An Executive Scorecard: Evaluating a CEO's Performance Using the Balanced Scorecard and Stakeholder Theory Approach

By

Patricia A. Beckenholdt

Dissertation submitted to the Faculty of the Graduate School of the
University of Maryland University College,
in partial fulfillment
of the requirements for the degree of
Doctor of Management
2011

Dissertation Advisory Committee:

James P. Gelatt, Ph.D.
Katherine Edwards, Ph.D.
Michael Evanchik, Ph.D.
John Glennie, Ph.D.

المنارة للاستشارات

www.manaraa.com

UMI Number: 3523572

All rights reserved

INFORMATION TO ALL USERS
The quality of this reproduction is dependent on the quality of the copy submitted.

In the unlikely event that the author did not send a complete manuscript
and there are missing pages, these will be noted. Also, if material had to be removed,
a note will indicate the deletion.

UMI 3523572

Copyright 2012 by ProQuest LLC.

All rights reserved. This edition of the work is protected against
unauthorized copying under Title 17, United States Code.

ProQuest LLC.
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106 - 1346

المنارة للاستشارات

www.manaraa.com

Abstract

Despite executive pay being closely scrutinized, the recent financial debacle in 2008 spring boarded executive compensation to the attention of the news, the public and the government. This study reviews the history of executive compensation and the findings of quantitative and qualitative studies concerning executive compensation in relation to excessive pay, firm size, agency theory, pay in other countries, pay-for-performance, and motivation. Various models including the Stakeholders' model, Total Reward approach, and the Balanced Scorecard are reviewed to see the possible ways management can approach executive compensation. Using the literature on stakeholder theory and the Balanced Scorecard, a conceptual framework (Executive Scorecard) is developed that provides organizations the ability to formulate executive goals that are translated into a set of measures that align executive compensation with a firm's goals and objective while meeting stakeholder expectations. The study concludes with a discussion of the findings of the research and a discussion of the implications for management practitioners and trends for future research.

Key Words: Agency Theory, Balanced Scorecard, Executive Compensation, Pay-for-Performance, Stakeholder Theory

المنارة للاستشارات
www.manaraa.com

Dedication

I dedicate this dissertation to my dearest children, Lindsay, Joel, and Paul who have spent their lives journeying down my educational path. Their love, support, and understanding of my need for lifelong learning are most graciously appreciated.

"We now accept the fact that learning is a lifelong process of keeping abreast of change."

--*Peter Drucker*

المنارة للاستشارات
www.manaraa.com

Acknowledgments

I would like to thank all of the people who supported me through this challenging yet rewarding program. To my children, who supported me over the past three years…a huge thank you! A special thanks to my friends Mary and Barbara, who spent countless hours shopping, going to the movies, and having dinners and breakfasts during semester breaks. I cannot thank you enough for always being there for me. To my sister, Marlene, who has supported me in more way than imagined over the years, and especially through my time in this program! Many thanks to my expert panelists, Dr. James O'Brien, Mr. Thomas Ettinger, and especially Dr. Liliana Meneses, who read through my paper, provided sound advice, and shared ideas. I would like to acknowledge and thank my colleagues with whom I journeyed through the doctoral program. You have been a wonderful group of people to share this experience and I appreciate your support and encouragement. Finally, I would like to thank the University of Maryland University College faculty for their dedication to teaching in the doctorate program.

المنارة للاستشارات
www.manaraa.com

Table of Contents

Abstract ... ii

Dedication ... iii

Acknowledgement ... iv

Table of Contents ... v

Chapter One: Introduction ... 1

1.1:Research Problem ... 1

1.2: Significance of Problem to Management ... 3

1.3: Purpose of Study ... 5

1.3.1: Research Questions ... 6

1.4: Definition of Terms ... 7

1.4.1: "Executive" Defined ... 7

1.4.2: Types of Compensation ... 7

1.4.2.1: Base Salary ... 8

1.4.2.2: Incentive Awards ... 9

1.4.2.3: Benefits and Allowances in Kind ... 10

1.4.2.4: Long-term Incentive Compensation ... 10

1.5: Assumptions ... 10

1.6: Chapter One Summary and Organization of Dissertation ... 11

Chapter Two: Literature Review ... 13

2.1: Introduction ... 13

2.2: Components of Salary ... 13

2.3: History of Compensation ... 20

المنارة للاستشارات
www.manaraa.com

2.4: Comparison of CEO Salary to Average Worker... 27

2.5: Excessive Pay 28

2.6: Comparison of U.S. Compensation to Other Countries 31

2.7: Regulatory and Legal Intervention 34

2.8: Agency Theory 36

2.9: Relationship between Pay and Size of Firm 38

2.10: Relationship between Pay and Performance 42

2.11: Relationship between Pay and Motivation 45

2.12: Total Rewards Model 47

2.13: Stakeholders' Model 50

2.13.1: Stakeholders' Expectations 52

2.14: Balanced Scorecard 57

2.15: Theoretical Lens and Summary 61

Chapter Three: Conceptual Model 64

3.1: Introduction 64

3.2: Applying the Balanced Scorecard to Strategy 64

3.3: Applying the Balanced Scorecard and Stakeholders' Model to Executive Compensation 65

3.4: Designing an Executive Scorecard 67

3.5: Stakeholders' 68

3.6: Evaluating Executive Performance 72

3.7: The Need for an Effective Evaluation 73

3.8: Creating the Evaluation 75

المنارة للاستشارات
www.manaraa.com

3.8.1: Step One: Identifying key stakeholders 75

3.8.2: Step Two: Defining stakeholders' expectations 76

3.8.3: Step Three: Setting the CEO's goals and objectives 78

3.8.4: Step Four: Defining key performancemeasures.................................. 79

3.8.5: Step Five: Developing metrics for setting targets............................... 83

3.9: Completed Scorecard 85

3.10: Managing Executive Scorecard Weaknesses.. 93

3.11: Summary 93

Chapter Four: Methodology 94

4.1: Research Process... 94

4.2: Evidence-based Research 96

4.3: Application of Evidence-based Research 96

4.4: Use of Expert Panel 96

4.5: Summary... 97

Chapter Five: Analysis and Discussion 98

5.1: Question 1 98

5.2: Question 2 101

5.3: Question 3 102

5.4: Question 4 105

5.5: Chapter Summary 106

Chapter Six: Conclusions, Implications and Trends 107

6.1: Conclusions.. 107

6.2: Implications for Management.. 109

المنارة للاستشارات

www.manaraa.com

6.3: Implication of Trends 111

6.4: Limitations and Areas for Future Research 114

6.5: Summary 115

List of Figures ....

Figure 1: Schematic of stakeholder theory 52

Figure 2: Balanced Scorecard 58

Figure 3: Performance Evaluation Process 74

List of Tables ....

Table 1: CompensationTerms Defined 8

Table 2: Performance Measures 17

Table 3: Timeline - History of Compensation 20

Table 4: 2009 CEO Compensation 26

Table 5: Stakeholders' Expectations Document 77

Table 6: CEO's Goals and Objectives 78

Table 7: Performance Measures 80

Table 8: Explanation for Selection of Performance Measures 82

Table 9: Executive Scorecard Targets 84

Table 10: Completed Executive Scorecard 89

References **117**

Appendix A (Panel Member 1) **129**

Appendix B (Panel Member 2) **132**

Appendix C(Panel Member 3) **135**

www.manaraa.com

Chapter One: Introduction

1.1: Research Problem

As organizations are faced with doing business in an increasingly competitive global market, executive compensation has become a more complex and controversial issue. The financial crisis of 2008 has brought the topic of executive compensation to the forefront of the news, raising criticism and debate from investors, the public, and the government over what they consider unacceptable and inappropriate pay packages. Although the recent executive compensation controversy has focused on the financial service industry with firms such as American International Group (AIG), Bear Stearns, and Goldman Sachs, the resulting initiatives (ex: more transparency of compensation, more corporate governance) are aimed at the entire public-company arena (Hodak, 2010).

Executive compensation started out as simple as executives receiving compensation in the form of salary (Ellig, 2006), and has evolved into a complex pay system that substantially rewards Chief Executive Officer's (CEO's) and senior executives for their services. Firm size has been shown to play a role in how much CEO's receive in compensation, with CEO's of larger firms receiving compensation that far exceeded the salaries of their counterparts at smaller firms (Agarwal, 1981). The literature review in Chapter Two provides a more comprehensive discussion of the history of executive compensation and the relation to firm size.

In more recent years, executive compensation has been headline news due to skyrocketing CEO compensation of US firms, especially in comparison to stagnant wage growth for the average employee (Agarwal, 2010). Much of the concern relates to executive compensation practices that bear questionable relationship to a company's financial performance (O'Reilly & Main, 2007), which will be discussed further in

المنارة للاستشارات
www.manaraa.com

Chapter Two. Further, public awareness has raised the question of whether senior executives deserve to receive the huge amounts of compensation received. There is concern as to who should have a say, and how corporations should design an executive compensation package to meets the criteria of stakeholders so everyone benefits to some degree. The problem is not only the amount senior executives earn but how they are paid. The last fifteen years have seen a shift in executive compensation from a cash-based (fixed salary and bonus) pay system to an equity-based pay system (stock options and methods of pay-for-performance) (Barrington and Hallock, 2009).

Corporate board directors and compensation committees are faced with new challenges as they attempt to find the right balance between providing meaningful compensation for performance and avoiding what government regulators and the public believe are extravagant payouts for taking on a level of risk that jeopardizes meeting established performance goals. Beyond meeting the ever-expanding legal and regulatory requirements, board members are also confronted with motivating and retaining good performance from executives while managing change-of-control provisions and severance packages that can result in high CEO payouts (Steinberg, 2009). Additionally, the board and compensation committee is tasked with aligning CEO and other top executives' compensation with a company's strategy. Ferracone & Gershkowitz (2010) suggest executive compensation be a derivative of corporate strategy that drives value for shareholders. The economic value created has a direct influence on compensation plans to include the pay mix, selection of performance metrics, and the setting of goals (p. 17), all of which should be easily understandable. Appropriate performance measures need to be in place to motivate a CEO's behavior that is also in the shareholder's best interest

المنارة للاستشارات
www.manaraa.com

while effectively measuring both short-term and long-term performance (Steinberg, 2008).

1.2: Significance of Problem to Management

Executive compensation has taken a front and center position in the wake of the financial crisis of 2008. Although not new to controversy, executive compensation came under scrutiny when companies such as American International Group, Inc. (AIG) received bailout funds only to later report that executives continued to received bonuses and perks. Edward M. Liddy, Chairman and CEO of AIG, and New York's Attorney General, Andrew Cuomo, met and came to an agreement to help recover bonuses and other payments paid out in bailout funds. Cuomo considered the $8 million dollars that was planned for executive perks and junkets to be "unwarranted and outrageous" (McLeod, 2008, p. 1). To make matters worse, in July 2009, AIG announced plans to pay the remaining quarterly bonuses that were part of a concession that AIG had agreed to delay. AIG executives received approximately $9.6 million in bonuses representing half of their 2008 bonuses with two more quarterly disbursements expected (Dennis and Cho, 2009).

With so many large corporations on the brink of financial collapse, U.S. regulators began discussing the need for changes to executive compensation policies and transparency. Public outcry fostered organizations to rethink how they determine executive compensation. In an effort to improve executive accountability, many shareholders wanted a say-on-pay and to have their votes count as more than advisory votes (Albano, Alcock, Emberger, LaPorte, & Bonnett, 2011). It has been suggested by President Obama's administration that say-on-pay will allow shareholders and members

المنارة للاستشارات
www.manaraa.com

of the board a way to express their opinions, resulting in a collaborative effort to design a compensation package that will encourage executives to maximize long-term corporate goals and wealth (U.S. Dept. of Treasury Fact Sheet, 2009).

The stakeholder concept of the organization implies that maintaining favorable relationships and affiliations with internal and external stakeholders is known to play an important role in generating current and future wealth (Susnienė and Sargunas, 2009). Ferrell (2004) noted that consumers identify with organizational images that are congruent with their self-identity, so when there is negative perception of an organization, consumers separate from an organization. When there is a perception that an organization has created an ethical corporate culture based on leadership and commitment to values that stress the importance of stakeholder relationships, an organization will be better prepared to maintain satisfactory relationships with all stakeholders.

Hartzell and Starks (2003) performed a study that showed a positive relationship between institutional investor ownership and performance sensitivity of executive compensation and a negative relationship between ownership and the level of compensation. The study, which will be discussed in detail in Chapter Two, is relevant in that it shows that institutional investors influence executive compensation and play an integral role in the monitoring of expenses emphasizing good leadership as a priority.

Evans and Hefner (2009) argue that CEO's who are socially responsible are those who consider the effects of takeovers and the presence of severance agreement clauses on stakeholders. Compensation committees are tasked with linking executive pay to performance or face tax consequences that impact both executive and company. For example, under the Internal Revenue Code Section 162(m), the employer can lose a tax

المنارة للاستشارات
www.manaraa.com

deduction and the executive is subject to a 20 percent excise tax on excess parachute payments if there is a change of control.

A way around such a laborious charge is to tie the majority of compensation to incentives based on fairness, motivation and morale of a firm's employees. Murthy and Salter (2003) argues that benefits given to executives should be the same as those provided to all other employees, otherwise there is a perception of unfairness that can directly influence an employee's morale, performance, and productivity.

In the past, stakeholders have had to have a blind trust when dealing with corporations. Stakeholders are well served when they know the rationale for executive compensation because pay packages can have a direct or substantial effect on their interest. For such reasons, it is important to take a closer look at the criteria used to determine executive compensation and to develop metrics by which to measure those criteria.

1.3: Purpose of Study

The issues outlined above describe some of the problems and concerns that have arisen in relation to executive compensation. Numerous models for executive compensation exist. However, many of the models demonstrate incongruence between incentive pay and performance, raising questions about possible managerial misconduct, and a lack of connectivity between executive compensation and the benefit to corporate stakeholders. Further, no one model links the company's business strategy to executive pay while aligning the company's performance with executive compensation. Short-term and long-term incentive payouts that make up the main portion of executive compensation are based on reported income, earnings per share (EPS), or other ratios.

المنارة للاستشارات
www.manaraa.com

Using such criteria does not necessarily correlate with the value of the firm and because these variables can be easily manipulated by managers, there is a potential to diminish company value.

In this dissertation, a conceptual model is developed using elements of both Kaplan and Norton's (1992) Balanced Scorecard and Donaldson and Preston's (1995) Stakeholder Theory to design a new model called Executive Scorecard. The Executive Scorecard identifies executive goals that are translated into a set of measures that align executive compensation with the firm's goals and objectives while still meeting stakeholder expectations. The model is designed to minimize the risk associated with any given business strategy and to reward long-term value creation while building long-term stakeholder value. The executive scorecard is posited as a better alternative to the abundant number of executive compensation models that already exists.

The purpose of this study is to look at the literature on executive compensation at the senior executive level, and mostly at the CEO level. Secondly, several compensation models are examined, criteria to determine compensation are identified and metrics are developed. Each of these elements is pulled together to form a model that ties executive compensation to a set of measurable criteria that meets key stakeholder expectations. The model is intended to be generic and can be altered to reflect the needs of a particular firm, the industry in which it operates, the stakeholders, and how well the organization is performing.

1.3.1 Research Questions

The questions that this study will address are as follows:

1. What criteria should be used in determining executive (CEO) compensation?

المنارة للاستشارات
www.manaraa.com

2. What metrics should be used to measure the criteria?
3. How can executive compensation tie a set of performance measures to stakeholder's expectations and a firm's strategic goals?
4. How can performance targets be designed to evaluate a CEO's efforts in meeting corporate goals and objectives and stakeholders' expectations?

1.4: Definition of Terms

1.4.1: "Executive" Defined

Defining the term "executive" is not as straightforward as it seems. It is understandable that no single term can clearly define an executive because of the complex nature of a business. For the purpose of this paper, the author has selected to use the position of CEO as "executive", but executive also can include the top four most highly compensated executive officers other than the CEO. The highest level executives are the Chief Operations Officer (COO), Chief Financial Officer (CFO), Chief Information Officer (CIO), and Chief Technology Officer (CTO).

1.4.2: Types of Compensation

For the purpose of this study, executive compensation is defined by the author as an executive's total compensation in a given year, which is the sum of the executive's base salary, incentive awards, benefits and allowances in kind, and any additional compensation. Due to companies not being required to disclose dollar amounts related to pension plans, the value of an executive's pension plan is not included in this study. Specific terms that fall within these categories are defined by Barrington and Hallock (2009) in Table 1.

المنارة للاستشارات
www.manaraa.com

Table 1: Compensation Terms Defined

Compensation Terms	Definition
Total compensation	Aggregate of annualized salary, bonus, non-equity incentive compensation, present value of options, stock awards, pension value and earnings on non-qualified deferred compensation, and other non-cash compensations.
Salary	Paid or deferred annualized pay (salary).
Cash compensation	Aggregate of annualized salary, bonus, and non-equity incentive compensation
Bonus	Paid or deferred cash awards, which are discretionary or subjectively determined. Can be any award paid above salary including formula-based incentive compensation
Non-equity incentive compensation	Includes short-term and/or long-term cash awards that are based on pre-established performance-based criteria. The outcome at the time of determination is unknown. Not considered a bonus but an addition to salary and bonus payout.
Stock options	Granted company stock.
All other compensation	Perquisites, company contributions to qualified and non-qualified defined contribution plans, preferential stock purchase, relocation, tax gross-ups, and other allowances.

Adapted from Barrington and Hallock (2009)

1.4.2.1: Base Salary

Murphy's (1999) empirical research discussed in Chapter Two indicates that executive base salaries vary by industry. Base salary is usually a fixed compensation determined by competitively benchmarking using industry-specific salary surveys (Murphy, 1999). Surveys adjust for firm size with the use of size groupings or simple

المنارة للاستشارات
www.manaraa.com

log-linear regressions with size measured by market capitalization or revenues (Murphy, 1999). Salary payments are not performance based and according to the IRS Reg. 162(m), payments made to an executive that are non-performance based are tax deductible up to $1 million. Determination of salary will be further discussed in Chapter Two.

1.4.2.2: Incentive Awards

Incentive awards are considered variable compensation. They consist of short-term and long-term bonuses. Short-term annual cash bonuses are given to executives usually with a target level, and are structured either based on a discretionary criteria or tied to defined performance measures. According to Ebert et al. (2008), performance criteria represent a series of practices that can be based on individual, business unit or corporate performance. Setting thresholds or ceilings that limit the amount of payment is part of developing a strategy for the performance criteria.

Long-term incentives are typically provided in addition to bonuses and are calculated based on a rolling-average three or five year cumulative performance (Murphy, 1999). Cash, stock options or stock shares can be provided as an incentive. Stock options represent a right to purchase shares in the future at a pre-specified price. Executives benefit from stock shares as the share value increases over time. Shares of stock are given to executives as incentive to contribute to increased stock value (Ebert et al., 2008). Similar to a stock option, a stock appreciation right (SAR) provides an executive the benefit of the share price appreciation without having to purchase the underlying security.

المنارة للاستشارات
www.manaraa.com

1.4.2.3: Benefits and Allowances in Kind

Benefits and allowances in kind are fringe benefits that are non-cash forms of compensation also known as perquisites or perks. Among the more common examples are a company car, designated parking spots, chauffeured limousine, health insurance, interest-free loans for housing, an executive jet, home security, country club fees, and professional fees. Perquisites have become a key compensation for executives and tend to be progressive, and aids in the retention of top executives (Ebert, et al., 2008).

1.4.2.4: Long-term Incentive Compensation

Lastly, executives frequently receive the benefit of restricted stock, generous retirement plans, long-term incentive plans, deferred compensation, and severance packages. Restricted stock is used as an incentive for the executive to remain with the organization for a specified period or is associated with performance goals (Lynch and Perry, 2003). Deferred compensation provides executives a tax benefit by allowing them to earn compensation but defer claiming the income until after retirement when the compensation is typically received (Lynch and Perry, 2003).

1.5: Assumptions

The U.S. Securities Exchange Commission (SEC) only requires publicly traded companies to report information on the top four executives. At times, this dissertation references senior executives, but the focus of the paper is on executive compensation in terms of the CEO. The conceptual model that is presented can be applied to any of the executive officers in an organization but is specifically linked to the CEO. The study is limited to U.S. publicly traded companies, but could be reconfigured to accommodate senior executives in non-profit organizations. The conceptual model is designed using a

المنارة للاستشارات
www.manaraa.com

set of predetermined variables that are known to relate to each of the stakeholders. The model is extremely flexible allowing variables to be added, deleted, or changed according to an organization's needs.

In this chapter, executive compensation has been presented as complex and long-standing with issues associated with how much executives are paid and how they receive compensation, whether it is salary, stock options, perquisites, restricted stock, retirement plans or severance. There is an abundance of literature on executive compensation prescribing ways to appropriately address pay and compensation issues but with widespread criticism of CEO pay packages there is a need for a model that addresses executive compensation design. The Executive Scorecard mentioned earlier will be discussed in the following chapters. The executive scorecard provides a well-structured compensation model that benefits the company, the CEO, and the stakeholders by setting objective standards that motivate the CEO while aligning with corporate short-term and long-term performance goals.

1.6: Chapter One Summary and Organization of Dissertation

This chapter introduced current issues surrounding executive compensation practices and a discussion of the history of compensation and how compensations has evolved into a complex pay system that now has investors, government and businesses asking how much executives should be paid, what criteria should be used in determining compensation and how should compensation be linked to a firm's goals and strategies.. The next chapter provides a detailed literature review of executive compensation.

Much of the scholarly literature on executive compensation focuses on the pay an executive earns in relation to the size of a firm, the performance of the firm, and the

المنارة للاستشارات
www.manaraa.com

ability of the firm to motivate the executive. The research on these specific areas of executive compensation is explored in Chapter Two. The focus is on senior executive level pay especially at the CEO level. Several key compensation models are described and the strengths and weaknesses of each model prototype are discussed. Specific interest is given to agency theory, firm performance, and stakeholder expectations as they are closely related to executive compensation.

