



Stern Stewart & Co. Research

The Americas

Compensation Strategy for the New Economy Age

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- Talent of all levels is flooding to the “New Economy” making it difficult for “Old Economy” companies to lead this important strategic transition.
- Performance measurement and reward schemes have failed to keep pace with change – we found extremely low correlations in both *level* and *sensitivity* of pay with performance, for *both* Old and New Economy companies – *despite* a preponderance of pay being “at risk”.
- The failure of incentive compensation makes equity holdings essential, but ownership has four important limitations.
- Option mechanics – grant guidelines and exercise price – are a critical but often overlooked degree of freedom in crafting more effective equity schemes.
- We propose four features to an effective owner-employee contract to share wealth creation as an essential guide to good governance.

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COMPENSATION STRATEGY FOR THE NEW ECONOMY AGE

INTRODUCTION

Talent from all levels is flooding to the New Economy

... but performance measurement and reward schemes have failed to keep up ...

Managing for value has become the mantra of today’s executive, not only in the U.S., but also increasingly in other parts of the world, such as Germany and Japan. But performance measurement and reward schemes have failed to keep up with the pace of change – traditional income statement-centric profit measures date from the 15th century and the status quo in compensation consulting circles has not changed since the days of the Edsel. Meanwhile, talent of all levels is flooding to the New Economy, leaving it more difficult for the “Old Economy” companies to make this important strategic transition.

MEASUREMENT & MOTIVATION

What gets measured gets managed – and that is not always shareowner value. A review of business’ favorite financial performance measures, and their pitfalls, shows that executives should be very careful. Warren Buffet highlights in a recent Berkshire annual report:

“When managers are making decisions it’s vital that they act in ways that increase per-share intrinsic value and avoid moves that decrease it. This principle may seem obvious but we constantly see it violated.”

Traditional profit measures drive over-investment, & over-production

1. **“Buy Earnings”**. Profit and profit margin measures often drive over-investment and vertical integration because they overlook capital and its cost. Increasingly, different businesses and business models consume varying levels of capital at varying costs. Managers are often drawn to higher margin businesses that, on the surface, may seem more attractive.

For example, profits are often improved with newer production technology – but they must be, to compensate for the higher levels of investment. Because traditional financial measures ignore the returns that shareholders expect, any corporate project with just a positive return, not necessarily an adequate return - just above zero, can improve a manager’s margins, unit cost, profit and productivity measures ... but destroy value.

% return-based measures starve high return businesses and feed low return businesses

2. **“Feed Dogs/Starve Stars”**. Many managers have a strong affinity for percentage returns because of their intuitive appeal. Unfortunately, a focus on margins and rates of return starves the stars and feeds the dogs.

A dog, low-return business might be motivated to pursue return expanding growth that, if below the cost of capital, would destroy value. A star, high-return business might reject return-diluting growth that although above its cost of capital, and thus additive to value and economic value added, will decrease returns.

	“Feed the Dogs”			“Starve the Stars”		
	“A”	“B”	Sum	“A”	“B”	Sum
Sales	\$250	\$133	\$383	\$1250	\$1000	\$2250
Margin	20%	30%	23%	20%	10%	16%
Income	\$50	\$40	\$90	\$250	\$100	\$350
Capital	\$1,000	\$500	\$1,500	\$1,000	\$500	\$1,500
Return	5%	8%	6%	25%	20%	23%
Capital cost at 10%	\$100	\$50	\$150	\$100	\$50	\$150
EVA	(\$50)	(\$10)	(\$60)	\$150	\$50	\$200

Figure 1: Traditional Financial Measures Drive the Wrong Behaviour



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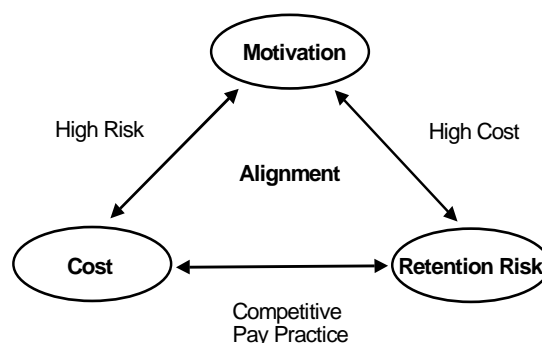
THE DOMINANT COMPENSATION PHILOSOPHY

Too much focus on level of pay, with too little on how to drive pay ...

