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Readings in Global Organization Design  
2005 Conference Proceedings

5 Levels of CEO Work & 5 Levels of Board  
Governance:  
Solving the Corporate Governance Problem

by Mark Van Clieaf & Larry Tapp

Article #05-08-09-S1-2

# **5 Levels of CEO Work & 5 Levels of Board Governance :**

## **Solving The Corporate Governance Problem**

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Global Organization Design Conference  
Toronto, Canada  
Aug 9, 2005**

# Today's Journey of Discovery

- Breakdown in the Accountability Hierarchy of Capitalism & Effective Corporate Governance
- CEO Decision Authority Problem
- The Pay for Level of Work / Performance Problem
- Future Value (FV) + Current Value (CV) = Enterprise Market Value (MV) the Finance of Levels of Work
- Universal Board and Universal CEO is a Myth
- Levels of Work as Defensible Process for CEO Accountability Design & Pay-for-Performance
- Boardroom Cases Studies / Application
  - CEO Pay Demand vs. Level of CEO Work vs. Level of Executive Capability
  - Challenging the Compensation Consultants Reports -
    - CEO roles & Executive Pay at Different Levels of Work - NOT Apples & Apples

# Liability Led Investment Model

## Shareholder Activism is NOT going away!

<b>Country</b>	<b>Country Market Cap</b> (1998 - US \$ Billions)	<b>Pension Invest %</b>
<b>USA</b>	<b>\$ 11,309</b>	<b>34 %</b>
<b>Japan</b>	<b>\$ 2,217</b>	<b>21 %</b>
<b>UK</b>	<b>\$ 1,996</b>	<b>42 %</b>
<b>France</b>	<b>\$ 674</b>	<b>14 %</b>
<b>Canada</b>	<b>\$ 567</b>	<b>24 %</b>
<b>Netherlands</b>	<b>\$ 468</b>	<b>27 %</b>

10 to 20 yr + Pension Liabilities and under funding is driving an increased level of institutional investor activism to improve investment performance and asset returns

Source : Bob Monks, "The New Global Investors" - Intersec / Deutsche Bank

# **What is Common About Accountabilities and Decision Authorities of the CEO's of these Companies ?**

- Enron, Worldcom, Tyco, HealthSouth,
- Livent, Loewen Group, Cinar, Bre-X, Nortel
- Marconi, Vivendi, Ahold, Parmalat

# To Whom is the CEO Really Accountable ?

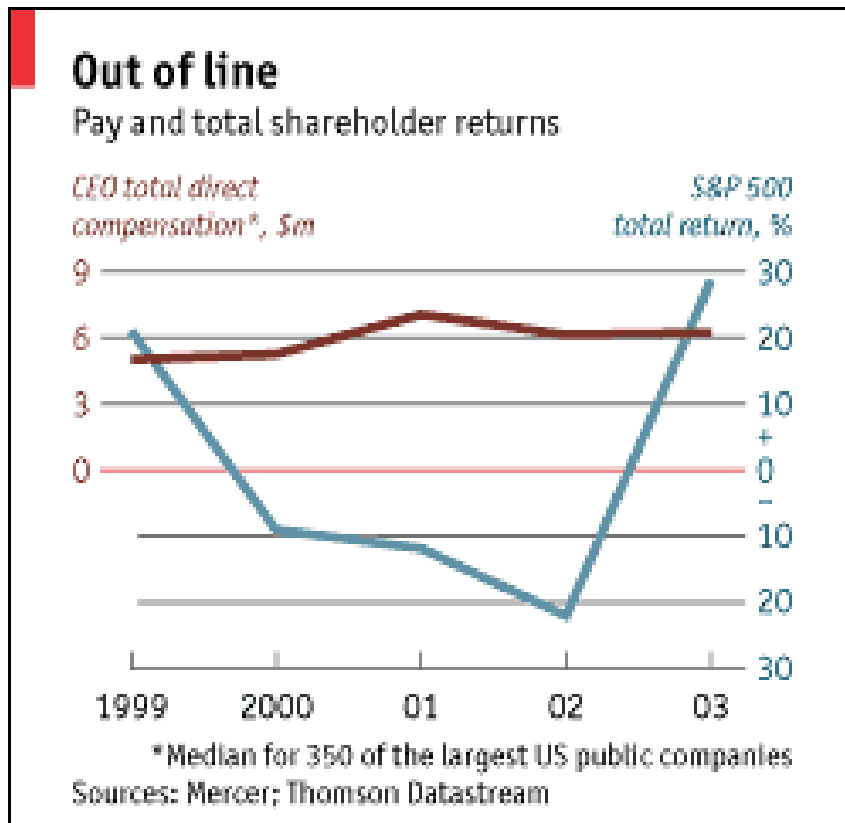
- **Inappropriate CEO Decision Authorities!**
  - Choose board members - not independent
  - Choose external auditors
  - Choose executive compensation consultants
  - Define own role, accountabilities and decision authorities
  - Influence pension trustees to be non-activist on corporate governance issues
- In many public corporations CEO's were / are accountable only to themselves!
- What happened to the Shareholder?

