. More details about the report will be provided after the mid-term exam.

In addition to the final report, there will be **group presentations** in **Week 8** (December 7). The presentation will be done online through Zoom.

Course Materials

1. **Canvas**. 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., [Canvas]). You do not need to purchase any textbook for this course.

Evaluation

	%
Attendance and Participation	10%
Weekly Quiz	15%
Case Discussion and Summary	15%
Final Group Presentation	20%
Final Group Paper	40%
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+	97-100
A	94-96.5
A-	90-93.5
B+	87-89.5
B	84-86.5
B-	80-83.5
C+	77-79.5
C	74-76.5
C-	70-73.5
D+	67-69.5
D	Below 66.5

Course Website

A website for this course (LER 590EC) is set up at Illinois Compass 2g at <https://ccanvas.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 (October 19): Course Introduction and Executive Compensation and 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.")
[Canvas]
- Rakesh Khurana. 2002. Searching for a Corporate Savior: The Irrational Quest for

Charismatic CEOs. Princeton, NJ: Princeton University Press. Chapter 1 (“Everyone Knew He Was Brilliant: The Wooing of Jamie Dimon”), pp. 1-19. [Canvas]

Week 2 (October 26): A Primer on Executive Compensation

- Kevin J. Murphy. 1999. “2.3. The Components of CEO Pay” and “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. [Canvas]
- Peer Fiss. 2016. “A Short History of Golden Parachutes.” Harvard Business Review, October 3, 2016.
- James B. Stewart. 2017. Metaphor for G.E.’s Ills: A Corporate Jet with No Passengers. New York Times, November 2, 2017. [Canvas]
- Case: “CEO Compensation at GE: A Decade with Jeff Immelt,” Harvard Business School, Case #9-112-003.

Week 3 (November 2): 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. [Canvas]
- Mark Maremont and Charles Forelle. 2006. “Bosses’ pay: How stock options became part of the problem.” Wall Street Journal, December 27, 2006. [Canvas]
- 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. [Canvas]
- Case: “Executive Compensation at Nabors Industries: Too Much, Too Little, or Just Right?” Stanford Graduate School of Business Case: CG-5.

Week 4 (November 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). [Canvas]
- 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. [Canvas]
- Case: “General Dynamics: Compensation and Strategy (A)” Harvard Business School, Case #9-494-048.

Week 5 (November 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. [Canvas]

- Peter Whoriskey. 2011. “Cozy Relationships and ‘Peer Benchmarking’ Send CEOs’ Pay Soaring.” Washington Post, October 3, 2011. [Canvas]
- Case: “AFL-CIO: Office of Investment and Home Depot.” Harvard Business School, Case #9-407-097.

Week 6 (November 23): Thanksgiving Break, No Class

Week 7 (November 30): Comparative Analysis of Executive Compensation (Japan) and Discussion about Group Presentation and Final Paper

- Sanford M. Jacoby. 2007. “Principles and Agents: CalPERS and Corporate Governance in Japan.” Corporate Governance, 15(1): 5-15. [Canvas]
- 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. [Canvas]
- Examples of final papers from past years [Canvas]
- Case: “The Rise and Fall of Carlos Ghosn” [Canvas]

Week 8 (December 7): Student Presentations and Course Evaluation

- **Final group report due on December 9, Thursday, by 5 pm**