A CEO Remuneration Model for the 21st Century
Linking CEO Reward to Total Stakeholder Value (TSV)

The Maturity Institute's (MI) Global Model for CEO Remuneration

Note. This document should be read in conjunction with MI's accompanying paper 'Rationale for a CEO Remuneration Model for the 21st Century Linked to Total Stakeholder Value'

'Price is what you pay, value is what you get'. Warren Buffet

The current CEO remuneration system needs to be replaced

Despite the clamour for action on apparently 'excessive' CEO and C-suite pay there has yet to be a clear and agreed definition of the problem - 'Are CEOs paid too much?' That question requires a basis for measurement that is universally agreed for a global marketplace. For publicly quoted companies, the company's market value acts as a proxy measure because the CEO has overall responsibility for the company's value but measurement in this field is highly complex. For example, how much credit should be given to the CEO's predecessor and for how long?

It is made doubly difficult by the fact that the fortunes of the company are influenced by a range of factors outside of the CEOs control. This is known as a wicked problem; one that is so fraught with complexity that a single, 'best' solution has yet to be found. MI's approach to the problem is a solution that is theoretically rigorous, evidence-based (using real world exemplars), highly compelling and yet simple to put into practice. This methodology, founded on MI's framework, has produced the 'CEO Rem Model': a global CEO value, pay and reward standard.

MI evidence on CEO pay: sub-optimal TSV

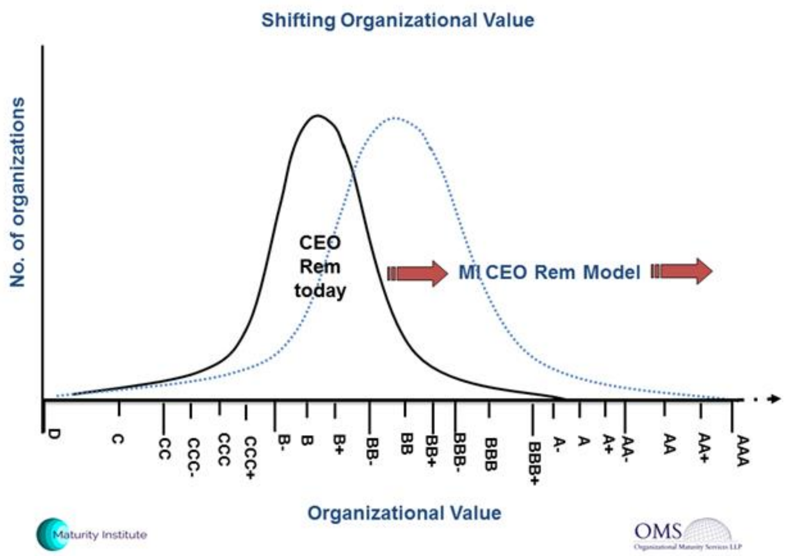


Figure 1. The current CEO baseline and lost value potential

MI already has clear evidence (see Figure 1 based on OMS LLP's Global OMINDEX) of a skewed distribution in CEO pay and company value. It shows that most CEOs lead organisations that generate well below their potential value, while CEOs of more mature companies, with long track records of improvement and value creation (such as Toyota, Handelsbanken and Costco) have significantly different pay characteristics than comparator CEOs (see Appendix 1).

Appendix 1 shows some comparative remuneration figures for MI exemplars (in bold). The characteristics of MI's exemplar organisations include:

- CEO's who espouse a clear corporate societal purpose summarised as 'Best quality at best cost'
- Companies managed according to a broader understanding of Value as serving the best interests of society as well as shareholders
- Pay levels lower, overall, than direct peer group comparators
- Variable pay (incentive bonuses) used more effectively (or not at all) than comparators
- Any equity awards made are geared to long-term value

Nestlé

Nestlé's operating profit margins recently recovered slightly to reach 13.98% in 2015. Research conducted by OMS LLP, in conjunction with the Maturity Institute, shows that organizations below a BBB- level of maturity have huge gains awaiting them if a CEO adopts a maturity-led strategy. In Nestlé's case, we view that an extra 5-10 percentage points on operating margins are achievable within 2 to 3 years.