# 50 % of CEO's at too Low a Level of Work & Accountability

- > 50 % top 1800 public companies in North America have failed to create a ROIC > Cost of Capital over 5 years
  - This means business model / strategy is NOT VIABLE nor SUSTAINABLE
- Based on Proxy Statement Disclosures:
  - 85 % not held accountable for business performance ( not stock market performance ) beyond 3 years
  - 90 % have NO non-financial measures of success and contribution to broader society
- Too many Pay for Performance models using medians of 1-2 year financial performance from Current Operations and are mismatched to compensation that should be focused on Strategic & Innovation Work
- Too many CEO's overpaid for current Level of Work

# NO Link between Pay & Performance !

**Executive Compensation Continues to Climb  
as Shareholder Returns Fall !**



**Median CEO Pay -  
S&P 500**

**1993 = \$ 1.8 million**

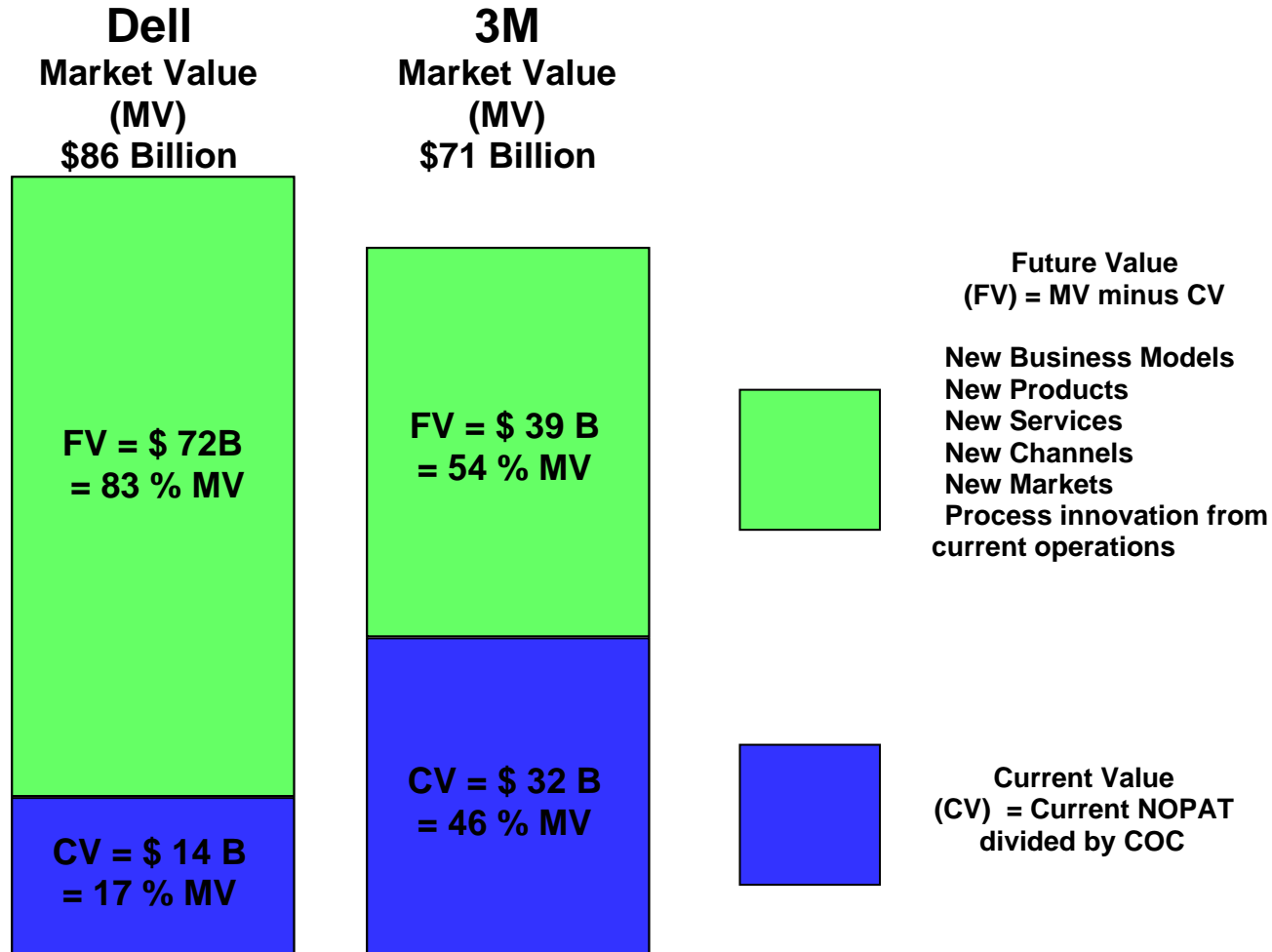
**1996 = \$ 3.1 million**

**1999 = \$ 5.6 million**

**2001 = \$ 7.5 million**



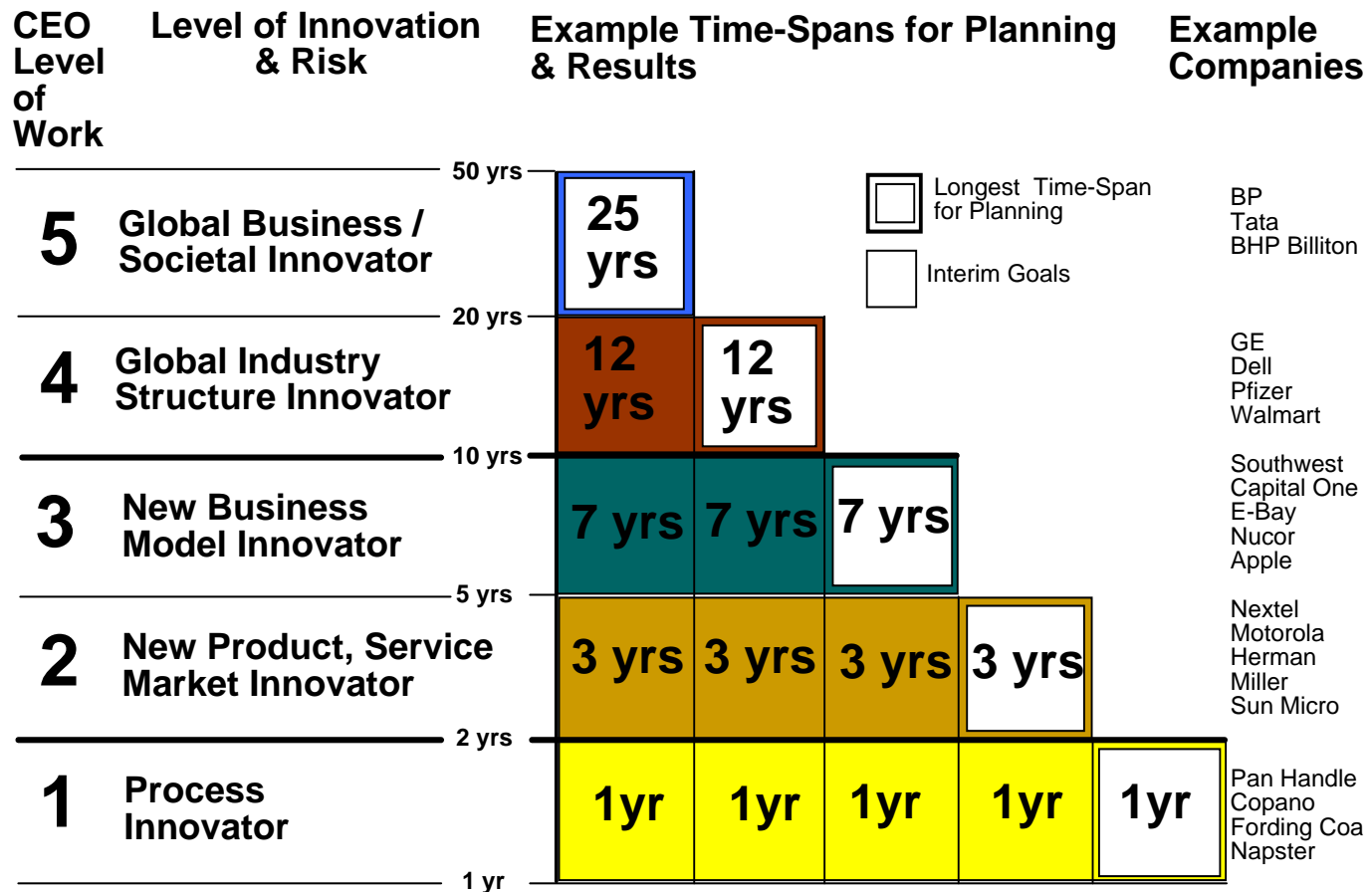
# Shareholder Value & The Finance of Levels of Work