Proxies report the dominant compensation philosophy of our day, speaking to “competitive levels of compensation”, “performance-related pay” and “significant levels of pay at risk”. The primary focus of compensation committees seems to be determining an optimal level of competitive pay - reflecting widespread belief that their most difficult challenge is to find an optimal balance between competitive pay and total cost. The media and pointed commentary of compensation critics play to this emphasis on levels of pay, reflecting the public’s general fascination. Disproportionate time is spent on competitiveness with little mention of what does, or what ought to, drive pay.¹

Proxies all claim the same objectives – but how do we really align interests - and how do we create sufficient leverage?

Agency issues – behavioural issues that stem from the formal separation of management and ownership in the professionally managed company – are often a determinant in both the target capital structure and the distribution policy decision. Yet, in the context of executive compensation and incentive compensation, we rarely find indication of the challenges associated with aligning the interests of professional managers with those of owners. Nor do proxies mention any practical difficulties associated with creating a significant degree of sensitivity in pay to performance.



More than anything, it is size that drives pay

Company size is really what determines executive pay today.² Yet executive and incentive compensation designs must carefully balance three competing objectives: align employee interests with value creation, limit retention risk – the risk of losing good people during the inevitable periods of poor or volatile performance, and to achieve this all at a reasonable total economic cost. How is this balance achieved in practice?

BUT IS IT WORKING?

In a statistical regression analysis of thousands of executives, we found very little correlation between pay and performance. The *level* of pay analysis is a cross-sectional view of four years of CEO TDC and TSR data, with TSR explaining only 1% of the variation in levels of “Old Economy” company CEO pay and 2% of the variation of CEO pay for the “New Economy” set.

Both CEO level of pay and sensitivity of pay are only mildly correlated with shareholder returns – for both Old Economy & New Economy companies

More importantly, looking at pay sensitivity, only 16% of the variation in *changes* in levels of pay are explained by three-year TSR’s for the Old Economy company CEOs, and 24% for the New Economy company CEOs. These results are surprisingly poor. Despite a preponderance of pay “at risk”, today’s competitive pay practices have neutralized the alignment and motivational aspects of incentive compensation – the trend toward equity holdings is clearly needed.³

To better understand the current context of pay philosophy and practices, we mapped the level and mix of total direct compensation (TDC) for Old Economy and New Economy CEOs (Figures 2

¹ Notwithstanding, Michael Jensen and Kevin Murphy’s, “Performance Pay and Top-management Incentives,” *Journal of Political Economy* (1990); Brian Hall’s, “A Better Way to Pay CEOs?” *Executive Compensation and Shareholder Value* (1999); and Stephen O’Byrne’s, “Total Compensation Strategy,” *Journal of Applied Corporate Finance* (1995).

² In a cross-sectional regression on Execucomp’s database with a universe of 1200 non-financial institution CEO’s we found 70% of the variation in the natural log of base salaries, and 50% of the variation in the natural log of total direct compensation, can be explained by variation in the natural log of revenue. Other measures of scope (assets, market cap) yield similar results. Interestingly, for New Economy companies, market capitalization provides much better results.

³ The impact of stock *holdings* and *post-grant* stock option appreciation does not enter the analysis because only the *grant* is the *compensation* event. We value stock options at the “compensation event” - the time of the grant, with changes in option values post-grant accorded to “holdings” rather than “compensation”.



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The pay/performance correlation is poor despite most compensation being “pay at risk”

and 3), after scaling all data to a representative company size of \$2 billion market capitalization.⁴

Despite the discouraging results of our regression analysis we did find that most CEO pay seems to be pay at risk – even more so for the New Economy CEOs. Base salary constitutes only about 30% of Old Economy CEO pay at the 25th percentile, and less than 20% of pay at the 75th percentile. Overall, more than 70%-80% of total pay is typically “pay at risk.” For New Economy companies the proportion is even higher – overwhelmingly in equity. Yet, it’s not working.