Using concepts described in the literature review, a conceptual model is presented in Chapter Three depicting an executive scorecard that identifies executive goals, which are used to develop a set of measures that align executive compensation with the firm's goals and objectives while meeting stakeholder expectations. Chapter Four presents a discussion of the research approach for this dissertation and supporting evidence of methodology. Chapter Five is an analysis and discussion of the findings from the literature review and conclusion that addresses answers to the research questions. The dissertation concludes with Chapter Six discussing future trends relating to executive compensation, implications for management, and suggestions for future research.

المنارة للاستشارات
www.manaraa.com

Chapter Two: Literature Review

2.1: Introduction

The financial crisis of 2008 brought renewed interest in executive compensation. A look at executive compensation in the United States shows a long history of debate by the public, the media and the government over what has been claimed as excessive pay. A review of the literature shows no shortage of academic research on executive compensation. Much of the groundbreaking research in the field of executive compensation has to do with explaining senior executive pay in relation to the size of the company. Research has also focused on the relationship between pay and performance and the relationship between pay and behavior with a focus on motivating factors. More than 100 compensation models have been designed to explain and determine the appropriate level of executive compensation. Freeman (1984) introduced the stakeholders' model that is critically acclaimed but has been criticized for having shortcomings, such as the use of the theory expressed either explicitly or implicitly for descriptive purposes (Donaldson and Preston (1995), the boundaries and the level of the firm's environment, the ambivalent position of pressure groups and regulators (Fassin, 2009). Donaldson and Preston (1995) address the stakeholders' model shortcomings, presenting a more comprehensive framework that considers all stakeholders who have an interest in a firm.

2.2: Components of Salary

Executive compensation is a term used for the assemblage of components that make up the pay package of a CEO. The components of executive compensation are base

المنارة للاستشارات
www.manaraa.com

salary, incentive awards, benefits and allowances in kind, and any additional compensation. Barrington and Hallock's (2009) study consisted of defining elements of compensation as described in Chapter One. No specific detail was provided on the study but one interesting finding was that the compensation mix for executives is moving away from total cash compensation and stock options to stock. Despite this finding, CEO's continue to earn more cash compensation than in previous years. The insurance industry was the largest median gainer in cash compensation with food and tobacco CEO's earning the highest median total compensation. Barrington and Hallock also noted that as a result of the financial crisis, companies can expect greater scrutiny of compensation packages due to mistrust in leaders.

Base salary is a fixed payments unrelated to performance. Bizjak, Lemmon & Naveen (2008) performed a study on randomly selected compensation committee reports of 100 companies from the Standard and Poor's (S&P) 500 index in 1997. Data was extracted from corporate proxy statements. Findings revealed that 96 firms used competitive benchmarking or peer groups to determine executives' base salary, bonus and option awards. Most firms that used peer groups target pay level at or above the 50th percentile of the peer group (Bizjak et al, 2008). Competitive benchmarking proved to be an important part of an executive's pay as CEO's paid below the median level of their industry-and size matched peers received increases in total pay of $1.3 million per year greater than the raises received by their counterparts whose pay was above the peer group median (Bizjak et al., 2008). The study also showed that one-third of executives paid below the peer group median consistently received pay adjustments that placed them above the median level of pay for their peer group. Lastly, Bizjak et al. (2008) found that

المنارة للاستشارات
www.manaraa.com

the effects of peer group benchmarking on changes in pay were much larger than the effects of stock price performance on changes in pay.

Incentive awards are used by almost every for-profit organization to compensate CEO's and top executives for a single year's accounting performance but are considered discretionary. Access to bonus information is typically derived from disclosures in company proxy statements. Companies such as the Hay Group perform studies and compile information from proxy statements. The results are released in publications akin to the Wall Street Journal. Murphy's (1999) study discussed below showed a wide disparity in executive bonus plans but consistency in categorizing plans into performance measures, performance standards, and the structure of pay-performance relation. The typical plan only pays a bonus once the threshold has been surpassed (expressed as a percentage of the performance standard), and then a minimum bonus is paid at the threshold performance (paid as a percentage of the target bonus), and target bonuses are paid for meeting the performance standard (Murphy, 1999). Additionally, most plans include a cap on the amount of bonus paid. The author points out that CEO pay literature has yet to reach a consensus on appropriate pay methodologies and metrics used in implicitly evaluating the CEO.

Financial and non-financial performance measures are used by almost all companies focusing on a measure of accounting profits (revenues, net income, pre-tax income, operating profits or economic value added) or using dollar-value of profits (earnings per share, income-to-sales, return on assets or return on equity) (Murphy, 1999). Most firms elect to use multiple measures or a matrix of performance measures to minimize the extreme effects on bonuses paid when only one measure is used.

المنارة للاستشارات
www.manaraa.com

The Behn (2003) study attempted to determine what kind of performance an organization should measure, how the organization should measure performance, and what the organization should do with the measurements. Although specific details of the study are not provided, this study was an exploration of the various purposes of performance measures. Behn focused on those people who manage public agencies and asks, “What purpose exactly is a public manager attempting to achieve by measuring performance?” (p. 587). Behn argues that if an organization or manager lacks a clear idea about how to use data, then all of the reliable and valid data about performance is of little use. Believing that a manager’s real job when working with performance measures is to improve performance, Behn identifies eight purposes for using performance measurements as part of an overall management strategy. These purposes include: evaluate, control, budget, motivate, promote, celebrate, learn, and improve.

Behn (2003) stated that the selection criterion for each measurement purpose was important because a measure appropriate for one purpose may be completely useless for another. No one single measurement is appropriate for all circumstances so by focusing on purposes rather than users, it becomes easier to identify which characteristics of the measures will be most helpful. To know whether a certain performance measure is helpful for a specific purpose is best understood by knowing the characteristics required by the manager’s purpose (Table 2).

المنارة للاستشارات
www.manaraa.com

Table 2: Performance Measures

Purpose	Questions that Performance Measure can Help Answer	Characteristics	Standard
Evaluate	How well is an organization performing?	Outcomes, combined with inputs and with the effects of exogenous factors	To use a measure to *evaluate* performance, public managers need some kind of desired result with which to compare the data, and thus judge performance.
Control	How can an organization ensure employees/CEO's are doing the right thing?	Inputs that can be regulated	To use a measure of performance to *control* behavior, public managers need first to establish the desired behavioral or input standard from which to gauge individual or collective deviance.
Budget	On what programs, people, or projects should an organization spend their money?	Efficiency measures (specifically outcomes or outputs divided by inputs)	To use efficiency measures to *budget,* public managers need an idea of what is a good, acceptable, or poor level of efficiency.
Motivate	How can line-staff, middle managers, CEO, stakeholders, and citizens be motivated to do the things necessary to improve performance?	Almost-real-time outputs compared with production targets	To use performance measures to *motivate* people, public managers need some sense of what are reasonable and significant targets.
Promote	How can political superiors, legislators, stakeholders, journalists and citizens be convinced that an organization is doing a good job?	Easily understood aspects of performance about which citizens really care	To use performance measures to *promote* an agency's competence, public managers need to understand what the public cares about.
Celebrate	What accomplishments are worthy of the important organizational ritual of celebrating success?	Celebrate periodic and significant performance targets that, when achieved, provide people with real and collective accomplishments.	To use performance measures to *celebrate,* public managers need to discern the kinds of achievements that employees and collaborators think are worth celebrating.
Learn	What is working or not working?	Disaggregated data that can reveal deviancies from the expected	To use performance measures to *learn,* public managers need to be able to detect unexpected (and significant)

المنارة للاستشارات
www.manaraa.com

			developments and anticipate a wide variety of common organizational, human, and societal behaviors.
Improve	What exactly should who do differently to improve?	Inside-the-black-box relationships that connect changes in operations to changes in inputs and outcomes	To use performance measures to *improve,* public managers need an understanding (or prediction) of how their actions affect the inside-the-black-box behavior of the people who contribute to their desired outputs and outcomes.

Source: Adapted from Behn (2003)

In the study conducted by Murthy and Salter (1975), compensation of 53 executives was looked at along with the compensation characteristics of an organization. An average of nine years of data was reviewed, testing the relationship between compensation practices and corporate strategies. The sample of companies were placed into three strategies categories in ascending order of product-market diversity. Dominant-business companies consisted of firms with revenue derived largely from a single business; related-business companies consisted of firms with business that tended to be related through technological, marketing, or other skills, and unrelated-business companies were firms with a portfolio of old and new businesses that had little relationship to one another. Compensation characteristics of each company were compared with those of others in its class to develop patterns of practice and then contrasted with those in other classes. The purpose of the study was two-fold: 1) to determine how much corporate strategy influenced the characteristics of CEO compensation, and 2) to identify differences in the level of corporate profit performance affected by compensation characteristics. To achieve the second goal, each strategy classification was divided into either high or low-performing companies.

المنارة للاستشارات
www.manaraa.com

Findings of the study indicated that CEO compensation in one organization can be very distinct from other organizations even when characteristics are similar. For example, changes in top executive compensation were linked to changes in the financial measures of performance, especially earnings per share, more commonly among the high-performing related- and unrelated- business companies than among the dominant-business ones. Additionally, several dimensions of CEO can be related to organizational strategies. Attempting to explain the varying patterns of compensation, Murthy and Salter (1975) argued that as the degree of a company's product-market diversity increases, and there is a shift toward financial resource management, the basis of evaluating investment opportunities would move to financial measures of performance. It would be likely that the CEO is evaluated based on these same criteria. Additionally, Murthy and Salter (1975) believed that boards failed to be effective in evaluating, appraising, and measuring a CEO's performance due to a lack of defined criteria, being friendly board members, and control of data by the CEO.

Murphy (1999) also described the most commonly used non-financial performance measures used in annual incentive plans. An Individual Performance metric is evaluated based on pre-established objectives and subjective assessment of individual performance. Other non-financial measures include customer satisfaction, operational and/or strategic objectives such as increasing plant capacity, bringing a new computer system online by a particular date, reducing time-to-market, and measures of plant safety (p. 12). Murphy noted that financial institutions are less likely to use non-financial measures than industrial firms. However, the author noted that utility companies are more apt to use non-financial performance measures.

المنارة للاستشارات
www.manaraa.com

Compensation plans that supplement financial metrics overcome the short-run orientation of accounting based reward systems and are used to assess performance dimensions that included in short-term financial results (Ittner, Larcker & Meyer, 2003). Using data from the North American retail banking operations of Global Financial Services, the study by Ittner et al. (2003) led to the development of a new retail banking business model in 1992 that captured non-financial performance measures that included "cost effectiveness, risk control, employee relations, innovation, and customer satisfaction" (p. 732). These nonfinancial measures were tied to pre-established objectives and subjective assessments of individual performance are commonly used measures in addition to financial measures (Ittner et al., 2003, Murphy, 1999).

2.3: History of Compensation

The issues that surround executive compensation are not new. In fact, looking as far back as the 1800's, there were various measures taken by the government to regulate compensation payouts and to control the inequities that appeared to arise with compensation packages. Table 3 provides an overview of the history compensation and the legislation enacted in an attempt to regulate compensation packages.

Table 3 Timeline – History of Compensation

Timeline – History of Compensation	
Year	**Event**
1818	Pension established for war veterans
1861	Income tax of 3% on personal income over $800 established under the Revenue Act
1875	American Express established employee-sponsored pension plan

www.manaraa.com

1902	Bethlehem Steel adopted first executive bonus plan
1904	DuPont adopted bonus plan
1910	Montgomery Ward adopted the first group accident and sickness policy for employees
1911	Equitable Life Assurance Society established first group life insurance plan
1918	General Motors established its first bonus plan
1928	Metropolitan Insurance Company underwrote largest group health plan for General Motors
1928	Sixty-four percent of companies had bonus and profit-sharing plans
1930	Bethlehem Steel President, Eugene G. Grace earned a salary of $12,000 and a bonus of $1.6 million
1931	Stockholders filed suit against Bethlehem Steel contesting executive bonuses and options
1932	Bethlehem Steel issued dividend equivalents on depreciated stock options
1933	Congress enacted the 1933 Security Act to regulate the offer and sale of securities and stipulated disclosure requirements
1934	Marshall Fields created stock appreciation rights
1937	Social Security Act enacted
1942	Congress passed the Wage Stability Act that limited the increase in fringe benefits and froze executive pay
1947	Taft-Hartley Act passed; labor/management and pension plans permitted
1949	Liberty Mutual Insurance Company issued first major medical group insurance plan to General Electric
1950	Revenue Act passed creating restricted stock options that provided tax shield until shares were sold. Implementation of capital gains and ordinary income tax.
1959	First annual study of executive compensation published by American Management Association (AMA)

المنارة للاستشارات
www.manaraa.com

1964	Civil Rights Act passed prohibiting discrimination in pay
1969	First stock appreciation rights issued and tax advantage of qualified stock options reduced
1974	Employee Retirement Income Security Act (ERISA) established setting retirement benefit limits and savings/profit-sharing contributions maximums
1976	Three-fourths of publicly held firms report having bonus award programs
1980	Gap between rich and poor grew; first time in history that half of all women 20 years old and over were in the workforce
1986	Tax Reform Act passed that caused a change in tax brackets, faster minimum vesting schedules, restrictions on 401K and IRA contributions that impacted all aspects of executive compensation
1988	Average CEO earned $2 million
1991	Executive compensation deduction limited to $1 million
1992	SEC required disclosure of executive compensation through proxy.
1993	Fifty-eight percent of all women in workforce
1995	Average CEO compensation rose 30 percent
1996	Corporate profits rose 11 percent compared to CEO salary increase of 39 percent, and average compensation rose 54 percent
1997	Mix of executive compensation moved away from cash toward stock options
2006	SEC passed regulation to disclose all components of compensation in one location
2008	Financial crisis of financial services industry
2008	Emergency Economic Stabilization Act (EESA) of 2008
2009	American Recovery and Reinvestment Act (ARRA) of 2009
2009	Corporate and Financial Institution Compensation Fairness Act passed requiring certain financial institutions to have compensation structures

Adapted from Balkcom and Brossy (1997)

المنارة للاستشارات
www.manaraa.com

In the late 1700's, companies began hiring professional managers to perform work alleviating the burden on owners. At first, these professional managers earned just a salary, but it was not long before owners began paying stock options in an effort to get managers thinking like owners. It was not until 25 years later that benefits were extended to employees. For example, in 1818, pensions were established for veterans of the Revolutionary War, and in 1847, the Massachusetts Health Company of Boston issued medical insurance (Balkcom and Brossy, 1997). By the late 1800's, Standard Oil established the first trusts. During this time, J. P. Morgan had the mindset that CEO pay should be limited to no more than 20 times that of the average worker (Ellig, 2006). This amount did not include dividends and the expectation was that the CEO would retain possession of stock.

Prior to the stock market crash in 1929, many large corporation such as General Motors and Bethlehem Steel established annual cash bonus plans for their CEO's In 1930, when Eugene G. Grace, President of Bethlehem Steel received a salary of $12,000 and a bonus of over $1.6 million, there was an outcry by the general public and politicians. By today's standards, Grace's salary would translate into $110,000 in base salary and $14.9 million in cash compensation (Balkcom and Brossy, 1997).

After the crash, companies faced with the stagnant stock market, introduced alternative equity plans that were stock payouts based on company performance. In 1932, Bethlehem Steel issued dividend equivalents on outstanding underwater (sharply depreciated) stock options (Ellig, 2006). In 1934, Marshall Fields, an executive pay designer, created stock appreciation rights but rights were not issued until 1969.

للاستشارات المنارة
www.manaraa.com

Congress stepped in and enacted the 1933 Security Act, the first major legislation to regulate the offer and sale of securities and disclosure requirements on corporations.

In 1942, Congress passed the Wage Stabilization Act, limiting increases in fringe benefits and freezing executive pay. The enactment of this act might have led General Motors to defer pay increases (Ellig (2006). In 1950, the Revenue Act created restricted stock options that provided tax shields on stock options until the sale of shares, and implemented the capital gains and ordinary income tax (Balkcom and Brossy, 1997).

The 1960's and 1970's brought about long-term disability plans, savings and vacation plans, Medicare, prescription plans, health benefit plans, profit-sharing contributions, and pension plans. By the 1980's, the income gap between the rich and poor became apparent when American citizens with incomes in the "top 25 percentile increased their share of national income by 15.9% while those American citizens with incomes in the lowest 25 percentile experienced a drop in income of 6.8%" (Balkcom and Brossy, 1997, p. 60). The Reagan years brought several tax reform acts that changed the tax structure and rules concerning many top-heavy retirement plans that included severance agreement clauses in executive contracts. In fact, every aspect of executive compensation was affected with the Tax Reform Act of 1986. There was a reduction in tax brackets from 15 to 2 (15% and 28%) and the capital gains tax was changed from 28% to 20% (Balkcom and Brossy, 1997).

By 1988, U.S. CEO's earned an average of $2 million, which represented approximately 93 times the wages paid to the average production worker (Balkcom and Brossy, 1997). In 1991, the amount of executive compensation a company could deduct unless linked to performance was limited by Section 162 of the Internal Revenue Code to

المنارة للاستشارات
www.manaraa.com

$1 million (Hanley, 1996). Interestingly, in this same year, the average CEO's salary dropped approximately 7% in response to shareholder complaints but total compensation rose 26% to $2.5 million, an amount that represented 104 times the average wage for production workers (Balkcom and Brossy, 1997). A year later, the Securities Exchange Commission (SEC) required more transparent, succinct, and understandable disclosure about the type and amount of executive compensation of publicly companies.

In 1995, the average total CEO compensation rose 30% and in 1996, corporate profits were reported as rising 11% with the average CEO salary and bonus rising 39% to $2.3 million with total compensation rising to 54% or $5.8 million (Balkcom and Brossy, 1997). In the same year, the average wages for production workers increased 3% (Balkcom and Brossy, 1997).

In an effort to provide more clarity to executive compensation disclosures, the SEC passed a regulation in 1996 requiring companies to report all components of compensation for the CEO, CFO, and the next four highest paid executives within one location. The passage of this regulation was meant to provide transparency to shareholders and to help compensation committees improve corporate governance. By 2008, the SEC rules required companies to disclose the targets that executives were given in order to earn incentives. Many companies refused to disclose this information, claiming that doing so would provide other firms with competitive information (Balkcom and Brossy, 1997).

The Wall Street Journal reports that the highest paid executives of U.S. public companies during the past decade included Larry Ellison of Oracle Corporation receiving $1.84 billion in compensation, Barry Diller of IAC/InterActive at $1.14 billion, Ray Irani

المنارة للاستشارات
www.manaraa.com

from Occidental Petroleum Corporation at $857 million and Steve Jobs from Apple, Inc. at $749 million (Thurm, 2010). The Wall Street Journal Proxy Statement Survey of CEO Compensation conducted by the Hay Group in 2009 analyzed 456 U.S. companies with reported revenues of at least $4 billion in their most recent fiscal year. The study showed long-term incentive awards in the form of stocks and stock options fell 4.6 to a median of $5 million but salaries and bonuses rose 3.2% to $2.64 million (Lublin, 2010). Table 4 depicts CEO's who experience the largest percentage change in total direct compensation for 2009.

Table 4: 2009 CEO Compensation

CEO	Company	Salary	Percentage change from 2008 compensation
Charles Ergen	Dish Network Corp.	$623,100	(92.5%)
Jeffrey Immelt	General Electric Co.	$5.1M	(4.7%)
John Surma	U.S. Steel	$1.3M	(88%)
Andrea Jung	Avon	$6.8M	(74%)
Roger Penske	Penske Automotive	$3.9M	285%
Mike Jackson	AutoNation	$4.9M	108%
Stephan MacMillan	Stryker	$3.7M	104%

Source: Lublin, 2010

The study further indicated that the decline in compensation 0.9% to $6.95 million of CEO's for the 200 major U.S. companies was in response to the recession, government controls, and public outcry over high compensation packages (Lublin, 2010).

المنارة للاستشارات
www.manaraa.com

2.4: Comparison of CEO Salary to Average Worker

Part of the controversy surrounding executive compensation is the comparison of CEO salary to the average worker's wage. In 1990, CEO compensation was approximately 100 times that of the typical worker, but by 2000, CEO pay was between 350 and 570 times that of the typical worker mostly by use of stock options (Harris, 2008). These multiples represent a pay that is equivalent to the average worker making $517 a week versus the average CEO making $155,769 a week (Harris, 2008). Viewing the average worker's pay in terms of real wages, Mishel, Bernstein, & Allegretto (2007) assert that real wages have decreased the earning power of average worker's making the wage disparity more noticeable.

Harris' (2008) study raised the question of whether the income disparity between CEO and average worker is one of futility since making salary comparisons of other professions is disingenuous and violates a fundamental tenet of capitalism in which "different jobs with different educational requirements and differing levels of expertise and responsibility should be compensated differentially" (p. 149). The study also showed that when comparing salaries, the comparison should be done between jobs with the same function, which is why compensation usually reflects the size of the organization and the complexity of the managerial responsibilities. Based on the level of managerial complexities and firm size, Harris (2008) recommended comparison of salary be limited to the average worker at the same firm who demonstrates similar educational background, resume, promise, and qualifying requirements. Lastly, the study indicates that the average worker pool should include the highest paid knowledge workers (general counsel, CFO, vice presidents) and lowest paid workers (minimum wage employees and entry-level workers) to bring parity to the ratio and then have the information interpreted to

المنارة للاستشارات
www.manaraa.com

determine whether the CEO is overpaid or the average worker is underpaid (Harris, 2008).

2.5: Excessive Pay

The debate of excessive executive compensation is a long-standing one with claims that CEO's receive large compensation packages as a reward for the continued success of their firm, but Nichols and Subramaniam (2001) argue that this assumption is unjustifiable because the profits and stock prices have not risen as fast as CEO compensation. In their efforts to determine whether executive compensation is excessive or equitable, Nichols and Subramanian (2001) reviewed the literature on executive compensation and examined, compared, and provided conclusions on the validity of the arguments presented by critics of executive compensation. The authors focused on the size of CEO pay in terms of whether arguments are fair or equitable. Criteria used include the relationship between executive's pay and other workers' pay and the relationship between executive pay and firm performance (Nichols and Subramanian, 2001).