# SIX Factors Determine Enterprise Wide Levels of Work

	Innovation Level	Planning Horizon	Resource Management	Results	Leadership	Customer
<b>Growth Horizon 1</b> <i>Defend &amp; Extend Core Business</i>	Service					
	Quality / Continuous Improvement					
<b>Growth Horizon 2</b> <i>Build New Businesses For Medium Term Profitability</i>	Process					
	Business Development					
<b>Growth Horizon 3</b> <i>Strategic Investments To Secure Long Term Future and Enterprise Sustainability</i>	New Business Model					
	Stewardship / Citizenship					
	Global Enterprise Purpose					

# All CEO Roles Are Not Create Equal! (5 Levels of CEO Work)



# Board / CEO Capability Matrix

Level of Board Capability  
(Relative to Level of Work)

	<b>Board minus</b> Operating below required Level of Capability	<b>Board plus</b> Operating at or above required Level of Capability
<b>CEO plus</b> Operating at or above required Level of Capability	<b>CEO Driven Shareholder Risk</b>	<b>Shareholder Value Creation</b>
<b>CEO minus</b> Operating below required Level of Capability	<b>Shareholder Value Destruction</b>	<b>Board Driven Shareholder Risk</b>

Level of CEO  
Capability  
(Relative to  
Level of Work)

# A Defensible Process for Executive Accountability Design & Compensation Setting

- What is Management Accountable For ?
  - 5 Levels of CEO Accountability - (MVC Research + Jaques/Stamp/Billis/Hoebeke/Beer)
  - Board must agree and can't establish Pay for Performance or Compensation Peer Group Comparison without proper setting of Levels of Work, Metrics & Targets
  - Expert Advice in accountability design required to meet legal test of an "Informed Board"  
- NOT the same as compensation expertise
- How Much Is Fair, Equitable & Defensible Executive Compensation ?
  - Linked to 3 to 5 year Business Targets & Relative Equity Market Performance
  - Defensible Benchmarking Market Comparisons and Peer Groups - Apples to Apples
  - Internal Executive Pay Equity Calibration ( Felt Fair Pay )
  - Target Pay Position
- How and When Will it Be Delivered ?
  - Pay Mix and How Designed ( the expertise of compensation consultants)

# CEO / Executive Job Matching & Compensation Calibration

	<b>J&amp;J</b>	<b>Eli Lilly</b>
<b>Business Complexity</b>		
<u>Countries</u>	57	20 +
<u>Operating Companies</u>	200 decentralized full P&L centers	1 large global full P&L centlzd manf / R&D
<u>Industry Sectors</u>		
Pharmaceutical	\$ 19.5B	\$ 12.5 B
Consumer	\$ 7.4 B	
Medical Device & Diagnostics	\$14.9 B	
<b>Innovation Complexity &amp; Investment for Growth</b>	<ul style="list-style-type: none"> <li>• R&amp;D \$ 4.7 B</li> <li>• full time licensing teams per sector</li> <li>• 60 mid and large acquisitions</li> <li>• JJDC - \$ 400 million venture cap</li> </ul>	<ul style="list-style-type: none"> <li>• R&amp;D \$ 2.3 B</li> </ul>
<b>Accountability &amp; Compensation</b>		
<u>Proxy Disclosure Performance Measures</u>	5 yr growth in: <ul style="list-style-type: none"> <li>• Sales / EPS / Cashflow / # new products / TSR</li> </ul>	1 yr + growth in: <ul style="list-style-type: none"> <li>• Sales / EPS / Market Value / EVA / TSR</li> </ul>
<u>Job Matched CEO Level of Work</u>	<b>CEO Level 5 (32X)</b>	<b>CEO Level 3 (6X)</b>
<u>2003 Cash Comp (B&amp;B)</u>	<b>\$ 3,216,154</b>	<b>\$ 2,626,455</b>
<u>Job Calibrated Cash Comp</u>	<b>\$ 1,258,305</b>	