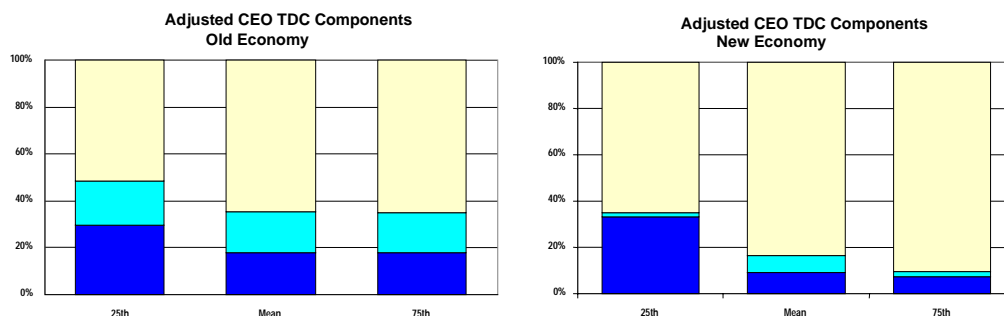


Figure 2: Total Direct Compensation - Mix of Pay

As expected, we found New Economy-type companies paying CEOs a higher (33%) TDC but almost exclusively in the form of stock options and other equity forms. Base salaries were actually only 33% of the Old Economy-type companies, and cash bonuses were equally low.

Average New Economy CEOs make 33% more than Old Economy CEOs, despite one third as much cash compensation

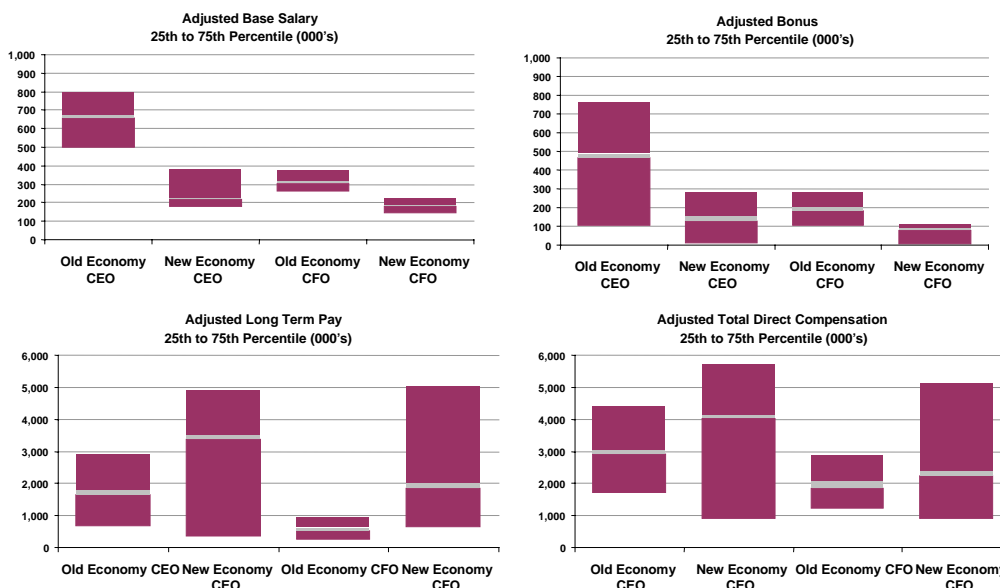


Figure 3: Total Direct Compensation - Components & Levels of Pay

Current practices in variable pay – both cash and equity – do not support good governance

In practice, variable pay is often more an ex post form of participation, than an ex ante performance motivator. Yet, the successful application of incentives, in a prospective, behaviour modification and reinforcement role, is essential to good governance. It should not be considered “mercenary” for us to expect that executives and employees can more completely embrace the difficult job of maximizing enterprise value when they can share in the fruits of their own efforts. A robust compensation system must truly align the interests of employees with owners.

⁴ The components of TDC are base salary, cash bonus, and the value of long term incentives. Each component is independently arrayed. We scaled the data for company size and eliminated the top and bottom quartiles (also from the mean). We revalued all grants using Black-Scholes, based on our own measurement of the inputs, due to issues with the public reporting.



Cases in Contracting

An automaker with operations in the United Kingdom supplying Continental Europe faced an eroding competitive position, in part driven by the Sterling/D-Mark exchange rate. The company "hedged" its British labour costs with a bonus plan that paid as a function of the Sterling/D-Mark exchange rate. While this may have taken the squeeze off thin margins by better matching local labour costs with revenue from the continent, what is the desired behaviour ostensibly promoted by this "incentive"?

A U.S. manufacturer acquiring East European production capacity faced reasonable growth prospects if productivity could be significantly improved to position the company more competitively with the West. Yet, modernization and cash bonuses failed to promote the dramatic efficiency gains expected and required for survival. Executives then realized that basic job security was a greater concern than compensation per se and successfully re-structured incentives to be tied to employment levels in a real-world demonstration of Maslow's hierarchy of needs.