Nichols and Subramaniam (2001) came to the conclusion that although there is a large disparity between CEO compensation and the average worker, there was no conclusive evidence that the difference was a result of CEO's being overpaid. The authors see the argument as unsuccessful because critics attempt to compare to an executive's pay to another worker's pay but fail to have a definitive standard for comparison. Different positions in an organization earn different salaries due to different levels of responsibility or complexity of duties. According to the authors, due to the high level of responsibility and job complexity a CEO has, the position warrants a significantly

المنارة للاستشارات
www.manaraa.com

higher pay than the average worker. A person working as a flight attendant would not expect to earn as much as a pilot since the level of responsibility and job complexity of a pilot exceed that of the flight attendant. This phenomenon can also be applied to a pilot and the CEO of an airline corporation. Although a pilot admittedly has a high level of responsibility and job complexity, the magnitude of responsibility and complexity of the CEO exceeds that of a pilot.

Cordeiro and Rajagopalan (2003) conducted a qualitative study of "313 U.S. firms in thirty 4-digit SIC codes in 1992 drawn from Standard & Poor's ExecuComp database" (p. O5). The study's purpose was to bridge the gap in the extant research between variations in CEO incentive compensation mix and variations in industry-level discretion. The use of SIC codes from Finkelstein and Abrahamson (1995) industry discretion scores provided at least five firm per SIC code forming a stable panel over the 1992-95 period. The findings revealed high salaries are needed to attract and retain CEO's and for the high level of risk associated with maximizing shareholder wealth in highly industry discretion environments wrought with uncertainty and complexity.

Other studies contrast with Nichols and Subramaniam (2001) and Cordeiro and Rajagopalan's (2003) results on job responsibility and job complexity. For example, Finkelstein and Hambrick (1988) conducted a study by designing a matrix of promising research prospects on CEO pay that helped the researchers distinguish between the determinants and consequences of CEO compensation, and between the exploration of overall amounts of compensation as opposed to types and mixes of compensation (p. 554). The study found that it is necessary to look beyond size and performance,

المنارة للاستشارات
www.manaraa.com

comprehending CEO pay from multiples perspectives that include economic, social, political, individual, and industry and a CEO's preference for mix and type of pay.

The Institute for Policy Studies (2007) indicated compensation is a function of supply and demand, and of the CEO's contribution (increase in firm value and profits) to the organization. A change in supply causes price and quantity to move in opposite directions. An increase in supply decreases the equilibrium price and increases the equilibrium quantity and vice versa. So, if the job of a CEO or senior executive becomes more attractive, then the supply of the CEO's or senior executives would increase and the equilibrium pay would decrease (O'Sullivan, Sheffrin, and Perez, 2008), and if the job of a CEO is seen as less attractive, then the supply of CEO's would decrease and the equilibrium pay would increase.

The attractiveness of the position is not the only variable that potentially influences a CEO's pay. Few individuals have the outstanding skills to play in a band or play a professional sport. The Kaplan and Rauh (2010) study used data from the ExecuComp database on pay for top executives of public firms utilizing realized or actual compensation that included options exercised during the year. Data was also extrapolated from companies not on the ExecuComp database but reported to the Internal Revenue Service (IRS). Financial statements of publicly traded investment banking firms were used to make assumptions of pay distributions and then pay estimates were done on the most highly compensated executives and managers, hedge funds managers, venture capital funds managers, lawyers and professional ball players.

It was estimated that the groups studied represented 15-27% of the individuals who comprise the top 0.1% AGI bracket with CEO's representing 2.0 -6.4% of the top

المنارة للاستشارات
www.manaraa.com

bracket. The findings of the study showed that between 1994 and 2004, top executives of nonfinancial firms in the top bracket represented in the study experienced an increase in realized pay but remained the same in ex ante compensation. In comparison, Wall Street hedge fund managers, venture capitalist investors, and corporate lawyers, experienced a substantial increase in pay. Kaplan and Rauh (2010) believed the most plausible explanation of these findings is "scale and technological change" in that advances in technology can increase relative productivity in individuals and firms that ultimately helps firms become larger (p. 1048).

Hodak (2010) provided a rebuttal to seven myths about excessive pay for CEO's in response to pay controversy focused on not just banks but the entire public-company world. Hodak (2010) claimed that there was resentment by the populace over U.S. banks paying out bonuses during a time of economic downturn because big banks were perceived as being responsibility for the financial crisis. Further, Hodak (2010) argued that CEO's possess a unique and cherished talent for which companies are willing to pay bonuses. While some CEO's are overpaid, most are underpaid in relation to their contributions. Another distinction to push myth aside is that CEO's take advantage of pliant boards, extracting perks and privileges that would not exist had they not possessed managerial power. Hodak (2010) did not support his arguments with theory or any other form of evidence, but he did suggest that boards should offer bonuses to align pay with performance rather than to pad management's pockets.

2.6: Comparison of U.S. Compensation to Other Countries

According to the Wall Street Journal's annual analysis of the 350 largest public companies, the average CEO was paid $10 million in 2004 representing a 14.5 percent

المنارة للاستشارات
www.manaraa.com

increase from 2003 (Burton and Weller, 2005). In 1999, the United for a Fair Economy annual Executive Compensation Survey showed German CEO's made 13 times more than the average German manufacturing employee and Japanese CEO's make 11 times more than the average worker (Greenfield, 1999).

A key topic covered in the International Institute for Labour Studies publication entitled World of Work Report was executive pay and the linkages to firm performance and related policy issues. The executive compensation study included in six countries (Australia, Germany, Hong-Kong, China, the Netherlands, South Africa, and the United States) across a wide geographic area where disclosure practices allowed comparison (Ebert, Torres, & Papadakis, 2008). The study examined executive pay of the 15 largest companies and the countries were selected based on Forbes' "Global 2000" ranked in 2008. The purpose of the study was to depict development in the six countries to show structural similarities, differences and trends. The results of the studies showed that between 2003 and 2007, the average American worker's pay grew at a rate of 2.7 percent compared to the average executive's pay at 15 percent, while CEO pay grew by 45 percent. By contrast, in the Netherlands, the average worker received a 2.4 percent increase while the average executive saw a 146 percent increase, and CEO pay increased by approximately 192 percent (Ebert et al., 2008). A comparison of executive pay in six countries showed that on average, executives (CEO and lower-level executives) earned between $1 million and $6.3 million and CEO's earn between $1.4 million and $10.4 million per year representing as much as 112 and 183 times respectively more than that of the average worker (Ebert et al., 2008). The authors believe these amounts are underestimated and actual amounts would be significantly higher if share-based compensation were included. This belief is based on the fact that the lack of disclosure

المنارة للاستشارات
www.manaraa.com

information on stock options and share-based compensation makes calculating actual or prospected value of these pay forms difficult. Additionally, the methodology of calculation varies by company. Some countries calculate the value of the share-based compensation at the time the shares were granted while other countries calculate the value at the time the shares and option were actually exercised.

China's economic growth has been impressive in the past 20-25 years. During this time, the corporate sector experienced privatization and a reduction in state-owned enterprises. With the reduction in state control, the role of the shareholder has increased. Although shareholder returns are minimal due to many floundering companies, executives play a major role in the profitability of Chinese firms (Rehbein, 2008). Chinese corporations have one major or dominant shareholder. Dominant shareholders are either state, state-owned enterprises that report to the central government, state-owned enterprises that report to the local government, private, non-state shareholders, or foreign investors (Rehbein, 2008). The state selects the dominant shareholder and oftentimes selects the CEO and determines his or her salary. The dominant shareholder owns approximately 46 percent of the firm with the next largest shareholder owning only 7 percent. Executive compensation is determined by the type of dominant shareholder in place. Interestingly, the size of the corporation affects the compensation and firms that have either private or foreign dominant shareholders tend to pay higher compensation to the executives, which Rehbein (2008) claims is a direct cause of executives hired for their knowledge and expertise. These findings were based on a study by Firth, Fung, and Rui (2006) who performed a comparative study between executive compensation and corporate financial performance of Chinese firms. Rehbein (2008) does not provide

www.manaraa.com

specific details on the methodology used by Firth, Fung, and Rui, but noted that relatively little is known about Chinese executive compensation but

the insight into Chinese corporate governance provided by the study was important. The study showed no relationship between executive compensation and firm performance when a firm's dominant shareholder is the State.

2.7: Regulatory and Legal Intervention

The government and governing agencies to some degree or another have been involved in setting regulations to control executive compensation since the Securities Exchange Act of 1934. Various tax acts were passed throughout the years to tax stock options and to impose taxes on high income. The Wage Stabilization Act was passed in 1842 to freeze pay and to limit fringe benefits and in 1964, the Revenue Act was passed to place mandates on stock option purchase prices. More recently, in 2007, the Securities Exchange Commission (SEC) implemented disclosure requirements on executive compensation. Added to these rulings, the Financial Accounting Standards Board (FASB) has taken action to promote accountability and to create a consistent and transparent accounting of executive compensation.

Today, regulators are contemplating measures to curb executive pay (Grant and Grant, 2008). In response to regulatory action, board of directors in many companies have moved towards setting stronger criteria and developing specific performance targets to support decisions concerning executive compensation. Executive decisions are now being scrutinized by stakeholders who view executive compensation as excessive and demanding accountability of the CEO's and the Board's actions (Grant and Grant, 2008).

المنارة للاستشارات
www.manaraa.com

Executive compensation programs have begun to change as a result of the financial crisis of 2008. Consequences of the perceived relationship between executive compensation and the financial crisis has been an increased focus on excesses in executive compensation and heightened involvement by the federal government in regulating the structure and disclosure of executive pay. . On February 4, 2009, the White House and the Treasury Department announced new guideline on executive pay for financial institutions receiving assistance under the Troubled Assets Relief Program (TARP) of the American Recovery and Reinvestment Act (ARRA) (O'Donnell, 2009). The American Recovery and Reinvestment Act signed in 2009 introduced new requirements restricting TARP participants prohibiting from paying or accruing bonuses, retention awards, or incentive compensation (O'Donnell, 2009). Additionally, companies receiving financial assistance under the (TARP) are subject to a host of restrictions including having to certify the use of luxury expenditures, disclosure of executive compensation arrangements and alignment of disclosures with promoting sound risk management and long-term value creation for the institution and shareholders, and compliance and certification by CEO and compensation committee of Treasury Department's contractual executive compensation restrictions (Morgan Lewis, 2009). The SEC encouraged all public companies to reassess and mitigate the risk associated with compensation programs (O'Donnell, 2009).

Steinberg's (2009) study presented the challenges board members experience when trying to offer closer oversight of management's activities and attempting to comply with legal and regulatory requirements. The study examined the challenges faced by boards when trying to balance the management of a comprehensive compliance

المنارة للاستشارات
www.manaraa.com

program and when providing advice and direction to CEO's so corporations can add value for the shareholder's benefit. The findings of the study showed that organizations need the correct strategy, the right CEO, good shareholder relations, and an enlightened board that can balance the role of monitoring management and providing wise counsel to the CEO.

Albano et al. (2011) reported on the passing of Rule 14a-21(a) and (b), adopted by the SEC in January 2011. The Rule included say on pay, say on pay frequency, and say on golden parachutes shareholder advisory votes required by the Dodd-Frank Act. The rule requires more disclosure on executive compensation including golden parachute agreements and allows public companies to "claw back" (take back) an executive's compensation if a company fails and it can be shown that the CEO is largely responsible for its failure.

2.8: Agency Theory

Since Berle and Means (1932) first described the separation of interest in the corporation between the management team and owners, agency theory has been discussed widely in the literature on agency theory. Based on the principal-agent problem, agency theory suggests that because the conditions of incomplete and asymmetric information (conflict of interest) occur when a principal hires an agent, corporate executives who use their discretion in management will act in their own self-interest, maximizing their own utility rather than acting on behalf of the owners (Jensen and Meckling, 1976). Even if complete information regarding the CEO's activities and the firm's investment opportunities were available, the shareholder cannot observe all of the actions the CEO

www.manaraa.com

takes. Incentives were designed to encourage managers to engage in actions that increase shareholder wealth (Jensen and Murphy, 1990).

Bebchuk and Fried's (2003) paper described two approaches to studying executive compensation. No methodology was provided but the authors set the discussion against the background of the agency problem that afflicts management decision-making. The purpose of the study was to distinguish between the "Optimal Contracting Approach" and the "Managerial Power Approach" as they relate to publicly traded companies without a controlling shareholder. The Optimal Contracting Approach assumes board members set out to work in the shareholder's best interest providing senior executives significant incentives to deter them from working in their own best interest, whereas the managerial power approach can be viewed in either of two ways, serving as a mechanism that addresses the agency problem or as being a part of the agency problem (Bebchuk and Fried, 2003).

Bebchuk and Fried (2003) noted that executives often receive non-performance incentives that are not visible to shareholders, which is inefficient compared to what the board awards in an effort to provide an efficient incentive. The authors recognized that executives sometimes use their influence to obtain option plans that appear to deviate from optimal contracting and benefit executives and managers but they support the use of equity-based compensation because it could provide attractive incentives to the executive. Bebchuk and Fried (2003) recognized that supporting the use of equity-based compensation is difficult to justify under the optimal contracting outlook but can advocate their view under the managerial power approach. The study focused on stock option plans that failed to filter stock price rises that occurred as a result of industry and market

المنارة للاستشارات
www.manaraa.com

trends that were unrelated to an executive's performance and at-the-money stock options. First, the authors suggested designing a reduced windfall options plan that completely or partially filtered stock price increases unrelated to performance by linking the exercise price of options to market-wide indexes or by the vesting of options on the firm meeting specified performance targets (earnings per share, stock price or other measures of firm performance) (Bebchuk and Fried (2003). The second method is to use out-of-money options. Out-of-money options are less likely to pay out than in-the-money options, and when they do the executive would receive less value. By giving executives more out-of-money options than in-money-options, the firm can increase the reward to the executive for performing well. The authors explain that the executive receives much higher pay-for-performance sensitivity per dollar of expected value than convention options.

2.9: Relationship between Pay and Size of Firm

In 1959, Roberts conducted a study to advance research on executive compensation. The study used a sample of corporations drawn from the Securities and Exchange Commission consisting mostly of larger publicly owned firms. Of approximately 3000 firms, a sample of 410 companies for the years 1945, 1948, and 1949 and 939 companies (including all but 18 of the 410) for 1950 were used. Also included was a subgroup of 65 for the period of 1935. Seventy percent of the sample companies focused on manufacturing with all major industrial divisions represented. Seven percent of the public utility industry is included in the early years and 25 percent in the 1950 sample. The airline industry was included in the 1950 sample with 70 percent coverage. Overall, each industry's output as well as large, medium and small firms was included.

المنارة للاستشارات
www.manaraa.com

The theoretical compensation (amount that would have to be paid to secure the services of the best alternative executive plus an indeterminate part of the difference in total company profit under the direction of the two executives) of a CEO of a small firm cannot be large compared to the amount that an executive of a large company would receive because of the amount of scope involved in each position (Roberts, 1959). To diffuse the argument that small firms have the ability to make huge profits, the authors argue that "profit is the product of profit per unit and the number of units sold, therefore, compared to a larger firm, a small firm sells fewer units, and even a substantial difference in profit per unit under two executives cannot yield a large difference in total company profits" (p. 292).

In Agarwal's (1981) study designed to identify factors that explain executive compensation, a conceptual model consisting of individual and organizational variables was proposed and empirically tested on data from chief executives of 168 life insurance companies, which was selected because of availability of funds and ease of data collection. Data was collected using a pretested, mailed questionnaire. Companies included in the study cover a wide range of sizes. The author stated that the model is useful in providing an explanation of the relationship found between executive compensation and firm size. The author contend that expansion in size tends to produce a more differentiated structure in terms of functional, vertical, and spatial dimensions creating a need for greater executive control and coordination. Having more complex structures renders the executive jobs more complex in terms of span of control, functional specialization, vertical differentiation, and spatial diversity. Findings of the study showed a significant relationship between executive compensation and firm size with a

المنارة للاستشارات
www.manaraa.com

correlation between the two of 0.784. Additionally, company size is closely related to job complexity and a firm's ability to pay.

O'Reilly and Main (2007) performed a series of empirical tests examining firms in the retail (127 firms) and semi-conductors industry (137 firms). An executive compensation firm provided data on firm size (revenue and employees), performance (total shareholder return), CEO (age, sex, tenure), the board (number of directors, insider-outsider status, number of meetings, number of committees), individual directors (sex, fees, status, age), and executive compensation (base, bonus, options granted, long-term incentives, restricted stock grants) (O'Reilly and Main, 2007, p. 5). The study investigated "principal-agent theory versus managerial power predictions for CEO pay, interpreted through the lens of reciprocity and social influence" (p. 4). Principal-agent theory is concerned with the separation of ownership and control, and how to motivate a CEO to act in the best interest of the principal (stockholder).

Since asymmetric information is present, there is a potential for conflict of interest and moral hazard by the CEO. Variables to assess reciprocity such as fees paid to the head of the compensation committee and the extent to which the CEO was on the board prior to the chair of the compensation committee that reflects the discretion of the CEO's to provide directorship were analyzed. To assess social influence over board members, variable such as whether the CEO was older than the chair of the compensation committee, whether the CEO's also served as chairman of the board, which facilities control, and whether the CEO is a member of the compensation committee. Findings were consistent with those of many other researchers such as Roberts (1959) and Agarwal (1981) in that firm size (revenues, employees) is relatively more important than firm

المنارة للاستشارات
www.manaraa.com

performance (total shareholder return) in explaining various measures of pay (base salary, bonus, total cash compensation, value of stock options, value of restricted stock awarded, and pay-for-performance sensitivity (O'Reilly and Main, 2007).

Simon (1957) as cited in Argawal (1981) performed a study based on a sociological premise that claim organizations are hierarchical structures containing different levels governed by a set of rules and practices that compensate executives based on the market forces that are influenced by a competitive market. Specific details of the study were not provided but the author described the differential in salary between executive and subordinate as a ratio rather than a measure in absolute terms. An executive's salary was described as "*b"* times the salary of immediate subordinates, no matter what the subordinate's level. Despite variation in the value of *"b",* the figure can be expected to average between 1.25 and 2 with instances of larger or smaller ratios. The study found that the more levels of management, the higher the pay expected for top executives. Simon (1957) explained that large companies have more levels in the hierarchy, so the CEO would receive higher compensation.

Baker, Jensen & Murphy (1988) use survey data relating to pay from the 1985 edition of The Conference Board. The Conference Board report to member firms on separate regressions related to compensation-to-sales by industry and hierarchical rank. Doing so helps compensation committees set and compare compensation levels across firms and industries. Using estimated elasticity of CEO salary (elasticities correspond to the estimated coefficient from a regression of Log (Salary plus bonus) on Log (Sales) and bonus with respect to firm sales (operating revenues for utilities, deposits for banks and total premium income) for years 1973 to 1983, the findings indicated that a

المنارة للاستشارات
www.manaraa.com

compensation/sales elasticity of approximately 0.3 suggested the criteria used by compensation committees in determining CEO compensation related pay directly to firm size as measured by sales (Baker et al., 1988).

The elasticities mean and median equal to 0.31, remained stable across time and industries, and the correlation between size and compensation was high (Baker et al., 1988, p. 609). The study also showed that when holding the value of the firm constant and growing sales by 10 %, the salary and bonus of its CEO will increase by between 2% and 3% suggesting a causal relationship with the CEO salary increasing with increased firm size even when market value is reduced (Baker et al., 1988).

2.10: Relationship between Pay and Performance

In a study of performance pay and top-management incentives, Jensen and Murphy's (1990) analyzed more than 2,000 CEO's in a three sample study that lasted for more than five decades. Findings of the study indicated that it is in the best interest of a firm to tie compensation to performance. The author's pay-for-performance sensitivity analysis showed that a CEO and other top executives should own a substantial amount of company stock providing a link between the shareholder and the executive's wealth. For example, results on dismissal-related wealth consequences of each $1,000 shareholder loss for an average sized firm with 50 percent net-of-market returns for two consecutive years is $0.30 for the full sample $0.05 for large firms and $2.25 for small firms (Jensen and Murphy, 1990, p. 261).

Senior executives who control a large portion of the company's equity experience the "feedback effect," which is the benefit from the change in share value that is considered a performance incentive in itself (Jensen and Murphy, 1990, p. 141). The

المنارة للاستشارات
www.manaraa.com

authors proposed awarding cash compensation structured in a way that compensates for outstanding performance while providing meaningful penalties for poor performance. Further, the pay-for-performance, "reward/penalty compensation was found to be fair and equitable," since a CEO's experience results in a change in wealth of $3.25 for every $1,000 change in shareholder wealth (p. 227); an amount too small to be considered a highly influential incentive (Aggarwal and Samwick, 1999).

The role of institutional investors in relation to influencing corporate governance is examined by Hartzell and Starks' (2003). This study finds a strong positive relation between the concentration of institutional investor ownership and the pay-for-performance sensitivity of managerial compensation, in that there is a possibility of institutional investor ownership playing a role in executives receiving increases in total compensation in relation to increases in shareholder wealth. Secondly, the study finds that the concentration of institutional investor ownership is negatively correlated to the level of executive compensation, which indicates a higher percentage of institutional investor ownership results in more oversight and a drop in incentive compensation. There are cost-benefit implications of the two components: monitoring by institutional investors and use of incentive compensation, especially if used in conjunction with one another. In fact, theoretical research suggests a needed interaction between monitoring by institutional investors and incentive compensation. When institutional investors monitor a firm, it can be costly due to the "required independent sources of information about managerial actions, the potential liquidity costs and free-rider problems (consumption of good without paying) with other shareholders" (Hartzell and Starks, 2003, p. 2352). Despite alignment of interests between managers' and shareholders, incentive

المنارة للاستشارات
www.manaraa.com

compensation can impose additional costs on shareholders and additional risk on managers and executives that necessitates higher pay that would be otherwise optimal (Hartzell and Starks, 2003).

The Bebchuk and Fried (2003) study described above found that a major problem with pay-for-performance is that as a CEO's power increases, members of the board may feel obliged to that CEO. The authors depend on the managerial power approach to explain this statement. The managerial power approach predicts that pay will be higher and/or less sensitive to performance in firms in which managers have relatively more power. Findings of the study showed that:

- If board members lack the fortitude to act on the behalf of the shareholder, then they may make inappropriate decisions that will lead to inappropriately high compensation and/or low levels of incentives;
- When publicly traded company fail to have a controlling shareholder, top executives tend to have significant power, a situation previously described as the agency problem; and
- Companies having a smaller concentration of institutional shareholders tend to pay higher executive compensation.