Calibrated compensation for the Level of Work / Accountability is 100 % less \$ 1.2M vs \$3.2m CEO compensation- a true comparable compensation number (material change)

Board CANNOT except compensation benchmarking report at Face Value

**Now Let's Apply Levels of Work /  
Levels of Governance to  
Real World Boardroom Case Studies**

# An Informed & Independent Board

## (Level of Work, Level of Exec Capability & Exec Pay)

- CEO demands 3 X Total Compensation increase based on wrong external benchmarks - comparing more complex levels of CEO work / compensation
- Board looks at the CEO role & required Level of Work / Accountability to sustain the business & targets minimum Level 3 CEO accountable role is required:
  - Planning 5 to 10 years out given changing technologies / customers
  - Need to Create New Business Model
  - Need to return company to Positive Return on Invested Capital (5 yrs negative)
- Board assesses CEO current capability as - “Great Operator” - CEO Level 1 capable!

Board does NOT agree to compensation demands, given GAP of required Level of Work (CEO 3) versus current Level of Leadership Capability (CEO 1) & starts external search



# Strategic Duty of Directors

## Ivey Case Study - Alignment Summary

Organization Structure, Strategy & Risk		CEO Talent	Executive Compensation & Pay for Performance	
Level of Work	Level of Innovation	Level of Executive Capability	Level of Pay	Level of Excessive Pay / Waste
5	Global Business / Societal Innovator	Universal Values & Purpose	32X	<p>Wasteful Compensation</p>
4	Global Industry Structure Innovator	Meta-Level Transformation	16X	
3	New Business Model Innovator	Extrapolation & Transformation	8X	
2	New Product Service, Market Innovator	Integration & Synthesis	4X	
1	Process Innovator	Analysis & Deduction	2X	
			X	1 Equitable Compensation

# **An Informed & Independent Board**

## **(Level of Work and Compensation Benchmarking)**

- Board reviews executive compensation report from leading global compensation consulting firm
- Board challenges peer group selection and medians / percentiles in report given majority of 11 peer group companies selected were significantly more complex enterprises - based of Levels of Work / Accountability
- Board moves targeted Total Compensation from above median to 25th percentile - 35 % DOWNWARD adjustment / calibration
- CEO watches and agrees with the rationale!
- Compensation consultant watches from the sidelines as report lacks a defensible job matching / compensation calibration methodology and is challenged by the Board!

# Summary

- There are structural /systemic problems in current model of Capitalism that need to be fixed ( accountabilities - time-horizons - incentives across all the players in the game - pension funds, money managers, boards, executive management)
- 5 Levels of CEO Work / 5 Levels of Corporate Governance
  - Has a direct link between Shareholder / Stakeholder Value &
    - Organization Design
    - Levels of Executive Capability
    - Levels of Equitable Pay
  - Recognizing ALL CEO's and Boards are NOT created equal provides the Principles, Process and Toolkit for:
    - Director Nomination to Boards / Board Capability
    - Organization Design, CEO Accountability, Level of Innovation & Risk
    - Organization Design to Achieve Future Value (FV) already in Market Value & Stock Price
    - CEO Selection / Succession Planning to the LOW
    - Alignment of Board / CEO Capability to Strategic Challenge / LOW
    - CEO / Named Executive Officer Pay for LOW / Performance that aligns with Shareholder / Stakeholder Value

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The Global Organization Design Society is a not-for-profit corporation registered in Ontario, Canada to promote the following objective:

The establishment and operation of a world-wide society of academics, business users and consultants interested in science-based management to improve organizational effectiveness for the purposes of:

Promoting among existing users increased awareness, understanding and skilled knowledge in applying concepts of Levels of Work Complexity, Levels of Human Capability, Accountability, and other concepts included in Requisite Organization and/or Stratified Systems Theory.

Promoting among potential users of the methods, appreciation of the variety of uses and benefits of science-based management, and access to resources.



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