OWNERSHIP VERSUS PAY

The failure of compensation makes equity holdings essential

We limit our analysis to total direct compensation, and thus exclude the impact of holdings in our research of the pay-performance relationship. For most executives, the degree of alignment achieved through compensation is dwarfed by the impact of holdings; hence, the recent push in governance circles to increase stock ownership holdings and adopt formal ownership guidelines for both directors and executives. The sharp increase in the use of stock and stock options is also partly driven by the failure of other forms of compensation – as well as a decade-long bull-market!

Equity incentive schemes separate and distinct from all other forms of compensation have been widely embraced. Compensation consultants and governance critics alike have effectively given up on compensation as a tool to achieve any alignment in interests whatsoever, resigned to the status quo where entrenched thinking and over-riding concerns with competitiveness have subordinated the alignment and motivational aspects of compensation. While we strongly support ownership initiatives and the appropriate use of equity as compensation, we also believe an important role remains for a much stronger owner-employee compensation contract.

Has Silicon Valley found the Holy Grail to the problematic separation of ownership and management in the modern public corporation? We believe that the broad-based use of stock and stock options may not be the simple answer to aligning interests and motivating value-maximizing behaviours. There are at least four important limitations to equity incentives.

But ownership has its limitations ...

1. **Volatility.** Market noise and stock volatility can be mysterious, frustrating and even demotivating. Many employees are also less able to bear such compensation risk. A diversified investor will make far more aggressive bets than employees bent on survival.
2. **Market Mystery.** Many employees, even executives, are not experts in the workings of global capital markets and have only a vague understanding of valuation. A common result is conflicting goals of market share and growth at any cost, destructive cost cutting and the deferral of important long-term initiatives, and an alarming focus on sell-side Analysts.
3. **Non-Operating.** Equity incentives are also far less prescriptive, or actionable, than cash incentives, where the linkage between actions and results can be made clear and period measures, upon which operating decisions are routinely made, are also used to drive pay.
4. **Line of Sight.** The line of sight between a traded security and the sphere of influence of most employees is poor, leaving little ownership over results, relegating many stock options to the realm of Christmas turkeys rather than affecting behaviour.



THE ROAD TO BETTER LONG TERM PAY: HIGH-POWERED STOCK OPTIONS

Option mechanics are an important but overlooked design element

Option grant guidelines and exercise price mechanics can undermine compensation objectives. Although often overlooked, grant guidelines create a connection between pay and performance that is analogous to cash incentives.⁵ While ownership guidelines and executive stock options are clearly an important element to the compensation solution at senior levels within the firm, they are only part of the compensation solution. Option mechanics and their integration with cash incentives must be considered as important degrees of freedom in the design process. Below the officer level, equity incentives tend to become less effective and risk only marginal benefits at substantial economic cost.

Three steps to more effective options ...

A compensation solution to the pay-performance problem cannot focus solely on cash incentives, as equity - particularly stock options, has become an increasingly dominant form of compensation. Accordingly, grant guidelines warrant a closer look in the design of total direct compensation:

1. Grant guidelines with a fixed share grant, rather than a fixed value grant, greatly enhance the sensitivity of pay to performance.⁶
2. Alignment and motivation can be further strengthened by linking the annual and long-term plans with the bonus multiple used as a grant multiplier.
3. Finally, out-of-the-money options, rather than at-the-money, are more shareholder-friendly and serve to increase pay sensitivity if the original target grant level is grossed-up to an equivalent value.

For example, assume an annual target grant of 10,000 stock options represents a competitive grant level, prospectively, based on a Black-Scholes value. The first step is to fix this grant level for the entire contract period, say three to five years, irrespective of future share prices. Not only does this produce a far more leveraged and definitive owner-employee contract than a fixed value grant, but it avoids the perverse incentive derived from rewarding employees with more options as the share price falls.

The second step is to use the bonus multiple from the annual incentive plan as a multiplier for the actual grant. Thus, a bonus multiple of 1.5x paid from the annual plan would also yield 15,000 options – 1.5x the target grant level.

An even more aggressive contract can be achieved through options that are priced “out-of-the-money”. If excisable at a 25% premium to the price at time of grant, a larger grant, say 12,000 options would be required for the same target grant value. Under a 1.5x performance case, 18,000 premium options would be granted.