In terms of managerial power and influence that CEO's exert on managers and board members, Bebchuk and Fried (2003) recommended correcting the defects in governance structures by increasing transparency, redesigning pay arrangements, and increasing board accountability.

Ferracone and Gershkowitz (2010) examined the debate that the financial crisis of 2008 raised concerning alignment between executive pay and performance. The debate is one in which the role of executive compensation is partially responsible for the financial crisis due to the rewarding of short-term performance with little attention to long-term value creation. No specific detail of the study was provided but the authors suggested

المنارة للاستشارات
www.manaraa.com

measures that should be taken to educate compensation committees, board members, and management. The study showed the importance of articulating a company's business strategy and performance and the link to executive compensation. Ferracone and Gershkowitz (2010) suggested creating a pay system that is "designed to align" (p. 39).

2.11: Relationship between Pay and Motivation

The principal-agent model maintains firms design efficient compensation packages to attract, retain and motivate CEO's (Conyon, 2006). In Conyon's (2006) study, changes in executive pay and incentives in U.S. firms between 1993 and 2003 were documented. To assess these changes, consideration is given to agency theory, managerial labor market changes, shifts in firm strategy, and theories concerning managerial power (Conyon, 2006). The author explains that the board determines the pay on behalf of the shareholder who uses enticers such as stock options and restricted stock to create an optimal compensation package (mix of stock options, restricted stock, and long-term contract) that will motivate executives to align their goals with the goal of maximizing firm value. Conyon (2006) uses a definition provided by Core, Guay, & Larcker (2003) to describe the optimal contract as one "that maximizes the net expected economic value to shareholders after transaction cost (such as contracting costs) and payments to employees" (p. 25). This optimal compensation package as determined by the contract implies an agreement meant to minimize agency costs and motivate the CEO to engage in non-self-interested behavior. The principal-agent model does not eliminate the agency problem but evaluates the marginal benefits of implementing the contract in relation to the marginal cost (Conyon, 2006). Additionally, an optimal compensation package that provides incentives through risky compensation such as stock options and

المنارة للاستشارات
www.manaraa.com

restricted stock is thought to reduce opportunism despite the contract not being a perfect contract.

Although the principal-agent theory indicates a positive relationship between performance incentives and reduction in the agency problem, two main problems arise from this model. First, the principal designs an incentive package to influence the agent's actions. Yet, the principal is unable to observe the agent's actions, so is subject to constraints in designing the incentive scheme (Weisbach, 1988). Secondly, the principal-agent model presumes that contracts are optimal, but it is likely that executives have control over the pay-setting process suggesting the occurrence of managerial power and rent extraction (attempt to derive additional pay or economic rent by manipulation business environment) (Weisbach, 2008).

Weisbach (2008) critiqued Bebchuk and Fried's (2004) book, Pay without Performance: The Unfulfilled Promise of Executive Compensation. Bebchuk and Fried argued against the principal-agent model contending executives hold control over their own boards and maximize their own compensation so an optimal pay contract cannot be negotiated. In a non-technical manner, Bebchuk and Fried discuss the principal-agent model and the managerial power hypotheses in their book. After doing an extensive review of the empirical evidence that distinguished the two views, the authors supported the idea that CEO's have great influence over the board and negotiated contracts are more likely to reflect rent-grabbing by the CEO rather than maximize shareholders' profit (Weisbach, 2008). Recommendations were made by Bebchuk and Fried (2008) to encourage investors to become aware of and discourage practices that lead to CEO's having managerial power, for regulators and market participants to advocate for more

المنارة للاستشارات
www.manaraa.com

transparency, and increase shareholder power relative to executives by giving shareholders the right to nominate candidates in corporate elections (Weisbach, 2008).

In his study, Agarwal (2010) discussed corporate governance in Indian companies and identified two components of corporate governance as 1) internal governance that consists of 1) concentrated ownership and the board of directors and 2) executive compensation that consists of basic pay, short-term incentives, long-term incentives, and perquisites and benefits. To provide readers with an understanding of motivation theory, discussion is focused on intrinsic (the work, responsibility, esteem, and autonomy), and extrinsic (salary and bonuses) rewards. The author's concern has to do with the fact that CEO compensation is significantly higher than the average worker in the U. S. and in India; CEOs pay is fast approaching U.S. salaries. Agarwal (2010) pointed out that if theory is followed, the intrinsic rewards received by CEO should be more satisfying and therefore, motivating. Yet, extrinsic rewards appear to exert considerable influence, which comes at the cost of shareholders, that relates back to agency theory (p. 30).

2.12: Total Rewards Model

Hiles (2009) described the Total Rewards model as an organizational game plan that allocates resources and tailors activities to achieve a target performance level within a set period of time. The Total Rewards model can also be thought of as a philosophy used to compensate employees for their talent, effort and results (Wilson, 2009). The model is designed to target all employees within an organization, including senior executives so the objectives of the reward system are written broadly. The total rewards model in unique to each organization and allows each organization to create its own system of rewards depending on the needs of the people within the organization. The

المنارة للاستشارات
www.manaraa.com

model is based on a Human Resources framework that addresses complex reward issues regarding pay, benefits, training and development, and the work environment in a holistic way (Rumpel and Medcof, (2006). The framework aligns with an organization's mission, business, and strategy and allows an organization to improve their decision-making process and focus on creating a sustained competitive advantage (Wilson, 2009). The Total Rewards model is beneficial in that it extends beyond how much to pay an employee or an executive, but analyzes current practices and programs and determines where an organization may need to focus their resources (Wilson, 2009). Having a sound total rewards strategy provides an integrated, comprehensive perspective of all rewards to promote congruency and effectiveness of plan design and delivery, provides a competitive advantage for attracting talent, and enhances employee commitment and reduces turnover (Kaplan, 2005).

After seeing the results of the Towers-Perrin survey study (no date provided) that showed non-technical workers' preferences were on pay and benefit rewards, Rumpel and Medcof (2006), performed a cross-study comparison using four different empirical studies, a comparison of the reward preferences of technical workers to assess whether the total rewards model is more appropriate for technical workers than non-technical workers. Towers-Perrin surveyed over 500 North American and European executives in a variety of industries. Findings of the Towers-Perrin study showed that in reporting rewards preferences, every respondent included pay elements, 96 percent included benefits, 83 percent included learning and development, and 75 percent included work environment rewards (Rumpel and Medcof (2006). Whereas non-technical workers'

للاستشارات المنارة
www.manaraa.com

main preferences were on pay and benefits, the results of the empirical studies showed technical workers preferred work environment rewards.

The findings of the first study showed work content and affiliation were the highest rated while all other preferences were tied at a much lower rating. The second study's results showed the work itself had the highest rating on attracting and retaining R&D people. Intrinsic rewards (working with competent colleagues, challenging assignments, and autonomy in idea generation) scored the highest rating in the third study, which fits into the work environment category in the total rewards model. The fourth study found work importance had the strongest effect upon productivity followed by participation and cooperation in teams, again an element of work environment.

By comparing the four studies, Rumpel and Medcof (2006) were able to ascertain that use of total rewards can differentiate the ability of firms to attract, retain and motivate staff, and knowledge of employee valued rewards allows for better customization of a rewards program that can reduce cost by eliminating non-valued rewards.

The Total Reward model is not without fault. A total rewards strategy is forward focused usually in response to a discontinuous change (sudden change that threatens existing business) in the market. Hiles (2011) explains that in employee reward programs, discontinuous change includes recession-induced stock price drops and in benefits, the change in the diversifying workforce, and growth in importance of benefit plan cost in meeting overall organizational goals (p. 45). Additionally, implementation of the model is time consuming and at times complex. For companies looking for a quick-fix solution, this is not a viable model. Companies will want to weigh the benefits against the costs to ensure the return on investment (ROI) benefits outweigh the costs and

المنارة للاستشارات
www.manaraa.com

timeliness. Expertise in using the model is needed as managing a firm's business needs and personal choice balance requires significant and constant managing.

2.13: Stakeholders' Model

Stakeholder theory identifies stakeholders as investors, employees, suppliers, customers, political groups, trade associations, trade unions, communities, associated corporations, prospective employees, prospective customers, government bodies, and the public at large, and at times the competition (Donaldson and Preston, 1995). Stakeholder theory "maintains that normative or legitimate stakeholders are owed an obligation by the organization and its leaders, while derivative stakeholders hold power over the organization and may exert either a beneficial or harmful influence on it" (p. 1).

Freeman (1984) wrote about stakeholder theory identifying the firm's stakeholders, and explained how management can address each stakeholder group from a moral and ethical approach. The model was created to help executives address the ethical problems that arise in business. After repeated infractions by executives representing Enron, Arthur Andersen, and of late, Lehman Brothers, and AIG, this model offers a fresh look at how companies can refocus the decision-making power and the benefits to not only stockholder but stakeholders (Freeman, 1984; Freeman, Harrison, & Wicks, 2007).

To Freeman (1984) and Freeman et al. (2007), a stakeholder is a person or group of people who affect or are affected by the activities of an organization. Stakeholder theory is defined as 1) the redistribution of benefits to stakeholders; and 2) the redistribution of important decision-making power to stakeholders (Stieb, 2009). The redistribution of benefits to stakeholders assumes that the shareholders are the owners of the company, and the firm has a fiduciary responsibility to put their needs first by

المنارة للاستشارات
www.manaraa.com

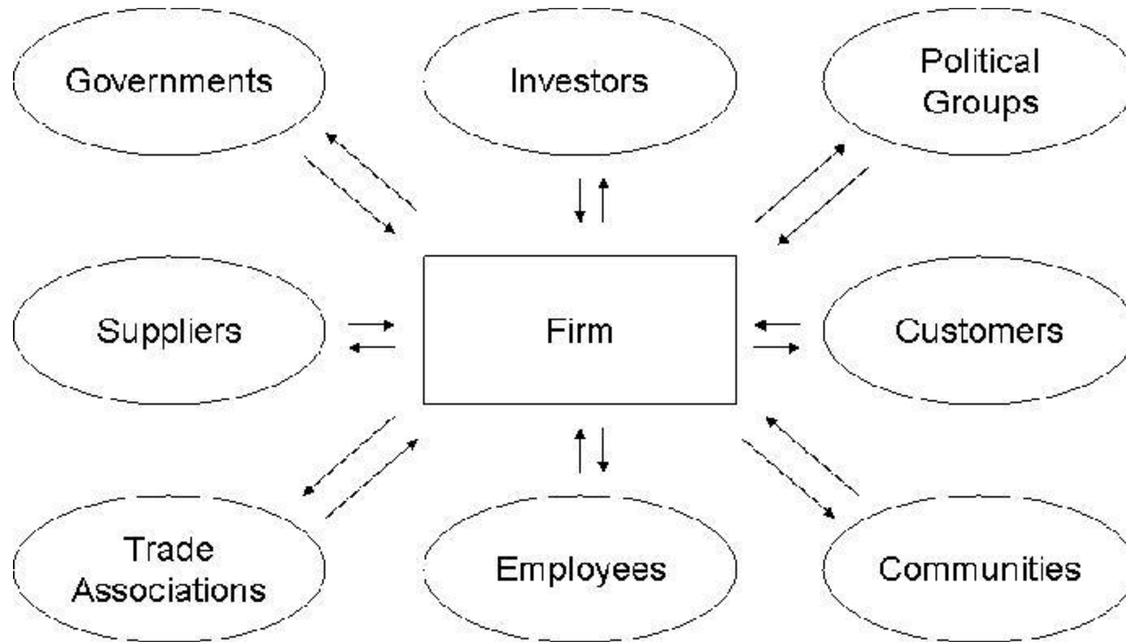
increasing company value. This requires interacting with those who influence or are influenced by the company (Stieb, 2009). Donaldson and Preston's (1995) approach to stakeholder theory is grounded on four central themes:

1. Stakeholder theory is descriptive in that it offers a model of the corporation
2. Stakeholder theory is instrumental in offering a framework for investigating the links between conventional firm performance and the practice of stakeholder management
3. Although stakeholder theory is descriptive and instrumental, it is more fundamentally normative. Stakeholders are identified by their interests and all stakeholder interests are considered to be intrinsically valuable.
4. Stakeholder theory is managerial in that it recommends attitudes, structures, and practices and requires that simultaneous attention be given to the interests of all legitimate stakeholders (Donaldson and Preston, 1995).

In Figure 1, Donaldson and Preston (1995) depict a stakeholder's model in which all individuals and groups with an interest in an organization benefit over time. The arrows between the firm and its stakeholders run in both directions, and are equidistant from the firm's. For the purpose of this paper, the stakeholder's model is used to explain how the organization acts as an entity by which many diverse participants accomplish multiple, yet oftentimes incongruent purposes (Donaldson and Preston, 1995). Since all of the identified stakeholders have an interest in the firm, the firm should consider them in developing an executive compensation plan. However, the various stakeholders do not have equal interest, so the firm must consider how to appropriately weight a particular stakeholder's interest in calculating executive compensation.

المنارة للاستشارات
www.manaraa.com

Figure 1: Schematic of stakeholder theory



Source: Donaldson and Preston, 1995

2.13.1: Stakeholders' Expectations

Gomes, Gomes, & de Oliveira (2011) conducted a case study to answer the question of how stakeholder perceptions influence the development of performance indicators in public organizations. The purpose of the study was to design more adequate and appropriate indicators that take into account stakeholder expectations. A phenomenological approach to collecting and analyzing data was used, interviewing managers and key stakeholders in order to explore the dimensions of performance the stakeholders identify for assessing public service organizations. Businesses from a small municipality located in southeast Brazil were used. The number of participants was not provided but the interviews were semi-structured, and recorded with the permission of the interviewees, transcribed, and returned to the interviewee for validation. Transcripts were

www.manaraa.com

analyzed using content analysis. Data was divided into partially ordered meta-matrices to ensure data reliability.

The study assumed stakeholders were “entities that inhabit a given organization’s environment and are capable of both influencing it as a resource and legitimacy provider and being likely to be affected by this organization in the process of achieving its objectives” (Gomes et al, 2011, p. 136). The study used a stakeholder analysis developed by Bryson (1995) to identify the stakeholders that populated an organization’s environment. The stakeholder analysis was used because it supports the identification of agents that matter to the process, which is relevant to strategy implementation. The steps to follows when using a stakeholder analysis are:

1. Identify who the organization’s stakeholders are;
2. Identify their criteria for judging the organization’s performance; and
3. Assess how well the organization performs according to those criteria from the stakeholders’ point of view. (Gomes et al., 2011, p. 137).

The tenets of stakeholder analysis are as follows:

1. Identify and define stakeholders’ features;
2. Identify stakeholder interests in the organization;
3. Identify conflicts of interest among stakeholders and between the organization and the interests of its stakeholders;
4. Identify opportunities for making coalitions with stakeholders;
5. Assess stakeholder potential for participating in the strategic plan; and
6. Assess how stakeholders can participate in the strategic process (Gomes et al., 2011, p. 136).

المنارة للاستشارات
www.manaraa.com

Overall, the findings showed that stakeholders expected from the relationship, wise use of public funds and a better quality of service provided. Expectations could be placed in one of two categories: effectiveness or efficiency. In terms of criteria used by stakeholders to assess performance, the findings indicated, stakeholders assess performance on the dimensions of efficiency, effectiveness, and equity with a focus on identified problems and complaints so means for improvement could be made.

A comparative analysis of academic literature is performed by Susniené and Sargunas (2009), for which a review of published research and formulation of conclusions are made. The purpose of the study is to identify and arrange criteria that will generate the premises in organization management for stakeholder satisfaction and adapt the criteria and associated indicators to organizational processes. Indicators used in stakeholder analysis are the means for monitoring performance progress of goals and objectives, for appraisal of organization management and processes. The authors argue that organizations should focus on those indicators that require significant improvement because they can have considerable influence on an organization's position in the market and on the value created for stakeholders. Focusing on profit alone ignores stakeholders who might have other interest such as social responsibility. Therefore, Susniené and Sargunas (2009) stated that it is necessary for an organization to:

- know their stakeholders and what to do to meet their needs and what to improve in the organization;
- set strategies, goals, and objectives that can assure the satisfaction of stakeholder needs;
- manage processes;

المنارة للاستشارات
www.manaraa.com

- Assess and evaluates processes;
- Improve processes according to stakeholder needs (p. 59).

The findings of the study indicate that to impart stakeholder satisfaction in organizational management, it is beneficial for organizations to identify criteria and the associated indicator. The authors identify ten criteria and indicators for organizations to follow in the performance of their analysis:

1. Senior management belief that relationship building with stakeholders is important to bottom-line success (9 indicators).
2. Time spent by managers communicating about building relationships with stakeholders and shared information (4 indicators).
3. Employee readiness to keep relationship with key stakeholders and their responsibility (5 indicators).
4. Organization's culture support for personal values and needs (8 indicators).
5. Organization's orientation to satisfaction of stakeholder needs (4 indicators).
6. Organization's actions ensuring stakeholder satisfaction (7 indicators).
7. Organizational systems set up or redesigned to support the mission (5 indicators)
8. Organization's policies geared to long-term success (2 indicators).
9. Care for environmental issues (1 indicator).
10. Aggregate appraisal of organization's performance concerning its capacity to satisfy stakeholders' needs (3 indicators) (p. 62).

المنارة للاستشارات
www.manaraa.com

In Rawlin's (2006) White Paper, the literature on stakeholder theory, stakeholder management and public relations is reviewed. Stakeholders and publics are differentiated. The author proposed that the use of the term stakeholders in the literature refers to their relationship to organizations while the term publics used in public relations and other mass media literature are identified according to their relationship to messages. The purpose of the study is to answer the question, "How much attention does each stakeholder group deserve or require" (Rawlins, 2006, p. 1)? The author states that a thorough stakeholder analysis can be achieve by combining public relations and stakeholder relations literature. Prioritizing stakeholders according to attributes and relationship to a situation allows organizations to give attention to the most important stakeholders rather than "squeaky wheel stakeholder" (Rawlins, 2006, p. 13). A main point made is that developing positive relationships with stakeholders is a necessity for organizations.

Evans and Hefner (2009) conducted a study on the economic and ethical justification for golden parachutes. An initial sample of 500 firms were randomly selected from the CRSP Daily Return file for period January 1980 to early 1990's, which represented an active takeover market and then a second sample of 500 firms from 1993 to 2006. Proxy statements were searched electronically to determine whether CEO's at each firm had a golden parachute agreement. The findings of the study showed that boards often enter golden parachute agreements for ethical reasons because of the firms' promise to award newly-hired CEO's compensation for their hard work and human capital value. The study also shows that golden parachute contracts are beneficial to stakeholders in that they represent an incentive device used to create wealth-increasing

المنارة للاستشارات
www.manaraa.com

takeovers or mergers and demonstrates care and concern for stakeholders by preventing layoffs.

2.14: Balanced Scorecard

The Balanced Scorecard was created in the 1980s to meet the changing needs of managers who believed that traditional financial performance measures hindered one's ability to manage effectively (Kaplan and Norton, 2005). The balanced scorecard was meant to be used as a supplement to traditional financial measures providing executives a way to track both financial and operational metrics and to compare performance in multiple areas at one time. The design of the balanced scorecard was particularly important so senior executives would not rely on one set of measures to the exclusion of the other (Kaplan and Norton, 2005). Financial measures reflect on past events but the use of the balance scorecard allows companies to create future value by investing in it customers, its internal business processes, learning and growth. The word "balanced" comes from the idea that the scorecard framework would provide managers and executives a clearer picture of what the company should measure to ensure balance with the company's financial perspective (Kaplan and Norton, 2006). However, the balanced scorecard provides an internal and external view of the business providing another sense of balance (Chaven, 2009).

The benefit of using a balanced scorecard is that an organization is viewed from a broad perspective having the ability to look at different critical performance measures at one time, without being overwhelmed by information. A balanced scorecard is a way for businesses to track and improve performance by using key performance indicators with

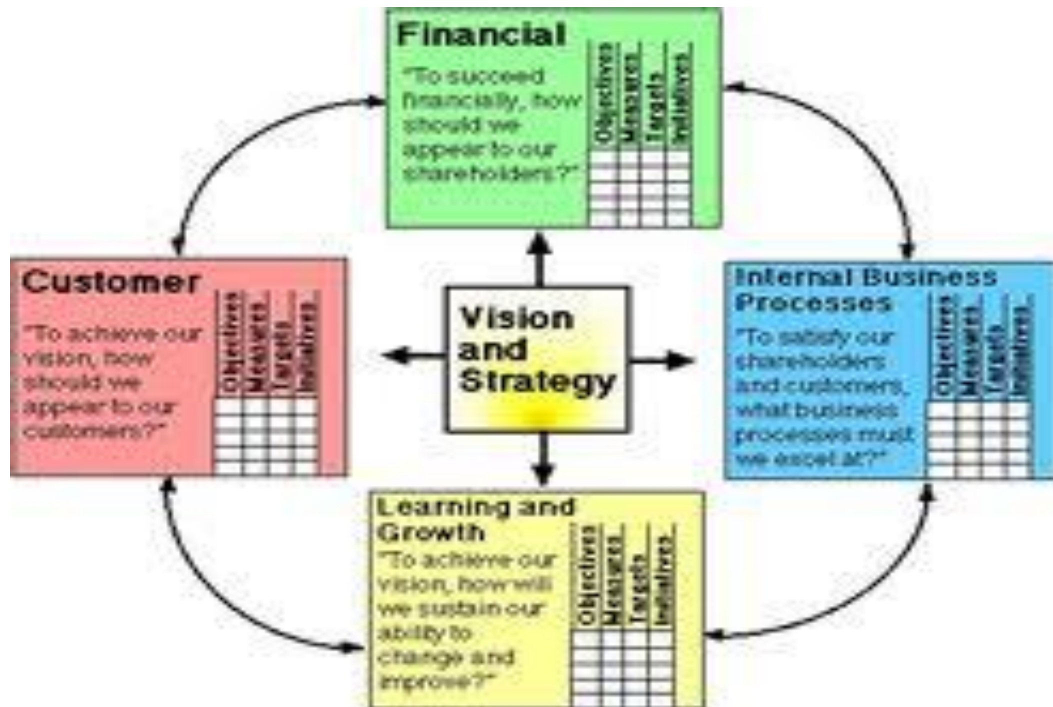
www.manaraa.com

either historical, target, or future results (Microstrategy, 2009). Measures and targets are developed and then action plans are put into place to meet the targets (Chaven, 2009).