MI's New CEO Remuneration Model

The MI Model has the following characteristics:

1. **CEO Assessment**: We assess and rate organisations according to their capability for producing the maximum value from available resources without causing undue external harm. The methodology measures the CEO's capability for running an enterprise to MI's Professional & Organisational Standard and is based on the OM30+ question set for CEOs. This existing technology has already been deployed to assess the CEO capability and performance of OMINDEX companies since January 2015, and is designed to enable Boards, investors and shareholders make better, more informed, decisions based on the long-term **Total Stakeholder Value (TSV©)** of companies (see 2 below). MI evidence shows that the shape of the performance curve for existing CEOs is represented above by Figure 1. Our model adopts this as a standard for assessing and measuring CEO capability.

2. **Identifying CEO TSV© goals**: Boards can now incorporate an OMINDEX rating alongside standard company value metrics to identify **Total Stakeholder Value (TSV©)** comprised of the company's Price-to-Book ratio **(P/B)** and OMINDEX value. This is simply and easily represented by the TSV equation:

TSV = P/B x OMINDEX

TSV is a baseline value measure that captures critical factors of organisational health to identify a more accurate picture of a company's ability to sustain and enhance its value over time. For example, a P/B of 1, with an OMINDEX rating of BBB (60%), would produce a baseline TSV of 0.6; indicating room for 40% more TSV (i.e. a 66% uplift from the baseline) in terms of organisational maturity.

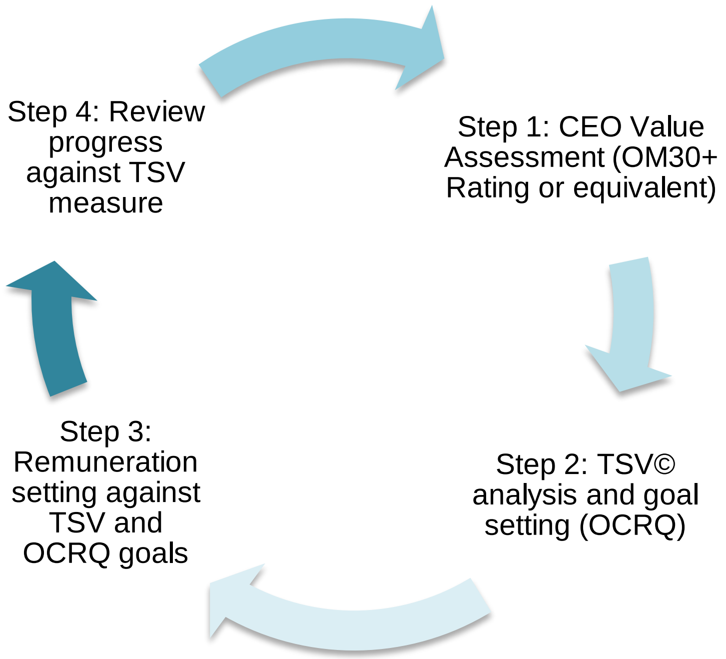
3. OMINDEX incorporates MI's defined Value measures of Output (O), Cost (C), Revenue (R) and Quality (Q) (see below). This enables detailed CEO goals to be set for each of these variables both individually and as *part of a whole system*. That is, any proposed 'Cost' savings (e.g. headcount reduction) must factor in the likely impact on the other three throughout the organisation. For example, potentially lower Output (productivity), lower customer Quality (satisfaction) and total Revenue loss (through lost business and pressure on prices). CEO goals may include:

- **Output** (volume of products or services delivered and measured in various ways e.g. products as a % of whole market)
- **Costs** (financial, sustainability index, whole system risk measures)
- **Revenue** (all financial income where the prime determinant is the price of products/services)
- **Quality** (safety, product defects, customer service, internal product innovation, trust measures, brand equity etc.)