High powered stock options represent a practical alternative to front-loaded options, or mega grants, because they achieve a similarly high degree of wealth leverage, but limit retention risk issues through annual the annual grant feature and the effective mechanics of step vesting.

Popular Pitfalls

The most common performance measurement and incentive compensation pitfall is to just always add more, layering new measures on top of old measures, leaving it to the incentive participants to somehow resolve any conflicts and determine the real goal. For example, while most acknowledge the intuitive appeal of a single measure that combines the income statement, balance sheet and cost of capital (EVA), many, unable to break from their past, feel obligated to accord importance to old favorites – income statement measures like operating income and earnings per share – measures that accord absolutely no importance to the level of investment required to

⁵ Brian Hall of Harvard University offers insightful guidelines in this area in, “The Design of Multi-Year Stock Option Plans,” *The Journal of Applied Corporate Finance*, Volume 12 Number 2 (Summer 1999).

⁶ Ibid



produce the operating cashflows. The incentive effect is perverse, but unfortunately not glaringly obvious without pushing a few simple numbers.

For example, assume we agree to “fund” bonuses 50% from EVA growth and 50% from operating income. Our cost of capital is 10%. What is the implied hurdle rate on new or existing capital? Any capital that earns even a meager 1% return is still accretive to operating income, but dilutive to EVA. With equal weights on EVA and operating income, I am paid to keep, or invest at, any returns that exceed 5%, effectively halving the hurdle rate. If this is the desired outcome, why not just use a 5% cost of capital! A similar example with e.p.s. is slightly more complicated because the financing costs of debt increase the implied hurdle rate, with a constant target capital structure at the margin. Assuming 33% debt/ 67% equity and a 4%-6% after tax cost of debt, the implied hurdle rate for earnings accretion is below 2%. If we fund our bonuses 50% from EVA and 50% from e.p.s., our incentive plan implies a 6% hurdle rate!

A second pitfall, pervasive among many public companies and dominant among private companies, relates to the use of goals for planning, budgeting and incentive compensation. The problem begins with a confusion between expectations (base goals) and desires (stretch goals), and the bonuses warranted for each. Big Harry Audacious Goals (BHAG’s) are now all the rage in leadership circles – being soft on goals is worse than being soft on crime. The question however, is how much one should pay for BHAG performance versus performance that meets investor expectations (as implied by enterprise values).

For example, the confrontational command-and-control culture leads with tough BHAG negotiations for stretch goals that promise only Target Bonuses. These are often goals mandated from above, lacking any real ownership. A performance threshold aggravates the demotivating effect by offering little-to-no bonus in the event that BHAG’s are missed even by small margins, but virtually no downside to missing by a wide margin! As a practical matter, year-end will force justifications for arbitrary bonuses to maintain competitive levels of pay, creating an undercurrent of paternalism and a rampant excuse-based culture - moving the company away from an environment of business stewardship and accountability for value.

WHAT WENT WRONG? THE CASE FOR CHANGE

A small core of pervasive but perverse design practices are at the root of all problem behaviours ...

In practice, a small core of pervasive, yet perverse, practices are at the root of much of the dysfunctional impact of today’s compensation designs. Not only do these characteristics undermine the sensitivity of pay to performance, but also they frequently promote sub-optimal behaviors among executives, professional managers and employees. The closely interrelated issues of weak or dysfunctional performance incentives, annual budget negotiations, and the need for capital rationing are symptomatic of today’s outdated incentive technology.

1. **Too Many Measures.** Traditional incentive design draws upon a basket, a veritable potpourri, of incomplete performance metrics, diluting focus and sending conflicting signals. Many of these measures reward maintaining or investing capital at returns far below the cost of capital. Many also promote the misallocation of internal funds leading to sub-optimization of total enterprise value.
2. **Performance Legacy Issues.** Tying incentives to absolute levels of performance, rather than performance improvements, effectively pays for history. Yet, value is created by changes in performance - profitable growth and sustainable continuous improvement.
3. **“Budget Arbitration”.** A process of sandbagging and negotiation characterizes any performance targets linked to annual budgets. This often unwittingly penalizes superior performance and rewards poor performance – a vestige of communism’s quota system.



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Most incentive plans create numerous reasons to “hold back”

4. **Big Baths/Performance Ceilings.** A performance threshold, with no further downside, creates an incentive to give up or even “sack” performance in a poor year. Similarly, a payment cap, with no further upside, creates a perverse incentive to “hold back” in a great year. Discontinuities provide inconsistent rewards for value creation, rather than a fixed percentage ownership in value creation. Discontinuities in the payout function reward perverse behaviors at each point of discontinuity.