Figure 2 depicts the balanced scorecard created by Kaplan and Norton (2005) providing four perspectives for managers and executive to evaluate a business. The balanced scorecard is designed to use four perspectives in translating a company's vision into strategy through the development of metrics, data collection and analysis as it relates to each of these perspectives:

- Financial perspective – How do we look to shareholders?
- Internal business perspective – What business processes must we excel at?
- Learning and growth perspective –How will we innovate to create value?
- Customer - How do our customers see us? (p. 4).

Figure 2: Balanced Scorecard



Source: Kaplan and Norton, 2005

المنارة للاستشارات
www.manaraa.com

The financial perspective is one in which current financial data is used but the data is timely and handled as a priority. The financial performance measures whether the corporate strategy, its implementation, and execution are contributing to the bottom line (Kaplan and Norton, 2005). The internal business processes perspective focus on factors that affect cycle time, quality, employee skills and productivity. Businesses may need to centralize and automate data to ensure timeliness and accuracy. Financial related data such as cost-benefit data and risk assessment are also good complements to traditional financial data. Development of metrics unique to the business allows managers to know how well their business is operating that in turn can ensure that the company's mission is being met. Such internal efforts help to meet customer's expectations. The learning and growth perspective relates to a company's ability to innovate, improve, and learn in order to achieve competitive success. Measures need to focus on a company's ability to learn and grow whether it is on introducing products or improvements on existing products, or even on meeting customer needs by measuring on-time delivery, cycle time, or defect rate. The customer perspective focuses on customers' concerns and the importance of customer focus and customer satisfaction. Kaplan and Norton (2005) categorize customers' concerns into four categories: time, quality, performance and service, and cost. The balanced scorecard is an effective tool for companies who want to develop measures that address customers' concerns by viewing performance through customers' eyes.

Implementing a scorecard in today's business environment goes beyond Kaplan and Norton's (2005) original idea of measuring financial performance using lagging indicators supplemented with leading indicators to predict future financial

المنارة للاستشارات
www.manaraa.com

performance (Brown, 2000; Chaven, 2009). The balanced scorecard now plays an important role in the planning and control of an organization's strategy. Scorecards help align business units (De Geuser, Mooraj and Oyon, 2009; Chaven, 2009), shared service teams, individuals in the organization, and key management processes (De Geuser et al., 2009). The balanced scorecard is a strategic management system that provides parity between external measures for stakeholders and internal measures of business processes (Chaven, 2009, p. 395) and provides managers and executives the tools to execute an organization's strategies.

De Geuser et al. (2009) performed a study on European companies who had implemented use of the balanced scorecard. Data were collected by a survey. The sample was taken from lists of attendances to four balanced scorecard conferences held in Zurich, Lausanne, London and Brussels in 1999 and 2000, and separated into two categories: academic and consulting companies (De Geuser et al, 2009). The attendance list was used to build a non-random list of 164 contact persons from different organizations. Each contact person was sent five copies of the researcher's questionnaire and a letter explaining the purpose of the project. Seventy-six questionnaires were received from 24 different organizations. The purpose of the study was to identify whether the balanced scorecard had a positive relationship with organizational performance. Results of the study showed that the balanced scorecard added value to companies. For the companies in the sample, organizational performance derived from three sources: its role in the translation of the strategy; its capacity to influence managerial practices on a continuous basis, and its role in

المنارة للاستشارات
www.manaraa.com

aligning resources (means) to strategic objectives (end) (De Geuser et al., 2009, p. 114).

Butler, Letza, & Neale's (1997) paper on the Balanced Scorecard is a review of the theoretical history of the development of integrated performance measures and the documentation of the Balanced Scorecard for Rexam Custom Europe. Rexam is a highly specialized contracting business that has a core business strategy of extraordinary growth and continuous improvement. To generate the scorecard, Rexam's principles (customers, people, innovation, process, performance, suppliers, and community) are used to develop a strategy using Kaplan and Norton's (2005) four perspectives. The model was easily adapted to the company's needs, which only required three perspectives: shareholders, extraordinary growth, and continuous improvement. Key performance measures were then determined. For this company, it was important that the new performance criteria be understood and accepted by all relevant staff, so the company held interviews and discussions with employees and engaged an external consultant who encouraged openness of expression. The final Balanced Scorecard was more extensive than Kaplan and Norton proposed, mainly in operationalizing the corporate mission, but the final product was grounded on Kaplan and Norton's approach.

2.15: Theoretical Lens

This dissertation reflects an Interpretivist view on executive compensation as it relates to aligning pay to company performance and strategy to increase firm value, meeting stakeholders' expectations, and motivating the CEO's behavior to act in the shareholder's best interest. Saunders, Lewis, & Thornhill (2009) stated that researchers

المنارة للاستشارات
www.manaraa.com

have to be empathetic putting themselves into the roles of the research subjects in order to understand their point of view.

Over the past few years, discussions about executive compensation have been heated making it easier to get caught up in the emotion and to believe stakeholders' interests suffer because of the high salaries of executives, but proponents of executives receiving high salaries stand firm believing executive earn their pay. Executive compensation is a complex issue that requires an integration of perspectives to interpret situations as they arise. The literature on executive compensation demonstrates just how much interest there has been on the topic, and it is evident that researchers have covered the topic exhaustively. The studies reviewed in this literature review reveal that executive compensation is oftentimes considered excessive when compared to the average worker's salary. However, the concept of excessive pay raises questions about pay in relation to the complexity of the organization (size) and the level of job complexity of a CEO. These areas of focus are highly subjective and subject to change based on one's level of knowledge.

A review of the literature demonstrates that issues surrounding executive compensation have taken on increased prominence. Considerable time and effort have been spent in understanding compensation issues and such discussion in the literature review that lead to the following propositions:

Proposition 1: Designing an executive compensation model requires the consideration of the short-term and long-term expectations of all stakeholders.

المنارة للاستشارات
www.manaraa.com

Proposition 2: The design of an executive compensation plan can be custom-tailored to fit a company's particular mission, strategy and the challenges they face.

Proposition 3: The relationship between a board and the CEO should be a collaborative effort but one that is maintained at arm's length.

Proposition 4: The performance appraisal process is a continuous process that addresses the success of the firm in attaining a set of predetermined goals and objectives, and measures the CEO's ability to successfully progress the organization toward a set of attainable goals.

Chapter Three provided an overview of the scholarly literature on executive compensation and some of the issues that relate to what are perceived as excessive pay. The abundance of literature clearly demonstrates the complex nature of executive compensation as well as interest by academics to understand the many facets of executive pay. Drawing from the literature review, Chapter Three presents a conceptual model that represents an executive scorecard based on the combined strengths of the Stakeholders' Model and the balanced scorecard.

المنارة للاستشارات
www.manaraa.com

Chapter Three: Conceptual Model

3.1: Introduction to Conceptual Framework

This chapter presents a conceptual framework that combines Kaplan and Norton's (1992) balanced scorecard and Donaldson and Preston's (1995) stakeholders' model to design an Executive Scorecard to help organizations determine incentive awards such as bonuses and stock options for CEO's and other senior executives. In developing the conceptual framework, there is discussion of strategy and application of the balanced scorecard and the stakeholders' model to executive compensation. Discussion moves to stakeholder expectations and the evaluative process needed to ensure implementation of a set of performance targets that align goals and objectives, with corporate strategy, stakeholders' expectations and CEO performance accountability. Lastly, the Executive Scorecard is presented.

3.2: Applying the Balance Scorecard to Strategy

Globalization and increased competition are causing organizations to adopt more complex corporate strategies that consider internal organizational factors that lead to performance advantages and provide a sustained competitive advantage. A firm's CEO is responsible for implementing such corporate strategy. Historically, managerial resources and the value brought to the firm are embodied in the knowledge, skills, experience and expertise of the executive. However, making the link between strategy and operations is not always directly related to a CEO's intelligence or capabilities. Linking strategy to operations requires a structured approach to the processes of planning, creating, and managing the firm's strategy in the form of a performance management process. Many

المنارة للاستشارات
www.manaraa.com

organizations use the Balanced Scorecard to translate a firm's vision and strategy into a set of performance measures to evaluate the effectiveness and efficiency of their business operations (Kaplan and Norton, 1996). As discussed in the study discussed above, Butler et al. (1997) suggests that when using the balanced scorecard, firms need to devise a set of measures explicitly linked to its strategy. Further, since each firm is different, the balanced scorecard should be specific to that firm with the indicators on the scorecard driven by the firm's strategy.

3.3: Applying the Balanced Scorecard and Stakeholders Model to Executive Compensation

A significant amount of literature on executive compensation is on the incentives provided to the CEO in the form of equity-based compensation that includes stock options and restricted stock. Equity-based compensation has become an increasingly important component of executive pay, but the use of this form of compensation is not always aligned with the firm's goal of firm value maximization but oftentimes favor the managerial power approach. Effectively integrating an executive compensation blueprint into the balanced scorecard system can potentially allow a company to construct a better performance evaluation and compensation system.

The goal in this dissertation is to create an executive scorecard that identifies possible executive goals and objectives and develop performance measures associated with the goals and objectives, and tie them to performance targets that support decisions concerning executive compensation. This process is performed for each stakeholder group and the information used to determine the performance measures would be derived from using Bryson's (1995) stakeholder analysis as described in Chapter Two. The

المنارة للاستشارات
www.manaraa.com

model is designed to consider incentive awards that include bonuses, benefits and allowance, and long-term incentives such as stock options that are more closely aligned with the interests of the shareholders. It is noted that not all stakeholders have the same level of interest in a firm. In determining executive compensation, it is therefore necessary to weight each individual participant or group depending on the level of interest he or she has with the firm.

In designing an effective executive scorecard, it was the intent of the author to incorporate both financial and nonfinancial measures such as quality performance, customer satisfaction, community outreach involvement, investor return, and market share into performance measures and compensation plan. Short-term and long-term expectations are considered since the pursuit of short-term targets often comes at the expense of long-term value creation. The assumptions of the Executive Scorecard developed by the author are listed as follows:

1. Executives should uphold high standards of ethical behavior in the performance of their responsibilities.
2. Only those stakeholders who have a direct interest in the economic performance of a company will be included in this model
3. Stakeholders have both long-term and short-term expectations that drive their view of how senior executives should be compensated.

To maintain the integrity of the balanced scorecard approach in relation to measuring the performance of a CEO or other executives, care must be taken to identify only those key factors that contribute to company performance without making the process too complex to the point that a CEO or his or her board may not focus on the correct factors.

المنارة للاستشارات
www.manaraa.com

3.4: Designing an Executive Scorecard

Similar to the way that Kaplan and Norton (2005) designed a balance scorecard that links performance measures to strategy; the purpose of the Executive Scorecard is to link a CEO's goals to a set of measures that strongly affect the behavior of all stakeholders to include: employees, investors, customers, suppliers, creditors, and the community-at-large. Stakeholders are critical to creating the Executive Scorecard. However, since it is difficult for stakeholders to have direct input into the creation of the executive scorecard, the board of directors is responsible for outlining short-term and long-term business expectations for the CEO that are consistent with a company's strategic plan, and are aligned with stakeholder's expectations. Stakeholders are groups of individuals that are dynamic in nature, so it is imperative that the identified expectations reflect the most current information.

The concept of the Executive Scorecard is to custom-tailor the measures to fit a company's particular mission, strategy, and the challenges it faces. Identifying stakeholders and short- and long-term expectations are critical to the Executive Scorecard.

Although it is possible to categorize stakeholders in any manner desired, for the purpose of designing the Executive Scorecard, it has been conceptualized that the board of directors role is to determine the variables of the Executive Scorecard, using the scorecard to rate the CEO on the basis of the firm's stakeholders as well as that of the board of directors. The role of the senior executive is to confront the issues and balance the interests of common stockholders, preferred stockholders, short and long-term creditors, suppliers, customers, employees, retirees, and the public at large (Carr and Valinezhad, 1994). Not all stakeholders carry the same weight so it is the responsibility

المنارة للاستشارات
www.manaraa.com

of the board to assign the appropriate weight for each stakeholder group. For example, organizations may tend to put little weight on suppliers but focus heavily on what investors think. Therefore, the assumption is that the board will assign a much more significant weight to investors and a much smaller weight to suppliers.

3.5: Stakeholders

For the purpose of this study, the stakeholders have been categorized as follows:

1. **Investors.** Most investors are not interested in having direct participation in compensation decisions (Crozier, 1992). However, as a whole, investors have requested extensive disclosure of executive compensation and social responsibility initiatives; but for the most part, the majority of investors want the details of the decision on incentive, cash bonuses, phantom stock plans, stock appreciation rights, and non-qualified stock options (Crozier, 1992). In response to pressure by lawmakers, the SEC amended reporting of executive compensation requirements. The new regulations provide individual shareholders the right to full disclosure of complicated information in a readable format so they are able to make informed decisions. In reviewing the pay-performance relationship, in Chapter Two, Jensen and Murphy (2009) supported full disclosure of information, which allows a contract to be designed specifying and enforcing managerial action; and since these managerial actions are not observable by shareholders, compensation policies need to be designed to give executives incentives to select and implement actions that increase shareholder wealth.
2. **Employees.** Large pay rewards are often used to help retain CEO's, and could be considered a good motivator to increase performance. However, the pay gaps

المنارة للاستشارات
www.manaraa.com

have become so pronounced that they affect the relationship between the CEO, the members of the executive team, and employees who may not understand the CEO's role in policy formation and implementation (Gnyawali, Offstein, & Lau, 2008). Attention to measures such as those that focus on employees and customers provide insight into factors that drive financial performance (Butler et al, 1997). For example, traditional performance measures specify actions wanted from employees, whereas the scorecard assumes people adopt the action necessary to meet a goal (Butler et al., 1997).

3. **Customers.** Key stakeholders help establish the firm's reputation and identification (Ferrell, 2004). The market is made up of market-drive global powerhouses that have brand recognition because they are producers of high-quality goods that are paramount to the company's success and longevity. The relationship between the customer and the company is based on mutual expectations of trust, good faith, and fair dealings (Ferrell, 2004). External stakeholders receive both corporate identity through mediated expressions via television, newspapers, and the internet, while organizational identity is directly experienced through the behavior and language of the firm and through interpersonal interaction (Schulz, Hatch, & Larsen, 2002). Additionally, the firm has an ethical responsibility to consumers, and in many states, a legal obligation. Customer relations is a necessary element of the executive scorecard because they identify with organizations and their products and play an important role in the shaping the ethical conduct of the company (Ferrell, 2004).

المنارة للاستشارات
www.manaraa.com

4. **Suppliers.** Suppliers play a crucial role in ensuring the safety and reliability of materials and components that are passed onto a firm's customers. The success of the "supplier relationship requires adherence to the highest ethical, legal and procurement standards" (Rose, 2004, p. 3).
5. **Creditors.** As many firms have filed for bankruptcy, it is no surprise that lenders are expressing concern that executive compensation packages are too generous and lack performance triggers. Creditors are pushing back even as organizations argue that expensive compensation plans are necessary to meet industry standards to retain key executives. Administrative agents such as JPMorgan, who act on behalf of a syndicate of 250 lenders, displayed outrage that many companies reward executives without regard to the health of the company (Barkholz, 2006). The CEO has a fiduciary responsibility to maintain a strong financial position that contributes to a strong, professional relationship with its creditors.
6. **Community.** The uprising that resulted from the financial crisis of 2008 is nothing new as society has been complaining since Bethlehem Steel paid what was then considered an outrageous bonus to Eugene Grace in 1932 (Balkcom and Brossy, 1997). Corporate social responsibility (CSR) is becoming a major concern for companies. Having strong corporate social responsibility leads to a sustainable competitive advantage for a firm. Freeman (1984) contended that if stakeholders are given a voice, then socially responsible firms will have a rational strategy to minimize conflicts and optimize synergies in their network of relationships with various stakeholders (local communities, consumers, environmentalists, associations, subcontractors, etc.) (p. 542).

المنارة للاستشارات
www.manaraa.com

7. **Regulators.** The question as to whether regulators can control or curb excessive pay continues to be asked despite the actions of the SEC to enact disclosure requirements. The financial crisis of 2008 was followed by a call for stronger and more effective regulation. After the downfall of Enron, the government implemented the Sarbanes-Oxley Act, changing reporting requirements for assets and liabilities, and made senior executive responsible for proper reporting. The government has been intervening since shortly after companies began paying executive bonuses but what is clearly not known is whether they are contributors to the problem.

8. **The Board of Directors.** Most of the issues that corporate boards face surround the issues of the "agency" problem. Boards are tasked with the responsibility of acting as agents for shareholders. To do so, it has been recommended by regulators, the public, and the government that the majority of directors remain independent of the organization, to hold regular sessions without the attendance of management, and that organizations create audit committees to oversee the hiring and firing of independent auditors (Cornell, 2003). Although the board and CEO must work together, the relationship between the two must be at arm's length. Crystal (1991) sees the CEO as a seller of his own services, and as a consumer of his company's compensation products who is familiar with all of the details of the plan, is in a position to influence board members. As discussed in the literature review, Bebchuk and Fried (2003) found a link between CEO power and pay. The more power a CEO wields over the board, the higher the CEO pay, which goes against producing reasonable compensation. Board members are the buyers of the CEO's

المنارة للاستشارات
www.manaraa.com

services, who do not work for the CEO and should not have significant economic tie to the company (Crystal, 1991). However, when the CEO also serves as the chairman of the board, the CEO is the boss of the board of directors. If directors are expected to support a CEO in his or her efforts, then they cannot exercise control over the CEO's compensation.

3.6: Evaluating Executive Performance

Developing an effective performance appraisal process ensures performance expectations are achievable by the CEO and maintainable by the board of directors. It is a continuous process that addresses the success of the firm in attaining a set of predetermined goals and objectives, and measures the CEO's ability to successfully progress the organization toward a set of attainable goals. Setting the performance goals and measurement criteria should be a collaborative effort between the CEO and the members of the board of directors.

Regulators play an important role in holding senior executives accountable for managing organizations. They are present to ensure stakeholders benefit from the actions of the corporation, the board of directors and the CEO. However, to appropriately manage a corporation, all stakeholders are considered and the short-term and long-term expectations of the stakeholders need to be aligned with the mission and activities of the organization. If done properly, the author assumes there should be little or no need for regulatory intervention. Therefore, for the purpose of this study, the executive scorecard does not include regulatory measures that go beyond the expectations document.

المنارة للاستشارات
www.manaraa.com

3.7: The Need for an Effective Evaluation

The financial crisis of 2008 led to the SEC and federal government agencies to move organizations to better align pay with performance. In his expectancy theory of motivation, Vroom (1964) hypothesizes that to motivate individuals; there must be a link between performance and motivation. However, to change to a culture that emphasizes performance will require organizations to invest time and money, but will also require redesigning compensation systems in order to succeed.

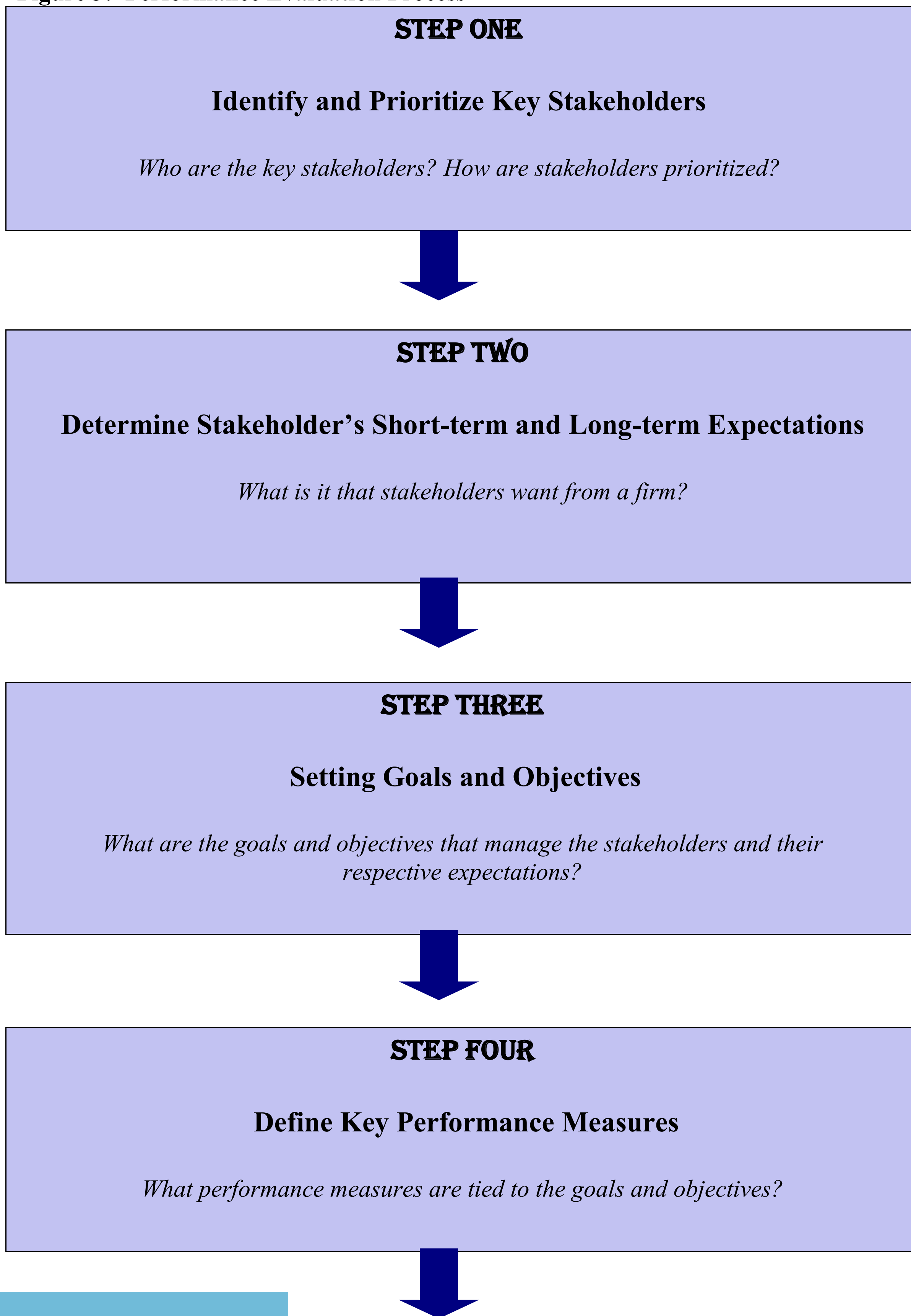
Atkinson, Waterhouse, & Wells (1997) used a stakeholder approach in identifying the contributions of performance measurements to three roles: coordination, monitoring and diagnosis. Coordination in terms of performance measurements is used to direct and focus attention on the primary and secondary objectives of the organization; monitoring refers to the reporting of performance in meeting stakeholder expectations, and diagnosis refers to the assessment of the relationships among performance processes (Atkinson et al, 1997).