4. **The reward mix** (e.g. base salary, variable pay, and long-term equity) and their magnitudes can then be set in relation to TSV, Value outcome goals (OCRQ) and the new CEO assessment using the OM30+ rating. Furthermore, this can then be set as a specific 'gate' (see rationale document).

CEO value, and the company's reward scheme, can now be considered and validated in relation to TSV, which automatically incorporates the total effect of the four value variables of OCRQ as opposed to the simplistic use of external comparators on CEO pay and company size in use today.

CEO Value and Remuneration - The TSV System



Step 1: The Board carries out an assessment of CEO capability for TSV creation and risk management.

The assessment will provide a CEO scorecard against critical TSV drivers including MI's strategic framework (Appendix 3) and Ten Pillars.

The CEO assessment is then repeated annually to gauge long-term CEO impact on sustainable value. Any positive or adverse variations in overall impact must then read across to CEO remuneration (e.g. in variable pay, equity award magnitudes).

Step 2: The Board identifies TSV and sets CEO goals according to MI's defined Value measure (i.e. 'OCRQ' defined above) and company OMINDEX rating.

Step 3: The remuneration committee sets the reward mix and magnitudes against TSV, OCRQ goals and CEO assessment 'gate' (e.g. OM30+ rating). Board and shareholder approval will be gained (as appropriate). CEO value and the corresponding reward scheme should be considered and validated in relation to TSV and Value added (OCRQ).

Step 4: Board reviews progress against TSV, OCRQ and OM30+ goals and then provides feedback to the CEO. The company then takes any necessary steps to manage progress.

The MI Model is ready

The MI Model can be used by Chairs of Boards, CEOs, shareholders, investors, regulators and policy makers. For further information please contact Paul Kearns, Chair of MI and project owner of the MI CEO Rem Model Project at paul.kearns@maturityinstitute.com

Appendix 1

CEO Remuneration comparators

Key observations:

1. MI's highly mature, prime exemplar, Toyota, reward CEO Akio Toyoda at a fraction of GM's CEO Mary Barra, yet Toyota's market cap is typically 3 times that of GM
2. Handelsbanken provide no variable pay (bonuses) for senior execs, yet retain key talent and consistently report 'best in class' book to market value and profit margins.
3. Costco CEO Jelenik has a significantly lower annual cash reward (base/bonus) than comparators with stock awards geared to long- term performance. Yet Costco has been a consistent provider of shareholder value (e.g. P/E ratio significantly higher than peers)

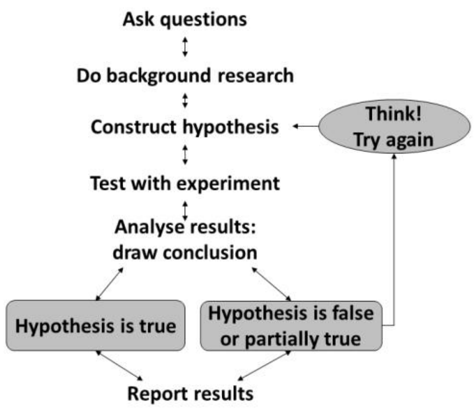
Costco (A Rated) CEO Craig Jelenik Base US$700,00 Bonus: $81,600 Equity: $5,563,064 MKT Cap: $71.60bn	**Target** CEO B C Cornell Base $1,300,000 Bonus $1,950,000 Equity $13,422,958 MKT Cap $35.7bn	**Wal-Mart** CEO C D McMillon Base $1,263,231 Bonus $3,406,971 Equity $14,270, 786 MKT Cap $203.5bn	**Sainsbury** CEO M Coupe Base $2,151,250 Bonus $1,351,250 Equity MKT Cap $7.1bn
Handelsbanken (A) CEO Anders Bouvin Base $628,397 Bonus: None Equity: None MKT Cap $27.79bn	**Lloyds Bank** CEO: A Horta-Osorio Base $2,566,250 Bonus: $710,000 Equity: $7,699,000 MKT Cap $58.6bn	**ING** CEO R Hammers Base $1,742,470 Bonus N/A Equity $313,217 MKT Cap $56.44bn	**Wells Fargo*** CEO T Sloan Base $2,000,000 Bonus $1,000,000 Equity $8,000,000 MKT Cap $283bn
Toyota (A+) CEO A Toyoda Base US$887,000 Bonus: $2,156,521 Equity: $N/A MKT Cap: $168.71bn	**GM** CEO M Barra Base $1,750,000 Bonus $3,062,500 Equity $23,167, 033 MKT Cap $55bn	**VW** CEO M Muller Base $5,376,449 Bonus Equity MKT Cap $85bn	**Ford** CEO M Fields Base $1,750,000 Bonus $3,465,000 Equity $12,133,000 MKT Cap $49.63bn
*Pay represents amounts awarded as COO before promotion to CEO			