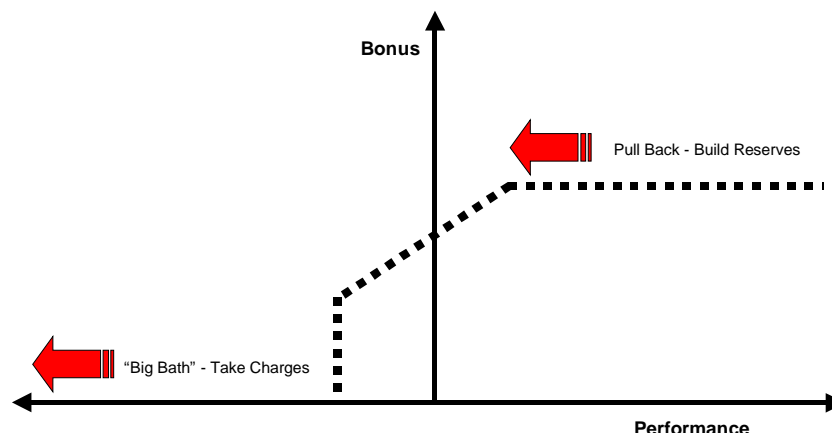


Figure 4: Traditional AIP Pay-Off Profile

5. **Short Term.** The single-year horizon of traditional pay practice makes no effort to relate longer term, multi-year cumulative pay with cumulative performance. But with each year evaluated in isolation, near term milestones like month, quarter and year-end take on a level of exaggerated importance, often leading to perverse behaviors and accounting practices.
6. **Fractionated.** All too often, compensation takes on a piece-meal approach, with new plans and components added every year. In time, measures and goals multiply until the company has more plans (long, short and mid-terms, performance-unit plans) than employees.

AN OWNER-EMPLOYEE CONTRACT TO SHARE VALUE CREATION

It is a whole new architecture that is needed, not just a better performance measure

The pervasive limitations of the dominant strategy in total compensation require that a new approach be adopted. The compensation solution cannot merely replace a basket of conflicting and incomplete measures with a more robust measure, such as economic value added, within the confines of a traditional incentive plan. The stated philosophy and objectives of the vast majority of public companies can only be reached through a combination of features that effectively create an owner-employee contract to share value creation.

1. **A Better, Single Measure.** Economic value added simply and simultaneously captures profit, capital and the cost of capital, converting net present value into a flow measure. EVA improvement, or growth, as the strategic imperative directs resources to their most productive uses – the maximization of shareowner wealth.
2. **Value-Based Goal-Setting.** Value-based goals, typically established from a fair market value, are essential to establish the correct performance standard and align the interests of employees and owners. Multi-year, EVA growth goals extend the term of the contract, and thus significantly improve the alignment and leverage between owners and employees.
3. **Multi-Year Accountability.** Accountability for multi-year performance is created with annual payments a function of annual performance, but held as a draw against cumulative, multi-year performance. This contract extends management decision horizons and holds cumulative pay with cumulative performance – a fixed percentage share of value creation.



- 4. **Equity-Like Payoff.** A straight line provides the simplest and the most sensible payment, with every dollar of value creation valued equally, at any level of performance. An unlimited upside/downside not only guards against damaging short-term behaviour, but it also ensures a continuously motivating payment structure that never “turns off”, even in exceptional years.

The design decisions are not if, but how, when and for whom

Unlike most compensation approaches today, the solution is a holistic one. To be implemented effectively, the practitioner must resist the temptation to selectively “cherry-pick” components as one might build an ice cream sundae. Rather than if, the critical implementation emphasis must be how, when, and for whom, these features are to be designed and applied in each case.

Cases in Cultural Advantage

The unlikely locale of Western Michigan plays home to at least two cases in cultural advantage – Herman Miller (MLHR), the office furniture company, and SPX Corp., a diversified industrial manufacturer. While very different, these two cases also share some unique similarities.

