Statistics Show Need for Executive Compensation Overhaul

by Mark Van Clieaf

Increasing Investor Confidence

Although investors appear to be more confident in general about equity markets, investor relations professionals, CEO's and boards still face issues of explaining executive compensation. The following statistics show why companies need to be rethinking their approaches to executive accountability, compensation and pay for performance.

- Of the 500 companies making up the S&P 500 in 1957, only 74 remained on the list through 1997. Only 12 outperformed the S&P 500 index in Total Shareholder Return (TSR) over the same time period. Based on this track record, the longer-term sustainability and viability of many corporations is in question.
- 95% of the S&P 500 have NOT disclosed any metrics related to non-financial measures such as corporate and social responsibility.
- 89% of the CEOs and their executive teams of the S&P 500, based on a review of the compensation policies in the proxy statements are NOT held accountable nor paid for business performance (not stock market performance) beyond two years.
- Over a five-year period, 35% to 40% of the largest public companies in North American (1,800 companies) have failed, after tax, to provide a return on invested capital greater than their cost of capital.

Current Pay Practices in Question

One of the most critical functions a board performs is defining the leadership accountability of the CEO role. Current practices of using an industry model, medians and averages for peer group comparison of compensation where CEO roles may be operating at significantly different levels of work, results in overpayment for the less complex CEO roles and underpayment for the more complex CEO roles. Our research has identified five levels of CEO work complexity and accountability.

Pay Doesn't Match Work

In our accountability audits, we frequently find there are too many layers of management compressed in the same level of work. There is significant title creep, and executive managers are being compensated at a strategic level when they are really doing operational work, and thus they are overpaid.

These findings put management on the defensive until they understand the implications for effective organization design that creates sustainable shareholder value.

New Pay for Performance Benchmarks

Compensation committees benchmark compensation by asking "how much?" rather than "for what?" Too many boards and compensation consultants are comparing apples and oranges when benchmarking executive compensation.

Thus, the current practices of compensation benchmarking for external market comparison as well as assigning compensation based on corporate position rather than work accomplished cannot be defended against criticism by shareholders or employees. The complexity of the CEO role at Johnson and Johnson is exponentially more complex than it is at Eli Lilly. The same is true when comparing the CEO roles at Procter & Gamble and Kimberly-Clark. Yet these companies have chosen what on the surface appear to be peer group CEO roles to benchmark against for compensation comparison.

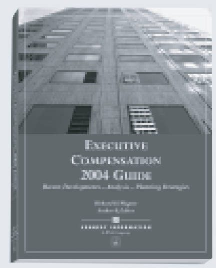
The problem is further exemplified when comparing the CEO role and compensation of the NYSE to the CEO roles and compensation at JP Morgan Chase or Merrill Lynch.

Accountability at the appropriate level of work is one of the most critical factors that has led us to the short-term views and current crisis in business leadership today. Our system is fundamentally flawed ethically, legally and economically.

Because the work of the CEO is not adequately defined, too many CEOs are being overpaid for their current level of operational leadership and the value they are creating (or destroying) for their shareholders.

For more information, go to www.mvcinternational.com; or email Mark Van Clieaf at Mark@MVCInternational.com.

New Guidebook Explores Hot Executive Comp Issues



A new book, Executive Compensation 2004 Guide, explores all the key issues relating to executive compensation, including the governance issues that impacted the New York Stock Exchange and the Grasso controversy.

The book has just been published by Kennedy Information, publisher of Investor Relations Newsletter, IR Guide and the Investor Relations Annual.

Executive Compensation 2004 Guide covers many topics that could impact IR executives in their dealing with the investment community, governance rating services, board of directors, and CEO/CFO issues.

Among the topics: executive compensation crisis summary; role of shareholders in the stock option saga; individual investor opposition; accounting for stock options and other equity-based compensation; related FASB and SEC standards; executive compensation disclosure practices, and more.

The book was written and edited by Richard Wagner, frequently quoted in The Wall Street Journal and other financial media.