Necessary to creating an effective performance evaluation system, the pay structure for senior executives must be credible and fair as defined as being capable of being believed and acceptable to all parties involved. Compensation must be aligned with a company's mission, goals and objectives, and provide alternatives for measuring and rewarding performance.

In order to design an effective mechanism for evaluating a CEO's performance, Figure 3 demonstrates a five-step process for successful evaluation and measurement of performance of a CEO.

المنارة للاستشارات
www.manaraa.com

Figure 3: Performance Evaluation Process



المنارة للاستشارات
www.manaraa.com

STEP FIVE

Develop Supporting Metrics

What are the detailed measures that feed and augment the key performance measures?

Adapted from http://www.slideshare.net/victorholman/developing-metrics-that-drive-performance-success

3.8: Creating the Evaluation

The proposed model is a multi-stakeholder design so an effective process is needed to eliminate any confusion with the roles and responsibilities of the players involved (Wyman, 2003). To help with process flow, the performance evaluation has been broken into five steps as follows:

3.8.1: Step One: Identifying the Key Stakeholders

The first step in creating an executive scorecard is to identify the stakeholders according to their relationship to the organization and then prioritize the stakeholders by relationship to the situation and by attributes. Stakeholders are those individuals or groups inside and outside of the organization who will gain or lose by the success or failure of the organization. As previously stated, the stakeholders have been identified as employees, investors, customers, suppliers, creditors, community, and the board of directors. Once an organization has identified their stakeholders then they must prioritize them in order to determine who to give attention, who to give more attention to, and who not to give attention at all (Rawlins, 2006). Prioritizing by situation helps to avoid the

المنارة للاستشارات
www.manaraa.com

dilemma that arises from having to make such decision. The methodology for prioritization is discussion in Step Five.

3.8.2: Step Two: Defining the Stakeholders' Expectations

Once the relevant stakeholders have been identified, the second step is to identify the stakeholder's expectations of the corporation and the CEO. Determining stakeholder expectations is crucial to the success of the executive scorecard. If expectations are not properly identified, then the goals and objectives, and the measurements to determine how well the CEO meets the expectations will not be adequately determined and the predetermined targets will not be met.

It is also important to understand that at times the wants of stakeholders are in conflict with one another making it nearly impossible to satisfy all stakeholders all the time (Boutelle, 2004). Stakeholders may have different goals than the CEO, so the task of identifying stakeholder's expectations can be challenging. Additionally, not all stakeholder expectations will be met equally, but the goal is to maintain as high a level of stakeholder satisfaction as possible. Once completed, the short-term and long-term expectations of the stakeholder groups become the basis for the board and CEO to work collaboratively to determine the CEO's goals and objectives.

Table 5 provides an example of key stakeholders and one corresponding short-term and long-term expectation for each stakeholder group. Depending upon the nature of the business and the number of expectations desired each firm can customize an expectations document to fit their needs.

المنارة للاستشارات
www.manaraa.com

Table 5: Stakeholders' Expectations Document

Stakeholder Group	Short-Term Expectations	Long-Term Expectations
Employees	*Equity in the workplace with the possibility of achievement and recognition for efforts made*	*Systemic, integrative communication approach that drives firm performance and demonstrate value for workers*
Investors	*Strong management team that makes decisions with shareholders in mind*	*Substantial returns and an appropriate level of risk to achieve returns*
Customers	*Cultivate a good relationship providing reputable service and products at the lowest competitive price*	*Demonstrate value by securing revenue streams and seeking economies of scale in shared-services and use technology for cost reduction opportunities*
Suppliers	*Establish relationships that encourage and support diversity*	*Establish long-term relationship with a commitment to integrity and an equal opportunity to sell products and services*
Creditors	*Explicit and implicit promise to repay debt*	*Sound judgment in decision-making process to protect assets*
Community	*Identify and respond appropriately to the essential needs and concerns*	*Establish relationships of trust with community groups and individuals, assuming corporate social responsibility toward economic development, education and green environment*

للاستشارات المنارة
www.manaraa.com

Board of Directors	*Works cooperatively to create an optimal governance environment, supports the policies, procedures and philosophy, and creates a sense of trustworthiness in board/executive team relations*	*Works closely and communicates well with board of trustees in developing the Mission, and long-and short-range strategic plans.*
Regulators	*Greater disclosure of decision-making process & transparency of compensation program*	*Greater oversight and communication building and establishing solid relationships with stakeholders providing satisfaction to all groups*

Source: Patricia Beckenholdt

NOTE: The short-term and long-term expectations are the creation of the author and can be changed depending on organizational need.

3.8.3: Step Three: Setting the CEO's Goals and Objectives

By focusing executive activities on the mission and strategic plan and then looking at the stakeholder's short-term and long-term expectations, goals and objectives can be developed to address the stakeholder's expectations. Table 6 depicts a set of goals and objectives for a CEO based on the author's own assumptions. Clearly, every organization would need to develop a set of goals and objectives for its CEO that aligns with its stakeholders' expectations.

Table 6: CEO's Goals and Objectives

Stakeholders	*CEO's Goals and Objectives*
Employees	*Provide job and compensation that improve workers' living conditions.*
Investors	*Provide an attractive return*

المنارة للاستشارات
www.manaraa.com

Customers	*Satisfy customers with superior quality and value assuring products and services are safe for the intended use.*
Suppliers	*Work closely with suppliers at all levels meeting with potential new and existing supplier maintaining open lines of communication, establishing purchase and payment controls, creating strategies to continue relationship while reducing delinquent accounts payable.*
Creditors	*Maintain high creditworthiness and frequent communication concerning outstanding credit lines and current credit terms.*
Community	*Bring community values to bear on major decisions by developing solutions that address environmental and social challenges, and supporting local needs and education in communities where employees live and work.*

Source: Patricia Beckenholdt

3.8.4: Step Four: Define Key Performance Measures

A performance measure is a comparison of actual returns against a predetermined benchmark, and is used by organizations to establish parameter to reach or assess a defined goal or objective. The selected performance measures are a mix of quantifiable and non-quantifiable measures directly linked to the CEO's goals and objectives. This does not mean that measures of performance have to be financial. In fact, non-financial measures can be just as important as financial performance measures. This can be seen in the performance measures for customers.

By developing a good set of goals and objectives, the board of directors can better select what to measure. Table 7 depicts the goals and objectives for a CEO that aligns with stakeholder's short-term and long-term objectives. A variation of the identified performance measures would depend on the organization and even the industry.

المنارة للاستشارات
www.manaraa.com

Table 7: Performance Measures

Stakeholders	*Executive's Goals and Objectives (Standard)*	*Performance Measure(s)*
Employees	*Provide job and compensation that improves workers' living conditions. Maintain a safe and healthy workplace that has a supportive, flexible environment.*	*75 percent of all jobs/positions, titles and salaries benchmarked against industry and competitive organizations and increasing salaries an average of two percent higher than either standard. Measure worker satisfaction with the use of survey. Safety of the work environment can be measured with the number of injuries and worker compensation cases.*
Investors	*Provide an attractive return*	*Financial measures – ROI, ROCE, GMP, OPM, NPM, stock price variances*
Customers	*Satisfy customers with good service, superior quality product or service with acceptable prices, assuring products and services are safe for their intended use.*	*Quality control, extension of warranties, surveys; number of customers complaints*
Suppliers	*Work closely with suppliers at all levels meeting with potential new and existing suppliers. Maintain open lines of communication, establishing purchase and payment controls, creating strategies to continue relationship while reducing delinquent accounts payable.*	*Number of partnerships developed that demonstrate reduced cost, improved service, and quality for parties involved.*
Creditors	*Maintain high creditworthiness and frequent communication concerning outstanding credit lines and current*	*Negotiate clear, written agreements at the outset.*

www.manaraa.com

	credit terms.	*Supply bank with regular management accounts, including cash flow forecasts and a brief commentary explaining variances. Be proactive, rather than waiting to be asked for the information.*
Community	*Bring community values to bear on major decisions by developing solutions that address environmental and social challenges, and supporting local needs and education in communities where employees live and work.*	*Establish/expand community outreach program that involves employees and implement a matching program for educational contributions*

Source: Patricia Beckenholdt

NOTE: *The goals and objectives and the performance measure are the creation of the author and can be changed depending on organizational need.*

The leadership team of an organization is tasked with determining the purpose and the performance measurements. There may be times when stakeholders such as legislators have the opportunity to do so. If external stakeholders make the determination, the use of performance measures to evaluate, control, budget or punish are used to hold an organization accountable (Behn, 2003). The leadership team is still responsible to report these measures and may be able to use these to meet their own objectives. Internal stakeholders are more likely to use performance measures to motivate, promote, or celebrate to effect improvement.

Performance measure are known to shape behavior, but that means that the shaping can be desirable or undesirable (Behn, 2003). Performance measures include both financial and non-financial measures to assess how well an organization is performing. One of the main reasons Kaplan and Norton (2005) created the balanced

المنارة للاستشارات
www.manaraa.com

scorecard was to alleviate the inadequacies of financial measures, i.e., historical perspective and inability to reflect value creation actions (Behn, 2003). A major benefit of the scorecard is to look at performance from various perspectives (financial and non-financial taking into account internal and external stakeholders and how the measures help achieve the short and long-term goals of the organization). No one performance measure can be used for all purposes. Additionally, some performance metrics are easier to measure than others.

Table 8 provides possible performance measures and the explanations for the section that supports the measure. The metrics include both financial and nonfinancial performance measures.

Table 8: Explanation for Selection of Performance Measures

Stakeholders	*Performance Measure(s)*	*Explanation*
Employees	*75 percent of all jobs/positions, titles and salaries benchmarked against industry and competitive organizations and increasing salaries an average of two percent higher than either standard. Measure worker satisfaction with the use of survey. Safety of the work environment can be measured with the number of injuries and worker compensation cases.*	*Employees want to know that they are valued, and by receiving a fair or more than fair salary keep many employees satisfied and motivated to produce work. Organizations can design surveys that will provide information on employee satisfaction learning about those items employees would like to see improved or changed. Employees want to work in a safe environment and to know the organization cares about them.*
Investors	*Financial measures – ROI, ROCE, GMP, OPM, NPM, stock price variances* *Nonfinancial measure – regulatory compliance, risk mitigation*	*Financial: Return on Investment (ROI), return on capital employed (ROCE), gross profit margin (GPM), operating profit margin (OPM), net profit margin (NPM), are all measures of profitability and are key measures used by most organizations that target increased profits. Investors want to see stock prices increase.* *Nonfinancial: response to growing*

المنارة للاستشارات
www.manaraa.com

		demand to effectively manage risk and regulatory compliance across the globe.
Customers	*Quality control, extension of warranties, surveys; number of customers complaints*	*Customers are the lifeblood of the organization; therefore it is important for the organization to develop a rapport with its customers instilling positive feeling from the customer.*
Suppliers	*Number of partnerships developed that demonstrate reduced cost, improved service, and quality for parties involved.* .	*Collaborating with suppliers and entering into strategic sourcing initiatives improves supply chain effectiveness and customer service.*
Creditors	*Negotiate clear, written agreements at the outset.* *Supply bank with regular management accounts, including cash flow forecasts and a brief commentary explaining variances. Be proactive, rather than waiting to be asked for the information.*	*Commonly used accounting ratios that provide useful measures of business performance include liquidity ratios, efficiency ratios and financial leverage ratios. Cash flow is a crucial in determining an organization's liquidity when a firm may appear profitable but fails to generate cash. Maintaining high bond ratings is a sign of creditworthiness.*
Community	*Establish/expand community outreach program that involves employees and implement a matching program for educational contributions.*	*Being socially responsible infers that the people of an organization will act ethically. . Community outreach efforts can be beneficial relationships to all involved by uniting together for a common mission.*

Source: Patricia Beckenholdt

3.8.5: Step Five: Developing Metrics for Setting Targets

A performance metric is a type of measurement used to quantify the performance component used by an organization. The use of metrics in measuring performance is instrumental to an organization's growth providing valuable information to evaluate the different areas in a business that allows CEO's to proactively manage performance.

Leaders carry a certain level of responsibility to stakeholders having a "commitment to share the pain as well as the gain" (Moran, 1996, p. 16). With this in

المنارة للاستشارات
www.manaraa.com

mind, targets are developed not only to benefit the CEO but penalize them for not meeting acceptable standards of performance.

So far, shareholder expectations, goals and objectives for the CEO, and key performance measures have been identified. The next step is to set performance targets that provide a clear path to what the CEO is expected to achieve. Targets form the link between the organization's strategy and its day-to-day operations, helping the CEO to achieve the goals and objectives by breaking them down into manageable steps.

Table 9 depicts the executive scorecard targets associated with the performance measures. These targets have been created by the author strictly for demonstrative purposes and in no way reflects any particular organization.

Table 9: Executive Scorecard Targets

Stakeholders	Performance Measure(s)	Target
Employee	*75 percent of all jobs/positions, titles and salaries benchmarked against industry and competitive organizations and increasing salaries an average of two percent higher than either standard. Measure worker satisfaction with the use of survey. Safety of the work environment can be measured with the number of injuries and worker's compensation cases.*	5% increase for every 10% increase over the 75%; 1% increase for meeting 75% employee satisfaction; 1% increase for every 10% decrease in injuries and worker's compensation claims 0% for meeting 75% 5% decrease for every 10% decrease under the 75%; 10% decrease for every 5% decrease in employee satisfaction; 2% decrease for every 10% increase in injuries and worker's compensation claims.
Investors	*Financial measures – ROI, ROCE, GMP, OPM, NPM*	10% increase for every percentage increase above current rate 0% for maintaining current level 10% decrease for every percentage decrease under current rate
Investors	*Stock price*	5% increase for every $1 increase in stock price

المنارة للاستشارات
www.manaraa.com

		0% for maintaining current stock price 5% decrease for every $1 decrease in stock price
Customers	*Quality control, extension of warranties, surveys; number of customers complaint; customer satisfaction*	10% increase for an increase of 2% in quality control efforts; 3% increase for every 5% decrease in customer complaints 0% increase for maintaining current level of complaints 10% decrease for a decrease in 2% in quality control efforts; 3% decrease for every 5% increase in customer complaints
Suppliers	*Number of partnerships developed that demonstrate reduced cost, improved service, and quality for parties involved*	2% increase for meeting with at least 25% of suppliers; 2% increase in honoring 95% of all contracts 0% for maintaining current levels 5% decrease for every 2% decrease below the 25% threshold for meeting with supplier; 2% decrease for every 5% below the 95% threshold not honored
Creditors	*Negotiate clear, written agreements at the outset.* *Supply bank with regular management accounts, including cash flow forecasts and a brief commentary explaining variances. Be proactive, rather than waiting to be asked for the information.*	1% increase for sending a monthly report to each creditor 0% increase for meeting 75% 1% decrease for every month that a correspondence does not go to a creditor
Community	*Establish/expand community outreach program that involves employees and implement a matching program for educational contributions*	5% increase for every $10,000 of benefit earned 0% for maintaining current level 5% decrease for every $10,000 of benefit lost

Source: Patricia Beckenholdt

NOTE: *The executive scorecard targets are the creation of the author and can and should be changed depending on an organization's characteristics.*

المنارة للاستشارات
www.manaraa.com

3.9: Completing the Scorecard

Table 10 depicts the completed Executive Scorecard that is compiled using the five-step process. The metrics are used to merely demonstrate how to set targets that will determine executive compensation and can be adjusted depending on the decisions made by the board. The completed executive scorecard also demonstrates the weight that each stakeholder group carries. The weights demonstrated in the scorecard are weights assigned by the author and in no way represents any particular organization. Although all stakeholders are important to an organization, some stakeholders may be deemed to be more valuable in assessing executive compensation. For example, Table 9 shows that investors are seen as more important with a weight of 50% in comparison to suppliers that are weighted at 5%. Again, it is important to note that the weights are assumptions made by the author and in no way represent any particular firm.

However, in order to assign a weight to its stakeholders, organizations prioritize based on some criteria to determine who to give attention, who to give more attention to, and who not to give attention at all (Rawlins, 2006). In his study described above, Rawlins (2006) prioritizes stakeholders according to attributes using Mitchell, Agle, & Wood's (1997) comprehensive model that includes the attributes of power, legitimacy, and urgency. Some stakeholders have the power to influence other parties to make decisions that the party would not have made under normal circumstances. Legitimacy plays out when a stakeholder has a legal, moral, or presumed claim that can influence the organization's behavior, direction, process or outcome (Rawlins, 2006). Also, stakeholders who invest capital into an organization are risk-bearers and are often dependent on the organization. Urgency refers to a relationship that is time sensitive or

المنارة للاستشارات
www.manaraa.com

critical to the stakeholder. Urgency alone does not predict priority of a stakeholder but is when a dimension that attracts the attention of the media or other stakeholders is added. The combination of these three attributes helps an organization develop a prioritization strategy. According to Mitchell et al. (1997) individuals or groups who do not possess any of the three attributes are not stakeholders. Individuals or groups who possess one attribute are latent stakeholders who are identified as dormant (possesses power only), discretionary (possesses legitimacy only), and demanding (possesses urgency only) and have lower salience to an organization. Individuals or groups who possess two attributes are expectant stakeholders who are categorized as dominant (possess power and legitimacy), dependent (possesses legitimacy and urgency), and dangerous stakeholders (possesses urgency and power). Stakeholders who possess all three attributes are definitive stakeholders and should hold the highest priority (Rawlins, 2006).

Rawlins (2006) referred to Grunig and Repper (1992), who wrote that prioritizing stakeholders by relationship to a situation is important to organization as a means to identify which "publics will communicate actively, passively or not at all" about decision organizations make that affect them (p. 9). Stakeholders have different levels of involvement, which is measured by the extent people connect with a situation. People have to recognize a problem, and behavior determines whether they will do something about the problem. The level of constraint recognition (belief that nothing can be done) also plays a role in whether a stakeholder acts on information received.

An organization has to use such criteria to determining how stakeholders are weighted in the executive scorecard. An organization must prioritize stakeholders, which can be difficult because each attribute is variable and not constant. Additionally, it is

المنارة للاستشارات
www.manaraa.com

difficult to assess behavior and how a stakeholder will respond to an organization's behavior but by prioritizing stakeholders, organization will be in a better position to handle unexpected responses to organizational decisions.

Lastly the conceptual model requires the stakeholder's weight to be multiplied by the rating the CEO receives to provide an overall weighted rating. At this point, the overall rating would be translated into compensation based on predetermined compensatory figures.

المنارة للاستشارات
www.manaraa.com

Table 10: Completed Executive Scorecard

Executive Scorecard						
Stakeholders	***Executive Goals & Objectives***	***Performance Measures***	***Targets***	***Rating***	***Stakeholder Weight***	***Overall Rating***
Employees	*Provide job and compensation that improves workers' living conditions. Maintain a safe and healthy workplace that has a supportive, flexible environment.*	*75 percent of all jobs/positions, titles and salaries benchmarked against industry and competitive organizations and increasing salaries an average of two percent higher than either standard. Measure worker satisfaction with the use of survey. Safety of the work environment can be measured with the number of injuries and worker's compensation cases.*	5% increase for every 10% increase over the 75%; 1% increase for meeting 75% employee satisfaction; 1% increase for every 10% decrease in injuries and worker's compensation claims 0% for meeting 75% 5% decrease for every 10% decrease under the 75%; 10% decrease for every 5% decrease in employee satisfaction; 2% decrease for every 10% increase in injuries and worker's compensation claims.		***15%***	
Investors	*Provide an attractive return*	*Financial measures – ROI, ROCE, GMP, OPM, NPM, Stock price*	10% increase for every percentage increase above current rate; 5% increase for every $1		***50%***	

المنارة للاستشارات
www.manaraa.com

			increase in stock price 0% for maintaining current level 10% decrease for every percentage decrease in current rate; 5% decrease for every $1 decrease in stock price			
Customers	*Satisfy customers with good service, superior quality product or service with acceptable prices, assuring products and services are safe for their intended use.*	*Quality control, extension of warranties, surveys; number of customers complaints*	10% increase for an increase of 2% in quality control efforts; 3% increase for every 5% decrease in customer complaints 0% increase for maintaining current level of complaints 10% decrease for a decrease in 2% in quality control efforts; 3% decrease for every 5% increase in customer complaints		***5%***	
Suppliers	*Work closely with suppliers at all levels meeting with potential new and*	*Number of partnerships developed that demonstrate reduced*	*2% increase for meeting with at least 25% of suppliers; 2% increase in honoring*		***5%***	

www.manaraa.com

	existing suppliers. Maintain open lines of communication, establishing purchase and payment controls, creating strategies to continue relationship while reducing delinquent accounts payable.	*cost, improved service, and quality for parties involved*	*95% of all contracts* *0% for maintaining current levels* *5% decrease for every 2% decrease below the 25% threshold for meeting with supplier; 2% decrease for every 5% below the 95% threshold not honored*			
Creditors	*Maintain high creditworthiness and frequent communication concerning outstanding credit lines and current credit terms.*	*Negotiate clear, written agreements at the outset.* *Supply bank with regular management accounts, including cash flow forecasts and a brief commentary explaining variances. Be proactive, rather than waiting to be asked for the information.*	*1% increase for sending a monthly report to each creditor* *0% increase for meeting 75%* *1% decrease for every month that a correspondence does not go to a creditor*		***15%***	
Community	*Bring community values to bear on major decisions by developing*	*Establish community outreach program that involves employees and implement a*	*5% increase for every $10,000 of benefit earned*		***10%***	

المنارة للاستشارات
www.manaraa.com

	solutions that address environmental and social challenges, and supporting local needs and education in communities where employees live and work.	*matching program for educational contributions*	*0% for maintaining current level* *5% decrease for every $10,000 of benefit lost*			

Source: Patricia Beckenholdt

المنارة للاستشارات
www.manaraa.com

3.10: Managing Executive Scorecard Weaknesses

Developing an executive scorecard is not self-sustaining and requires constant oversight and maintenance. This requires management to have a concise list of the success factors that includes a process (Huselid, Becker, & Beatty, 2005) to have the right perspective and the right measures for the organization. The right perspective focuses on the workforce strategy balancing the short-term performance requirements for revenue/ productivity/cost with the required longer term workforce investment in support of future growth opportunities (Huselid et al., 2005). Further, an organization wants to ensure that a mechanism is in place to obtain feedback from all relevant parties. If these are not evident or if the organization fails to maintain an appropriate relationship with the key stakeholders, the model will fail, and the company will not be successful in its efforts.