Sources:
www1.salary.com
http://insiders.morningstar.com/trading/executive-compensation.action?t=TM
https://uk.finance.yahoo.com
http://www.reuters.com/finance/markets/indices

Appendix 2

Applying the Scientific Method

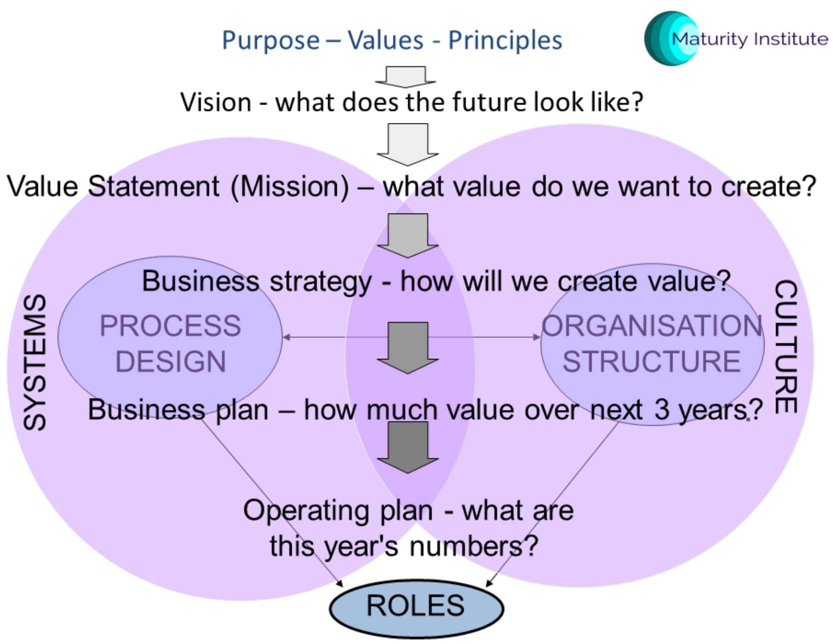
MI is the evidenced-based, scientific, professional institute for developing mature thinking, leadership and management. The rationale for the MI Rem Model is available on request. Our approach to developing the CEO Rem Model is predicated on application of the scientific method as follows:



- We asked the question - ‘Are CEOs remunerated according to their contribution to Total Stakeholder Value’?
- We did extensive background research to provide our initial research narrative and rationale
- We constructed a hypothesis (see Figure 1) that revealed the discrepancy between CEO remuneration and organisational value creation.
- We have tested the hypothesis against OMINDEX research and ratings
- We have analysed the results and drawn conclusions regarding our original hypothesis
- This cycle will continue in the pursuit of maximising value

Appendix 3.

MI’s Strategic Framework



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