

# MVC Associates International

Consultants In Organization Design, Leadership & Stakeholder Value

Sept 25, 2003

The Honorable William H. Donaldson  
Chairman  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W, Washington, D.C. 20549  
by Fax

**Re: Corporate Governance – Fixing CEO Selection and CEO Compensation in America**

Dear Chairman Donaldson,

I am writing you as a follow up to our formal comment filed with the SEC Sept. 4, 2003, regarding proposed amendments to NYSE rules for listed companies. In this comment we noted concerns about proposed rules as they impact Boards of Directors in effectively carrying out their governance duties related to CEO compensation and CEO Selection / Succession Planning. ( this filing is on our website in the research and publications section )

The most important recommendation we made, based on our research and expertise<sup>i</sup>, addressed a significant gap in the NYSE listing rules related to the board's role and required process to carry out its duties related to CEO Compensation and CEO Selection. These are processes and standards that are required to restore investor confidence in corporate America, including the capital markets.

Far too many boards and advisors in executive compensation and executive search lack a clear and legally defensible framework for defining CEO work and accountability, performance metrics and the comparison of CEO roles, skills and compensation. As outlined in our Sept. 4 document, without a rigorous executive job analysis Boards have no legally defensible basis from which to assess candidates when making CEO hiring decisions, or when comparing CEO roles for making executive compensation decisions.

This is nowhere more evident than in Mr. McCall's Sept. 9 response to you about CEO compensation at the NYSE. On Page 8 of his response he details the accomplishments of the NYSE over 2000 and 2001, as a basis for linking these to their Longer Term Incentive Plan and executive compensation payout. Yet the majority of the accomplishments listed were operational and productivity improvements over 1 to 2 years.

If the top three levels of the organization have the same 1-2 year metrics and the same short-term time horizon for planning and decision making, then what is the real value-add of the CEO that is different from his or her direct reports or direct reports once-removed? Compensation Policy disclosures that focus on year over year operational efficiency metrics ( VP / Director level work accountability) as the basis for executive compensation, call into question whether the CEO is being held accountable for the right work and or/ being overpaid for the work he/she is doing.

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In the case of the NYSE we would have to ask the same question about their top 3 levels of the enterprise.

As we mentioned in our Sept 4. comment, the Level of Complexity of the CEO role at Johnson and Johnson versus at Eli Lilly, is exponentially more complex, as it is at Procter and Gamble versus Kimberly Clark. Yet Eli Lilly and Kimberly Clark have chosen these peer group companies and CEO roles to benchmark against that are far more complex than their own CEO roles. J&J and P&G due to the higher complexity of their CEO roles should have a CEO compensation band exponentially higher than Eli Lilly and Kimberly Clark.<sup>ii</sup> However, faulty benchmarking is contributing to excessive executive compensation for the less complex CEO roles. This example represents much of current practice. This problem is further exemplified in comparing the CEO role of the NYSE to the CEO roles at JP Morgan Chase or Merrill Lynch. Not all CEO roles are at the same level of work complexity (not-for-profit or other), and thus many of the comparisons are not defensible.

Research and field implementation has shown that the size of the business, budget and number of employees does not determine the level of complexity of CEO / General Management work. The fact that the largest public pension fund in America is developing a model for evaluating CEO Pay for Performance effectiveness based on similar inappropriate benchmarking, just further highlights the problem in understanding levels of executive work and appropriate compensation across corporate America.

So what is the standard we need to improve CEO selection and CEO compensation practices?

Boards must analyze the CEO role and answer the following questions to determine the true level of accountability, work complexity and value-add of the position. Only then can effective and defensible CEO selection and pay decisions be made by Boards of Directors.

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Questions include:

- 1) What is the level of innovation which the CEO role will be held accountable for;
  - a) • Process innovation and productivity improvement
  - b) • New Product / New Service innovation
  - c) • New Business Model innovation
  
- 2) How far into the future must this CEO role think and plan for;
  - a) • 1 to 2 years
  - b) • 2 to 5 years
  - c) • 5 to 10 years
  
- 3) What customers / stakeholders does the CEO need to spend time with most to add value;
  - a) • Today's current customers related to today's products / services
  - b) • New and current customers for New Products & Services
  - c) • All key Stakeholders that impact the external environment on a country level  
in which the business operates and could impact creating a new business model

A CEO title can apply to any of the 3 levels of work complexity we have identified (a-c) above. However, answers to the above and similar questions define the true level of work complexity which a CEO role could be held accountable for by the Board.