3.11: Summary

Chapter Three provided a discussion on the conceptual framework for the Executive Scorecard that is a combination of the Stakeholders' model and the Balanced Scorecard. The conceptual framework is developed with a five-step process to ensure the successful evaluation and measurement of CEO performance. In the next chapter, a discussion of the methodology is provided.

المنارة للاستشارات
www.manaraa.com

Chapter Four: Methodology

4.1: Research Process

The time was early 2009 and global economies were experiencing the aftershocks of the financial crisis that resulted in the stock market crash, plummeting real estate prices, failed financial institutions, and damaged investor confidence. As governments rushed to stabilize the financial service sector, top executives of some of these same companies continued to receive incentive pay in the form of bonuses causing outrage from investors, the public, and the government. Considering the unsettled environment in which these executives operated, and the call for a closer examination of executive pay programs led to want to further research executive compensation and to develop a compensation model that would well serve all stakeholders.

The author performed an exploratory study on executive compensation that included scholarly journals, books, and current event articles. Due to the uncertainty of the initial focus of the dissertation, the UMUC databases were scanned for various topics related to executive compensation. The initial process was acutely manual with the author having to browse each article and then categorize them by themes. This inductive approach, while a difficult strategy to follow especially in light of the fact that there was no clearly definite theoretical framework, allowed theory to emerge from the process of data collection and analysis (Saunders et al, 2009). The categorization process was paper intensive. However, many articles were saved to an electric file that was beneficial when searching for key words.

As the purpose of the research became clearer and the conceptual framework developed, the categories became critical pieces of the research. It was found that some of the categories were not relevant, thereby eliminated; while other categories became the main sources for pursuing the research and analysis. The research on executive compensation is complex and extensive. It is difficult to cover one area of interest without touching on several other issues

المنارة للاستشارات
www.manaraa.com

related to executive compensation. This same problem was noted in trying to keep the identified categories separate. One particular article could cover several key themes but after exhaustive research, the patterns of relationships emerged. The literature in paper form were maintained by category and filed in folders accordingly.

Scholarly articles as sources for the research were retrieved from several databases such as Business Source Complete, ABI/Inform, JStor, ScienceDirect, Books24x7, Wall Street Journal, and Web of Science, which is a process to access to leading citation databases. The databases provided access to peer-reviewed articles, studies, and journals related to executive compensation, the balanced scorecard, and management theories necessary to complete this dissertation. The Internet was instrumental in providing articles that were not available through the databases, but still in most cases peer reviewed.

At times, it was appropriate to use the databases to retrieve articles on a single topic such as balanced scorecard or stakeholders' theory, but then it was also necessary to unitize data, using bits or chunks of information on multiple topics such as executive compensation, customers, and expectations to locate articles. Using the reference list of already retrieved articles provided a good base for additional research on various topics related to executive compensation, pay-for-performance or agency theory. Much of the literature was written in the mid-20th century such as the theory of the corporation, theory of motivation, and agency theory. The literature review includes some material from this era but also provides relevant scholarly research from more current decades as there has been ongoing debate surrounding executive compensation.

المنارة للاستشارات
www.manaraa.com

4.2: Evidence-Based Research

Evidence-based research (EBR) is a methodology used to describe a type of research in which practitioners use theory and evidence laid out from previous research to test the validity of their own ideas. EBR requires a detailed explanation of a study's research methodology, and a summarization of a study's outcomes. The use of literature with high internal and external validity provides an abundance of information or what Slavin (1995, p. 11) refers to as "best-evidence synthesis."

4.3: Application of Evidence-Based Research

This study applied evidence-based research to examine executive compensation as the topic relates to excessive pay, agency theory, firm size, performance, and motivation. It is the author's desire that by using evidence-based research, that there a greater understanding of issues that relate to determining equitable pay for senior executives of publicly-held firms. Executive compensation is a complex and controversial issue and no simple solution is possible to resolve all of the issues, but this study attempts to prove that it is possible to design a compensation model that meets stakeholders' expectations and aligns with meeting a firm's strategic goals.

4.4: Use of Expert Panel

Part of the dissertation process was to include feedback from an expert panel of three members. The composition of the expert panel is as follows:

Panel Member 1 – An academician with a Masters degree in Human Resources (HR) who currently serves as an adjunct associate professor for the School of Undergraduate Studies at UMUC He is an HR professional with more than 20 years experience designing, developing and directing compensation programs.

المنارة للاستشارات
www.manaraa.com

Panel Member 2 – President of a Management and Human Resource consulting firm with an MBA. He has more than 30 years of management experience that focuses on aligning HR practices with the strategic and operation needs of employers and clients.

Panel Member 3 – An academician with a Ph.D. in Leadership and is currently serving as an adjunct associate professor for the School of Undergraduate Studies. She has extensive experience in Management and Human Resources and acts in the capacity of mentor to doctoral students at another U.S. based University.

The subject matter experts noted that the executive compensation topic was timely and not new to the practicing field but the Executive Scorecard approach could enable boards to more effectively address significant areas where organizations struggle to find acceptable solutions including retention of top executives, compliance and regulatory statutes, and code of professional conduct.

4.5: Summary

This chapter discussed how the methodology, evidence-based research, and scholarly literature were used to develop the literature review. The completion of the literature review could not have been done without the insight from cohort members, academic faculty members, and a panel of experts. In the next chapter an analysis and discussion of the findings of the literature is provided.

المنارة للاستشارات
www.manaraa.com

Chapter Five – Analysis and Discussion

This chapter provides an analysis and discussion of the literature review findings discussed above in an attempt to answer the following research questions:

5.1: Question 1 – What criteria should be used in determining executive (CEO) compensation?

Analysis and Discussion

History shows that executive compensation has been closely scrutinized and debated for the large sums of money paid in salaries and bonuses, especially when the U.S. was experiencing economic turmoil. When the economy turned downward in recent years, large pay packages became the focus of public outrage, particularly toward the executives of companies receiving taxpayer funds under TARP. From the literature discussed in Chapter Two it is assumed that criteria used to determine executive compensation include the relationship between executive's pay and firm size, the relationship between executive's pay and other workers' pay and the relationship between executive pay and firm performance. However, Freeman (1984) introduced the stakeholders' model because stakeholders are the people or groups affected by the activities of the organization. After seeing the problems created by executives from Enron, Arthur Andersen and more recently from AIG and Lehman Brothers, this model offers organizations a moral and ethical approach that refocuses decision-making power to not only shareholders but to stakeholders. Such efforts should be extended in developing an executive compensation plan because of the interest stakeholders hold in the organization.

In the case study performed by Gomes, Gomes, & de Oliveira (2011) as described above, the stakeholder analysis was used to identify stakeholders that populated the organization's environment. Once the stakeholders were identified, then the criteria for judging

المنارة للاستشارات
www.manaraa.com

the organization's performance could be identified and assessed according to the criteria from the stakeholders' point of view. Findings of the study showed that stakeholders expected wise use of corporate funds and improved quality of service provided. Additional findings indicated that stakeholders assess performance on criteria of efficiency, effectiveness, and equity focusing on identified problems and complaints so improvements could be made.

Susniené and Sargunas' (2009) study as described above identified and arranged criteria that generated the premises in organization management for stakeholder satisfaction and adapted the criteria and associated indicators to link to organizational processes. The indicators focused on in the study were those that required significant improvement because of their influence on an organization's position in the market and on creating value for stakeholders. Findings of the study show that organizations cannot focus on profit alone as stakeholders with other interest would be ignored. Therefore, identifying criteria and associated indicators imparts stakeholder satisfaction in organizational management.

Alternative Findings- #1

Jensen and Murphy's (1990) study discussed above links executive pay to performance. The authors argue that executives should own a substantial amount of company stock because it creates a link between the shareholder and the executive's wealth. Executives benefit from increases in share value providing an incentive to perform well so in turn the organization performs well. Contrary to this review, Bebchuk and Fried's (2003) study discussed above on pay-for-performance led to increased CEO power. The study showed that CEO pay will be higher when CEO's dominate board members, in firms that fail to have a controlling shareholder, and in firms that have a smaller concentration of institutional investors. The authors noted that

المنارة للاستشارات
www.manaraa.com

executives often receive non-performance incentives that are not visible to shareholders, which is inefficient compared to what the board awards in an effort to provide an efficient incentive.

Alternative Findings- #2

Conyon's (2006) study discussed above looks at the relationship between pay and motivation through the lens of the principal-agent model. Pay is determined using enticers such as stock options and restricted stock in an effort to create an optimal compensation package. The goal of using such enticers is to motivate executives to align their goals with the goal of maximizing firm value. Weisbach's (1988) study described above argues against using the principle-agent model because the principal is unable to observe the agent's actions so determining the appropriate criteria is difficult. Also, there is a high likelihood that the tenet of the principal-agent model, which presumes contracts are optimal, is invalidated since many executives have control in determining their own pay.

Summary on the Criteria Used in Determining Executive (CEO) Compensation

There is a lot of disagreement and confusion over the appropriate criteria to use in determining executive compensation. However, the literature is replete with articles on the effects of firm size, performance, motivation, and stakeholders' expectations on executive pay. Findings of the various studies show that stakeholders are interested in responsible management of corporate funds, high quality of service, and continual process improvements, which indicates the importance of preserving the value of the business as well as the existence of the corporation. It is observed from the literature that the legislation passed in the past several years by the government appears to be considering the interest of stakeholders. In light of this fact, the stakeholders' model is used in developing the conceptual model.

المنارة للاستشارات
www.manaraa.com

5.2: Question 2 - What metrics should be used to measure the criteria?

Analysis and Discussion

From Murphy's (1999) study discussed above, financial and non-financial performance measures are used by almost all companies. Financial performance measures associated with accounting profits include revenues, net income, pre-tax income, operating profits or economic value added. Additionally, the author identified dollar-value of profit measures that include earnings per share, income-to-sales, return on assets or return on equity as possible measures. The author also pointed out that most organizations use multiple measures or a matrix of performance measure. The author identifies non-financial performance measures to include individual performance measures based on pre-established objectives and measures based on customer satisfaction or operational and/or strategic objectives such as increasing plant capacity, bringing a new computer system on line by a particular date, or reducing time-to-market.

Ittner et al. (2003) performed a study as described above and identified non-financial performance measures that included cost-effectiveness, risk control, employee relations, innovation, and customer satisfaction (p. 732). These non-financial performance measures were directly linked to the pre-established objectives and subjective assessments of individual performance. Financial measures were also tied to individual performance.

Alternative Findings- #2

In Bebchuk and Fried's (2003) study discussed above, designing a reduced windfall options plan that partially or completely filtered stock price increases unrelated to performance was recommended by the authors. Linking the exercise price of options to market-wide indexes or by the vesting of options on the firm meeting specified performance targets such as earnings

المنارة للاستشارات
www.manaraa.com

per share, stock price, or other measures of firm performance provides the firm the ability to increase to the executive for performing well.

Summary on What Metrics Should be Used to Measure the Criteria

As seen in the literature, it is possible to develop a list of financial and non-financial performance measures. However, not every performance measure fits a particular industry or business and not every performance measure is easily used to measure an outcome. Developing a set of metrics unique to a business allows executives to know how well their business is operating which in turn captures a company's strategy and drive organizational goals.

5.3: Question 3 - How can executive compensation tie a set of measurable criteria to stakeholder's expectations and a firm's strategic goals?

Analysis and Discussion

Freeman's (1984) study on stakeholder theory as discussed above focuses on executives managing stakeholders using a moral and ethical approach. The basic tenet of stakeholder theory is that executives create value for shareholders, employees, customers, suppliers, and communities by building relationships. The model has been used for decision-making that extends benefits from stockholders to stakeholders. The newer perspective provides decision-making power to stakeholders and assumes the firm has a fiduciary responsibility to put stakeholders first by increasing firm value.

In Donaldson and Preston's (1995) study discussed above, the stakeholder model views individuals and groups as having an interest in an organization. Although all stakeholders are important, they do not have equal interest so tying compensation to a set of measure criteria requires the stakeholders to be weighted in relation to the importance of interest in the company.

المنارة للاستشارات
www.manaraa.com

Murthy and Salter's (1975) study discussed above, compared compensation characteristics of a wide range of companies in an attempt to determine how much corporate strategy influenced the characteristics of CEO compensation and to determine differences in the level of corporate performance affected by compensation characteristics. The study's findings indicated that CEO compensation in one organization can be very distinct from other organizations even when characteristics are similar. Changes in executive pay were linked to changes in the financial measures of performance, especially earnings per share. Several dimensions of CEO were found to be related to organizational strategies. The authors explained that the varying patterns of compensation occur when the degree of a company's product-market diversity increases and there is a shift toward financial resource management that could be subjected to measures of financial performance. Additionally, a CEO can be evaluated on the same criteria, but the criteria must be well defined to be effective.

The current use of the balanced scorecard provides organizations with the ability to take financial measures and reflect on past events while gaining an internal and external perspective of the business. The broad perspective that the balanced scorecard provides, allows an organization to look at different critical performance measures at one time. The balanced scorecard is a good mechanism for tracking and improving performance by using key performance measures and targets and then implemented to meet the targets. The development of metrics unique to the business allows managers to know how well their business is operating that in turn can ensure that the company's mission is being met.

DeGeuser, Mooraj, and Oyon's (2009) study discussed above showed the balanced scorecard as a strategic management system capable of managing stakeholders while providing

المنارة للاستشارات
www.manaraa.com

managers the tools to executive organizational strategies. The study showed the balanced scorecard was effective in translating strategy and aligning resources to strategic objectives.

Alternative Findings- #1

The Total Rewards Model is a comprehensive framework that allocates resources and tailors activities to achieve a target performance level for a set period of time. The literature indicates that this model encompasses compensation for all employees as well as aligning to an organization's mission, business and strategy, which allows for improved decision-making while creating potential competitive advantage. However, implementation is not only time-consuming but costly and requires personnel with expertise in using the model. This model also does not directly address stakeholders' expectations.

Summary on trying to a set of measurable criteria that meet stakeholder's expectations and a firm's strategic goals

The literature significantly references stakeholders' theory and over the years there has been much debate over the theory's relevance to strategic goals. The literature on the balanced scorecard discusses its use in meeting a firm's strategic goals but does not incorporate the expectation of stakeholders. There appears to be a need to a more comprehensive framework as neither the stakeholders' model nor the balanced scorecard provides an adequate construct to set measurable criteria that meets stakeholders' expectations and a firm's strategic goals. Yet, by combining the two constructs, it is possible to formulate a set of measurable criteria and then tie these criteria to stakeholder's expectations and a firm's strategic goals.

المنارة للاستشارات
www.manaraa.com

The study performed by Murthy and Salter (1975) shows that corporate strategy is influenced by CEO compensation. The balanced scorecard is used to track the executive of activities and can be linked to corporate strategy as well as stakeholders' expectations. Murthy and Salter's (1975) study indicated that CEO compensation in one organization can be very distinct from other organizations even when characteristics are similar. The Executive Scorecard is designed to adapt performance measures and performance targets to meet stakeholders' expectations and align to an executive's goals and objectives.

5.4: Question 4 - How can performance targets be developed to ensure CEO's carry a level of responsibility to stakeholders?

Analysis and Discussion

An Executive Scorecard was developed using elements of the Stakeholders' model and the Balanced Scorecard. Using the stakeholders' model, stakeholders were identified and then a set of goals and objectives for the CEO were developed for each corresponding stakeholder group. A set of sample performance measures (financial and non-financial) were derived using Bryson's stakeholder analysis and from the performance measures identified in the literature. The author designed a set of performance targets that supported decisions concerning the performance measures but are only meant to be used as examples and do not relate to any particular organization. Short-term and long-term expectations were considered since the pursuit of short-term targets often comes at the expense of long term value creation. The board of directors would be responsible for outlining short-term and long-term business expectations for the CEO consistent with a company's strategic plan, and aligned with stakeholders' expectations.

المنارة للاستشارات
www.manaraa.com

The concept of the Executive Scorecard is to custom-tailor the measures to fit a company's particular mission, strategy, and the challenges it faces.

5.5: Chapter Summary

This chapter provides an analysis and findings for the research questions identified in Chapter One. For each of the research questions, an analysis and discussion is performed and alternative findings provided. The next chapter discusses the implications for management and possible trends that could impact those findings.

المنارة للاستشارات
www.manaraa.com

Chapter Six – Conclusions, Implications, and Trends

6.1: Conclusion

In researching executive compensation, it is clear that executive pay has been well-researched in the literature. Although the concepts are not generally new, the research is timely and relevant. The financial debacle of 2008 brought to light the huge payoffs executive make and continued to make even when the economy turned downward. The economic crisis resulted in record unemployment but many executives continued to receive huge bonuses, even executives of faltering companies that received TARP funds. These events brought to the public's attention the failure of corporations to align executive compensation with firm performance. What has been considered excessive compensation has become the subject of public concern and regulatory and legislative action.

Freeman (1984) as discussed above argued that an organization is an entity not owned by anyone, but contended that management had a legal and moral obligation to their stakeholders since they are significant contributors to the firm. Repeated infractions by executives of major firms such as Enron, Arthur Andersen, Lehman Brothers, and AIG heightened the awareness of poor decision making and self interests. This dissertation provides a renewed interest in stakeholder interest, whether attention should be paid to stakeholder, if attention is warranted, and who gets priority attention is a long-standing debate. Also of concern is who are the stakeholders and what are the expectations of stakeholders. Linking stakeholder expectations to CEO pay and holding a CEO accountable for meeting predetermined goals and objectives is possible by designing an executive scorecard. The CEO pay is determined by how well the goals and objective are met using targets that are tied to performance measures.

المنارة للاستشارات
www.manaraa.com

This dissertation identified a group of stakeholders for the purpose of the framework but each organization would want to identify their own stakeholders based on the type of business and the industry in which they operate. A model was developed that helps a firm identify the most important criteria to meet the stakeholder's expectations and still satisfy the firm's strategic goals while holding the CEO and other top executives accountable for meeting these goals. The literature shows that each stakeholder group wants different things depending on their relationship with the firm. Using an executive scorecard, a firm can attempt to meet the expectations of each stakeholder group, and still compensate executives in a manner that is directly tied to each stakeholder group's expectations.

The literature proves to be a rich source of information in helping to understand the long-standing issues that surround executive compensation. The recent financial debacle showed huge payouts to executives at a time when firm performance was less than adequate only serving to spur the controversy as to how much compensation is too much.

This paper attempted to provide some resolution to the longstanding debate about stakeholder legitimacy, offers insight into criteria of how organizations pay executives, presents a framework to determine how to pay executives for the work they perform while meeting strategic goals and stakeholder's expectations, and possibly make significant inroads into restoring credibility to the corporation. The proposed theoretical framework proposes a model in which all stakeholders benefit but to varying degrees. Although there may be an assumption that stakeholders are subject to equitable distribution of resources and entitled to organizational input, the model is not designed to allow each user of the model to determine the desired level of distribution and input. The model compensates an executive based on a set of metrics that are associated with the executive's goals and objectives that are directly tied to the expectations of

المنارة للاستشارات
www.manaraa.com

each stakeholder group. An executive benefits or is subject to penalties depending on his or her effort to meet or exceed the goals set forth by the board, thereby providing the executive with a compelling reason to work hard and make an organization successful in terms of people processes, strategies, learning and growth.

6.2: Implications for Management

The effects of 2008 indicate that organizations need to think beyond using compensation committees made up of board members or compensation consultants that are influenced by the executive to determine their own pay. Independent compensation committees are recommended to ensure balanced negotiations and to avoid conflict of interest and the possibility of excess exertion from executives (Randolph-Williams, 2010). The ARRA of 2009 requires TARP recipients to establish a compensation committee composed of independent directors. The CEO and CFO of publicly-held TARP firms are required to sign a certification of compliance that is submitted with a firm's annual filing to SEC (Schneider, 2009). The Obama administration and the SEC promote independent compensation committees to work toward designing fair and equitable compensation programs that adds credibility to the compensation process while protecting shareholder value (Schneider, 2009),

Organizations can shift from having a dependency on compensation committees and consultants by relying on evidence-based management to make and implement important strategic decisions. By using scientific research, organizations can identify, assess, and implement strategies focusing resources on executive compensation issues and other complex phenomena in which there are no simple solutions. Rousseau (2006) proposed that organizations use evidence-based management to transform managers into experts who make decisions based on scientific evidence rather than personal preference and unsystematic experience. Evidence-

المنارة للاستشارات
www.manaraa.com

based management can address the gaps between management research and management practice. Developing a culture of learning and inquiry through research is needed. Starkey and Tempest (2009) suggest the need to be "open to new ideas, to new images of possibility, to new design principles…upon which to build" (p. 576). Organizations that adapt a culture that "values and encourages innovation, experimentation, data collection, and analysis" are more likely to use research evidence management (Management Research in VA, 2002, p. 7).