MLHR’s strategy is single-market-focused, SPX’s is clearly not. SPX’s growth is through acquisition, whereas MLHR’s is organic. MLHR is a premium player with a strong brand. SPX sold the only division that bore its name. SPX is decentralized with many autonomous business units under an aggressive leadership-style – its CEO, John Blystone hailed by Fortune magazine as part of GE’s alumni of top CEO’s in the United States. MLHR is more a network organization with a culture that reflects its family roots and stewardship of former CEO Max Depree (Leadership As An Art), a direct descendant of the founding family - Fortune perennially ranks it one of America’s 100 best companies in which to work.

Yet, both companies have combined leadership changes with the implementation of a new value-based strategy and governance system to achieve a high performance culture as the foundation for tremendous turnarounds. Turnarounds that have since been catapulted forward as successful growth stories. Among the stable of spectacular investments to have been made this past decade, these two companies stand apart – they actually make things: previously sleepy industrials mired in the inert sea of mediocrity that pervades the sector now known as, “The Old Economy”. These companies offer the hope that the entrepreneurial spirit once labeled “hustle as strategy” is not only the domain of internet start-ups.⁷ Our most precious resources – talent and capital, need not abandon this Old World for the New Economy.

Both companies have made EVA growth their clear and unequivocal single measure of financial success – for management reporting, planning and budgeting, operating, investment and strategic decisions, and for compensation.⁸ In both cases, this focus has led to a clear, decisive culture where action, rather than hedging and indecision, are the default behaviors. Interestingly, the implementation of lean production and extended enterprise values have also flourished in both cases, now that the “way to keep score” is economically robust.

In both companies, objective, multi-year goals, derived from enterprise values, have unleashed planning and performance to outperform. No longer is the emphasis on just “making the numbers” – performance often far exceeds goals. Both have cultivated a culture of accountability for results, rather than excuse-based cultures. Rather than negotiating conservative goals, businesses actually stretch without fear of the personal ramifications. Stretch thinking and a long term horizon are also reinforced by their bonus plans, where annual payments represent an annual draw against cumulative, sustainable EVA growth. Both SPX and MLHR have thus witnessed the extinction of the year-end effect – where dysfunctional behaviour works to short term quarter and year-end results at the expense of the longer term.

⁷ “Hustle As Strategy” by Amar V. Bhide appeared in the *Harvard Business Review*, September 1, 1986.

⁸ As a matter of technicality, it is the present value of all future EVA’s, or Net Present Value (NPV), that drives their strategy, investment and divestment decisions.



At both companies, virtually all employees, including bargaining units, participate in the EVA bonus plan and own stock in the company. Their bonus plans feature straight line payouts – an equity-like payout for managers – and a somewhat safer payout range for all else. Notwithstanding this, the concepts of employees as owners, and managers as business stewards are in practice. Performance, planning, reporting and rewards support this philosophy – there is little mention of fairness, controllability, or making the numbers. The high performance cultures of both SPX and MLHR are reinforced by non-traditional stock option programs. Both companies have adopted fixed grant guidelines and taken other steps to increase wealth leverage. SPX uses premium priced options, MLHR links grants to bonus multiples.

IN CLOSING

How can we really go about making employees, managers and executives into business leaders who think, act, and are paid like, owners? How does one avoid the pitfalls of traditional incentives and competitive pay practices? Is the world ready for “employee-capitalism”?

Despite their prevalence, incentives remain an ineffective art-form

Despite the widespread use of bonuses throughout business, incentive and executive compensation remain largely misunderstood and misdirected practices. A critical flaw in traditional competitive pay practice is the commitment to always maintaining competitive levels of pay, ensuring that a large proportion of management pay is not really at risk, even though a large proportion of compensation may be variable. Thus, the sensitivity of pay to performance is far less than that of an entrepreneur. Competitive pay practices remain largely a vestige of past times with conventional wisdom developed from a legacy of command-and-control, paternalistic practices. The status quo of compensation consulting undermines the spirit of coaching, stewardship and entrepreneurialism – tools of today’s modern business leaders. Limitations to the dominant total compensation strategy require that a new approach be developed.

Effective governance can only be reached by crafting an effective owner-employee contract to share wealth creation

The stated philosophy and objectives of the vast majority of public companies can only be reached through a combination of features that effectively create an owner-employee contract to share value creation. One cannot merely replace old performance measures, or add a more complete measure, like EVA. For the adoption of a more robust measure of financial success and its associated financial management tools to be an enabling mechanism, it must be coupled with a powerful change to total compensation strategy - one that unleashes the latent power of employee capitalism. Building on the notion of organizational software, the competitive advantage derived through employee capitalism might be considered a cultural advantage – a product of such software.



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