Too many CEOs today are held accountable for the wrong level of work (more operational in nature), are measured against the wrong metrics, and are overpaid for the work they are doing, using the above as a basis for analysis. With 55 % of the S&P 500 only measuring and disclosing CEO performance and compensation metrics for one year, it calls into question what is the value-add of many CEO roles for which compensation seems excessive.

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We would hope that in creating a new model for corporate governance for America, the Board of the NYSE would:

- 1) Give serious consideration to incorporating many of the recommendations outlined in our Sept. 4 comment about required NYSE listing mandate rules for the compensation and human resource committee;
- 2) Undertake a rigorous executive job analysis for the go forward CEO role of the NYSE, based on its charter and strategy, by defining:
  - a) which level of CEO work will the role be held accountable for, as outlined above
  - b) what will be the key accountabilities and decision authorities of the CEO role and how will these be different from direct report positions
  - c) what will be the key metrics used to evaluate success of the CEO role, over what time horizon, and how are these different than direct report positions
  - d) Based on the strategy for NYSE, Level of Work of the CEO role, outline what key activity areas does the board expect the CEO to spend his/her time ( 20 % buckets )
  - e) Only after the above has been defined and agreed to, the board will then define the most critical skills and experience for the new CEO of the NYSE;
- 3) Share the final draft position guide / skills profile for the CEO role resulting from the above executive job analysis with key stakeholders for comment, prior to starting any search for CEO candidates. You can't assess executive talent if you have not effectively defined the role.

I appreciate the opportunity to share with you our recommendations on improving CEO selection and CEO compensation practices as part of restoring investor confidence.

Yours very truly

Mark Van Cleef  
Managing Director

CC:

Hon. Paul Atkins, Commissioner, SEC  
Hon. Roel Campos, Commissioner, SEC  
Hon. Cynthia Glassman, Commissioner, SEC  
Hon. Harvey Goldschmid, Commissioner, SEC  
Giovanni Prezioso, General Counsel, SEC  
Laurence Fink, Chair, CEO Search Committee NYSE

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Leon Panneta, Co-Chair, Corporate Accountability & Listing Committee, NYSE  
Gerry Levin, Co-Chair, Corporate Accountability & Listing Committee, NYSE  
Richard Bernhard, EVP & General Counsel, NYSE  
Eliot Spitzer, Attorney General, New York State  
Alan Hevesi, New York State Comptroller  
Phil Angelides, California State Treasurer  
Denise Nappier, Connecticut state Treasurer  
Jonathan Miller, Kentucky State Treasurer  
Senator John McCain, Chairman, US Senate Committee on Commerce & Science  
Senator Ernest Hollings, Ranking Member, US Senate Committee on Commerce & Science  
Senator Richard Shelby, Chairman US Senate Committee on Banking & Housing  
Senator Paul Sarbanes, Chairman US Senate Committee on Banking & Housing  
Sean Harrigan, President CALPERS  
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Richard Trumka, Secretary Treasurer, AFL-CIO  
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Dr. Carolyn Kay Brancato, Director Corporate Governance Center, The Conference Board  
John Castellani, President, The Business Roundtable

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My background includes:

- 1) Member of the NACD Blue Ribbon Commission on CEO Succession Planning
- 2) Special guest lecturer – Ivey Business School – Corporate Governance and Pay for Performance
- 3) Founding Member, Executive Selection Research Advisory Board, Center for Creative Leadership
- 4) Past Special Guest Editor and member Editorial Advisory Board, Human Resource Planning
- 5) Led North American Best Practices Benchmarking Study in Performance Management
- 6) Formerly in executive search and business strategy consulting with Price Waterhouse
- 7) 10 + years of research on executive work design and leadership assessment to create shareholder value
- 8) Numerous published articles and presentations on organization design, leadership and shareholder value

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The complexity factors would include but not limited to the variety of different business models operating within the enterprise, the variety of resource and capital management, and the variety of stakeholder groups to be managed given the number of different businesses and countries in which the enterprise operates. Not merely the size of business and number of employees.

MVC Associates International, during the 1990's completed 350 interviews at the Global CEO, Group President, President and VP/GM levels to uncover how these complexity jumps in General Manager roles should be designed differently to add value to the enterprise, and what are the differential skills at each level that drives shareholder value.

Unilever, during the 1990's undertook over 1000 interviews in over 40 countries in furthering the implementation of Work Level concepts. The following is from a related monograph about the project.

*“ How could a national company with a turnover of \$1 billion manage with the same number of management levels as a comparatively small company with say a \$200 million turnover? How could their managing Directors both be in Worklevel 5? At first sight the analysis, which led to this conclusion, was greeted with disbelief by the larger company. So the interviewing and analysis was done again and again. The result remained the same. **Complexity not sheer size was the driving force of the new approach”***