The traditional business model is one that focuses on maximizing shareholder wealth. The stakeholders' model sharply contradicts this model, and is a more holistic approach that will help organizations plan for the future and consider stakeholders by attempting to manage business in a way that balances the competing claims of a group of diverse stakeholders and integrate multiple objectives and multiple stakeholders' interest with no prima facie priority of one group over another (Freeman, Wicks, & Parmar, 2004). The stakeholders' model is a more socially responsible approach for businesses who want to think beyond the pursuit of accumulating wealth for shareholders.

With globalization of world economies, increasing competition, environmental concerns, and changes in stakeholder expectations, the corporation must innovate and take a broader view of its business environment integrating the needs of its stakeholders, society, and the natural environment into its strategic plan. The CEO plays a vital role in the adoption and implementation of innovations in an organization (Daily and Huang, 2001; Dechant and Altman, 1994) so linking compensation to environmental initiatives makes sense. Further, the CEO's support of corporate innovations can promote employee empowerment, encourage reward and incentive systems, and can change an organization's culture (Cordeiro and Sarkis (2008).

المنارة للاستشارات
www.manaraa.com

Linking executive compensation to social and environmental initiatives is an effective tool that encourages CEO's to integrate innovation and sustainability into the corporation's daily business practices and decision making. Business practices comprise environmental concerns plus business continuity activities that are based on the innovation of the processes and products of an organization that lead to gaining a competitive advantage over its adversaries.

6.3: Implication of Trends

Economic Recovery:

Using pay data from 292 companies in the Standard & Poor 500 index, the AFL-CIO reported 2009's average total compensation for CEO's at the nation's largest corporations as $9.25 million (AFL-CIO, 2011). These same CEO's experienced a decline of 9 percent in total compensation from the previous year, but for the same period, retirement benefits increased 23 percent (AFL-CIO, 2011). Many corporations have elected to modify compensation policies that have resulted in decreases in executive pay. The implementation of claw back provisions (executive must repay a percentage of their pay under certain circumstances such as malfeasance) increased approximately 46 percent between 2006 and 2009 to 64 percent of the 100 largest U.S. companies (Bloomberg Business, 2009). As the economic recovery continues, performance expectations increased and are expected to continue to rise reflecting higher performance requirements to earn 2011 incentives (AFL-CIO, 2011).

Societal:

Using current data from the AFL/CIO, Dornhoff (2011) noted that the median compensation for CEO's in all industries as of early 2010 was $3.9 million; $10.6 million for companies listed in Standard and Poor's 500, and $19.8 million for the companies listed in the

المنارة للاستشارات
www.manaraa.com

Dow-Jones Industrial Average. The average worker's pay is approximately $36,000 a year. CEO salaries rose approximately 12% between 2009 and 2010. The income gap between CEO and average worker is one element in the larger social trends in the United States towards the concentration of wealth in the hands of a relative small number of people (Current Trends in Executive Compensation, 2011)..

Dornhoff (2011) contributed the growing income gap to the control CEO's often have over the board and the use of compensation consultant who bring a degree of economic respectability to the corporation after speaking with Edgar S .Woolard, Jr., retired CEO of DuPont. According to Dornhoff (2011), Woolard claimed corporate leaders are losing respect with the public especially as reports of CEO compensation packages are exposed. Shareholders want transparency of pay packages, and in return for current pay and severance packages, shareholders expect to see strong results and accountability on the CEO's part (Dornhoff, 2011).

Values:

Values are what corporate mission and vision statements are based upon. Values provide a roadmap for management to shape decisions and guide strategy (Rainey, 2006), and represents an organization's deepest beliefs. A value statement defines an organization's culture and describes how an organization behaves as it strives for success. A vision statement describes the strategic direction and encompasses the external stakeholders and social, economic, and environmental factors. CEO's plays a critical role in shaping and guiding their organizations (Carpenter, Geletkanycz, & Sanders, 2004), instilling their own values in the firm, which serve as the foundation for the vision and strategies that steer a firm's future (Stead & Stead, 2004). A relationship exists between CEO values and the attention given to stakeholders, including employees, government, and community (Agle, Mitchell, & Sonnenfeld, 1999). CEO's must be

المنارة للاستشارات
www.manaraa.com

responsible for articulating and managing values to ensure the conveyance of the right message (Rainey, 2006; Wally and Baum, 1994). A CEO's values are indicated as having important implications for organizational outcomes (Berson, Oreg, & Dvir, 2008). However, just because CEO's influence organizational outcomes, this does not mean that their pay should be linked to strategic goals and social, economic, and environmental initiatives.

With so many concerns about rising executive compensation, corporations are rethinking the way they structure executive pay. Corporations have begun linking executive compensation to both financial and non-financial performance. The Dutch bank and insurance company, ING admits to linking social, environmental and ethical goals to components of top executive pay structures (Williams, 2010). Further, ING developed a set of corporate responsibility targets for their Executive and Management boards that integrates sustainability into the personal accountability and performance objectives linked to non-financial drivers. Three other Dutch companies, Akzo Nobel, DSM, and TNT, provide evidence that they link executive compensation to environmental improvements and other nonfinancial objectives such as customer and employee satisfaction, but each company admit that efforts were done to reduce potential controversial management decisions (Williams, 2010).

Global Competition:

Several implications for executive compensation exist in relation to foreign competition. Total executive compensation increases with executives earning proportionally more when competition is high, also increases inequality within firms (Cuñat & Guadalupe, 2009). Increases in wage differential are contributable to the composition of top executives. Higher foreign competition leads to a higher demand for talent so as globalization increases, firms can expect to face more competitive pressure, which will lead to a higher demand for more talent and

المنارة للاستشارات
www.manaraa.com

the willing to pay CEO's for their effort (Cuñat & Guadalupe, 2009). However, Cuñat & Guadalupe (2009) found that increases in foreign competition lead to lower levels of fixed pay and a higher sensitivity of pay to performance. U.S. firms can expect to see an increase in the use of incentive contracts.

Legislation/Regulation:

With repayment of their TARP funds, recipient banks are now free to compensate executives any amount they choose. Yet, the financial regulatory reform legislation before Congress includes a provision to give shareholders a "Say-on-Pay" vote at each public company's annual shareholder meeting. The SEC is also considering new regulations to give shareholders equal access to the proxy to nominate their own directors.

6.4: Limitations and Areas for Future Research

A premise of evidence-based research is that gaps between scholarly knowledge acquired from management literature and managerial practice can be closed through research studies conducted by others. This study relied on evidence-based research to identify how organizations can align executive compensation with its corporate strategy while meeting stakeholder expectations. It is possible that there are alternative methods in managerial practice to achieve this end, which provides opportunity for future research.

This dissertation briefly touched on executive compensation in other countries. The studies conducted by Ebert et al. (2008) and Rehbein (2008) demonstrated U.S. CEO's are paid substantially more than those in other countries. Although the studies in the dissertation demonstrate executive compensation on the rise in other countries, comparing international companies to U.S. publicly-held companies can be difficult due to difference in tax laws,

المنارة للاستشارات
www.manaraa.com

variations on insider trading rules, permissibility of stock options, and calculation differences. These differences are outside the scope of this paper but provide opportunities for future research.

The recent financial crisis has raised awareness concerning questionable compensation packages for executives during a time when corporations are dealing with the impact of continued economic recovery. As performance expectations continue to escalate, there are opportunities for future research that include:

1. Evaluating the financial institutions that were subject to TARP to see whether these firms adapted new executive compensation practices or disregarded the regulatory legislation; and
2. Conducting a lesson learned study to identify what measures U.S. publicly-held company have implemented to align executive compensation with strategic goals and objectives and to prevent failure.

6.5: Chapter Summary

This chapter provided the overall conclusion resulting from the analysis of the findings discussed in Chapter Five above. It also discussed the implications for management trends that could impact the findings, and opportunities for future research.

CEO compensation has always attracted attention but in recent years economists, researchers, legal and regulatory bodies, educators, consultants, the government, and the general public have heightened interests as many of the large financial institutions collapsed requiring bailout of banks by the federal government. The housing market suffered tremendously, businesses failed, and consumer wealth declined as the recession spread globally. Yet, bonuses were paid to top executives.

المنارة للاستشارات
www.manaraa.com

This dissertation shows the need for practical application of the theoretical and empirical research in an effort to tie executive pay to an organization's long-term strategies and for organizations to align executive compensation packages to stakeholders instead of shareholders and self-interested executives. Motivation of executives can be achieved by aligning stakeholders' expectations to a set of performance measures that not only rewards executives but penalizes them for poor performance.

المنارة للاستشارات
www.manaraa.com

References

AFL-CIO (2011). Trends in CEO Pay. Retrieved July 9, 2011 from http://www.aflcio.org/corporatewatch/paywatch/pay/index.cfm

Agarwal, A.S. (2010). Motivation and executive compensation. *IUP Journal of Corporate Governance, 9*(1/2), 27-46.

Agarwal, N. (1981). Determinants of executive compensation. *Industrial Relations*, *20*(1), 36 – 46.

Aggarwal, R. K., & Samwick, A. A. (Feb 1999). The other side of the trade-off: The impact of risk on executive compensation. *The Journal of Political Economy, 107*(1), 66-105.

Agle, B. R., Mitchell, R. K., & Sonnenfeld, J. A. (1999). Who matters to CEOs? An investigation of stakeholder attributes and salience, corporate performance, and CEO values. *Academy of Management Journal, 42*, 507–525.Agrawal, A., & Mandelker, G. (1992). Shark repellant and the role of institutional investors in corporate governance. *Managerial and Decision Economics, 13*, 15-22.

Albano, M., Alcock, M., Emberger, K., LaPorte, L., & Bonnett, E. (2011, March/April). The SEC's final "say": SEC adopts final say-on-pay and shareholder advisory vote regulations. *Corporate Governance Advisor, 19*(2), 20-33.

Atkinson, A. A., Waterhouse, J. H., & Wells, R. B. (1997, Spring). A stakeholder approach to strategic performance measurement. *Sloan Management Review*, 25–37.

Baker, G. P., Jensen, M. C., & Murphy, K. J. (1988, June). Compensation and incentives: practice versus theory. *Journal of Finance, 43*(3), 593-616. doi: 10.2307/2328185.

Balkcom, J., & Brossy, R. (1997). Executive pay--then, now, and ahead. *Directors &*

www.manaraa.com

Boards, 22(1), 55-64.

Barkholz, D. (Jan 2006). Delphi compensation plan troubles lenders. *Automotive News*, *80*(6184), 4-4. Retrieved August 18, 2009 from Business Source Complete database.

Barrington, L., & Hallock, K. (Mar 2009). CEO compensation: *Leadership Excellence, 26*(3), 17.

Bebchuk, L. A., & Fried, J. M. (2003). Executive compensation as an agency problem. *Journal of Economic Perspectives*, *17*(3), 71-92. doi:10.1257/089533003769.204362.

Behn, R. D. (2003, September/October). Why measure performance? Different purposes require different measures. *Public Administration Review, 63*(5), 586-606. doi: 10.1111/1540-6210.00322.

Berle, A. A., & Means, G. C. (1932). *The modern corporation and private property*. Brunswick, NY: Transaction Publishers.

Berson, Y., Oreg, S., & Dvir, T. (2008). CEO values, organizational culture and firm outcomes. *Journal of Organizational Behavior, 29*, 615-633. Retrieved from www.interscience.-wiley.com. doi: 10.1002/job.499.

Bizjak, J., Lemmon, M. L., & Naveen, L. (2008). Does the use of peer groups contribute to higher pay and less efficient compensation? *Journal of Financial Economics*, *90*(2), 152–168. doi: 10.1016/j.jfineco.2007.08.007

Bloomberg Business (2009, May 13). Executive pay trends for 2010. Retrieved on July 10, 2011 from (http://www.businessweek.com/managing/content/oct2009/ca20091013-_224531.htm

Boutelle, J. (2004). Understanding organizational stakeholders for design success.

المنارة للاستشارات
www.manaraa.com

Retrieved August 23, 2009 from http://www.boxesandarrows.com/view/understanding_organizational_stakeholders for_design_success.

Brown, M. G. (2000). *Winning score: How to design and implement organizational score cards*. New York, NY: Productivity Press.

Bryson, J. M. (1995). *Strategic planning for public and non-profit organization*. San Francisco, CA: Jossey-Bass Publishers.

Burton, J. A., & Weller, C. E. (2005, May). Supersize this: How CEO pay took off while American's middle class struggled. Retrieved on May 28, 2011 from http://www.americanprogress.org/kf/ceo_pay_web_final.pdf

Butler, A., Letza, S. R., & Neale, B. (1997, April). Linking the balanced scorecard to strategy. *Long Range Planning, 30*(2), 242-253.

Carpenter, M. A., Geletkanycz, M. A., & Sanders, W. G. (2004). Upper echelons research revisited: Antecedents, elements, and consequences of top management team composition. *Journal of Management, 30*, 749–778.

Carr, L. L., & Valinezhad, M. (1994). The role of ethics in executive compensation: Toward a contractarian interpretation of the neoclassical theory of managerial remuneration. *Journal of Business Ethics*, *13*, 81-93. doi: 10.1007/BF00881576.

Chaven, M. (2009). The balanced scorecard: a new challenge. *Journal of Management Development, 28*(5), 393-406. doi:10.1108/02621710910955930.

Conyon, M. J. (2006). Executive compensation and incentives. *Academy of Management Perspectives, 20*(1), 25-44. doi.10.5465/AMP.2006.19873408.

Cordeiro. J. J., & Rajagopalan, N. (2003). Industry discretion as a determinant of the mix and level of executive compensation: A multilevel analysis. *Academy of Management Proceedings.* O1 –O6, Retrieved, June 15, 2009 from Business

المنارة للاستشارات
www.manaraa.com

Source Complete.

Cordeiro, J. J., & Sarkis, J. (2008). Does explicit contracting effectively link CEO compensation to environmental performance? *Business Strategy and the Environment, 17*, 304-317.

Core, J. E., Guay, W. R., & Thomas, R. S. (May 2005). Is U.S. CEO compensation inefficient pay without performance? *Michigan Law Review, 103,* 1142-1185.

Cornell, B. (2003). The information that boards really need. *MIT Sloan Management Review, 44*(3), 71-76.

Crozier, A. (1992). How investors rate executive pay. *Directors and Boards*, *16*(3), *56*.

Crystal, G. S. (Fall 1991). Why CEO compensation is so high. *California Management Review, 34*(1), 9 – 29.

Cuñat, V., & Guadalupe, M. (2009, April). Globalization and the provision of incentives inside the firm: The effect of foreign competition. Journal of Labor Economics, 27(2), 179-212.

Current Trends in Executive Compensation (2011). Retrieved from http://connection.ebscohost.com/businessfinances/executive-pay/current-trends-executive-compensation.

Daily, B. F., & Huang, S. C. (2001). Achieving sustainability through attention to human resource factors in environmental management. *International Journal of Operations and Production Management, 21*(12), 1539–1552.

Dechant, K., & Altman, B. (1994). Environmental leadership: from compliance to competitive advantage. *Academy of Management Executive 8*(3), 7–27.

De Geuser, F., Mooraj, S., & Oyon, D. (2009). Does the balanced scorecard add value? Empirical evidence on its effect of performance. *European Accounting Review*

المنارة للاستشارات
www.manaraa.com

18(1), 93-122. doi:10.1080/09638180802481698.

Dennis, B. & Cho, D. (2009, July 10). *AIG seeks clearance for more bonuses*. *The Washington Post.*

Donaldson, T. & Preston, L. (1995). The Stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of Management Review 1*(20), 65–91.

Dornhoff, G., W. (2011, July). Wealth, income and power. Who Rules America? Retrieved from http://sociology.ucsc.edu/whorulesamerica/power/wealth.html.

Ebert, F. C., Torres, R., & Papadakis, K. (2008). *Executive compensation: Trends and policy issues.* International Institute for Labour Studies, Geneva, Switzerland: ILS Publications.

Ellig, B. (2006). The evolution of executive pay in the United States. *Compensation and Benefits Review, 38*(1), 55-61.

Evans, J. & Hefner, F. (2009). Business ethics and the decision to adopt golden parachute contracts: Empirical evidence of concern for all stakeholders. *Journal of Business Ethics, 86*(1), 65-79. doi: 10.1007/S1055-008-9818-9.

Ferracone, R. A. & Gershkowitz, T. M. (2010, April/May). Performance and pay alignment: A top priority for compensation committees. *Directorship, 36*(2), 38-39.

Ferrell, O. C. (2004). Business ethics and customer stakeholders. *Academy of Management Executive*, *18*(2), 126-129. doi: 10.5465/AME.200413836176.

Finkelstein, S. & Abrahamson, E. (Oct, 1995). Assessing managerial discretion

المنارة للاستشارات
www.manaraa.com

across industries: A multi-method approach. *Academy of Management Journal, 38*(5), 1427-1441. doi: 10.2307/256864.

Finkelstein, S. & Hambrick, D. C. (1988, November/December). Chief executive compensation: A synthesis and reconciliation. *Strategic Management Journal*, *9*(6), 543-558. doi: 10.1177/0886368705284023

Firth, M., Fung, P., & Rui, O. (2006). Corporate performance and CEO compensation in China. *Journal of Corporate Finance, 12*(4), 693-714. doi: 10.1016/j.jcorpfin.2005.03002

Freeman, R. E. (1984). *Strategic management: A stakeholder approach*. Marshfield: MA: Pittman.

Freeman, R. E., Harrison, J. E., & Wicks, A. C. (2007). *Managing for Stakeholders: Survival, Reputation, and Success.* New Haven, CT: Yale University Press.

Freeman R. E., Wicks A. C., & Parmar, B. (2004). Stakeholder theory and 'the corporate objective revisited.' *Organization Science, 15(*3), 364–369. doi: 10.1002/smj

Gnyawali, D. R., Offstein, E. H., & Lau, R. S. (2008). The impact of the CEO pay gap on firm competitive behavior. *Group & Organization Management, 33(*4), 453-484. doi: 10.1177/1059601108321637.

Gomes, R. C., Gomes, M., & de Oliveira, L. (2011, April). Performance measurement and stakeholder perceptions: Assessing performance through the dimensions of stakeholder expectations. *Administration Review (BAR), 8*(2), 133-149.

Grant, C. T. & Grant, G. H. (2008). Can regulations curb excessive executive pay? *Strategic Finance*, *90*(3), 31-39.

Greenfield, J. (1999, January). Study finds inequities in CEO pay, worker pay, profits. *The*

www.manaraa.com

Working Stiff Journal, *2*(8). Retrieved from http://www.utwatch.org/archives/workingstiff/vol2no8_ceo.html

Grunig, J. E. & Repper, F. C. (1992). Strategic management, Publics, and Issues," In J. E. Grunig (Ed.), *Excellence in Public Relations and Communication Management* Hillsdale, NJ: Lawrence Erlbaum Associates, 117-157.

Hanley, P. J. (1996). Executive compensation tax issues. *Find Law*. Retrieved June 11, 2011 from http://library.findlaw.com/1996/Jan/1/174701.html

Harris, J. (2008). What's wrong with executive compensation*? Journal of Business Ethics, 84*, 146 -158.

Hartzell, J. C. & Starks, L. T. (2003). Institutional investors and executive compensation. *The Journal of Finance*, *LVIII*(6), 2351-2374. doi: 10.1046/j.1540-6261.2003.00608.x.

Hiles, A. (2009). Tough times demand focus –Total rewards strategy. *Benefits Quarterly, 25*(4), 44-47.

Hodak, M. (2010, April/May). Myths of executive compensation. *NACD Directorship, 36*(2), 66-68.

Huselid, M. A., Becker, B. E., & Beatty, R. W. (2005). *The workforce scorecard*. Boston, MA: Harvard Business School Press.

Hymowitz, C. (2003, May 13). Readers complain of problems caused by overpaid CEOs. *Wall Street Journal - Eastern Edition*, *241*(93), B1. Retrieved July 26, 2009, from Business Source Complete database.

Institute for Policy Studies (2007). Executive excess 2007. Retrieved July 5, 2009 from http://www.ips-dc.org/reports/070829-executiveexcess.pdf

Ittner, C. D., Larcker, D. F., & Meyer, M. D. (2003). Subjectivity and the weighting of performance measures: Evidence from a balanced scorecard. *The Accounting*

المنارة للاستشارات
www.manaraa.com

Review, *78*(3), 725-758. doi: 10.2308/accr.2003.78.725.

Jensen, M. C., & Murphy, K. J. (1990). Performance pay and top management incentives. *Journal of Political Economy*, *98*(2). 225-264. Retrieved on August 1, 2009 from http://www-rcf.usc.edu/~kjmurphy/jmjpe.pdf. doi: http://dx.doi.org/10.1086/261677.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics*, *3*(5), 305-60.

Kaplan, S. L. (2005). Total rewards in action: Developing a total rewards strategy. *Benefits & Compensation Digest*. 32-27. Retrieved on June 19, 2011 from http://www.diamond-consultinggroup.com/pdf/Stacey_Kaplan_Total_Rewards.pdf

Kaplan. R. S. & Norton, D. P. (2005, July/August). The balanced scorecard: Measures that drive performance (Best of HBR 1992). *Harvard Business Review*, 1-10.

Kaplan, R. S., & Norton, D. P. (1996). Linking the balanced scorecard to strategy. *California Management Review*, *39*(1), 53-79.

Kaplan, S. N. & Rauh, J. (2010, May). Wall Street and Main Street: What contributes to the rise in the highest incomes? *Review of Financial Studies, 23*(3), 1004-1050. doi: 10.1093/rfs/hhp006.

Lublin, J. S. (2010). CEOs see pay fall again. *The Wall Street Journal*, (CCLV(75), A1-A1.

Lynch, L. J. & Perry, S. E. (2003). An overview of management compensation. *Journal of Accounting Education*, *21*, 43-60. doi: 10.1016/S0748-5751(02)00034-9.

Management Research in VA (2002). Retrieved from www.colmr.research.va.gov/mgmt

المنارة للاستشارات
www.manaraa.com

McLeod, D. (2008). AIG forced to curb exec pay, spending. (cover story). *Business Insurance, 42*(42), 1-33. Retrieved on June 15, 2010 from Business Source Complete database.

MicroStrategy (2009). Balanced scorecard. Retrieved on July 29, 2009 from http://www.microstrategy.com/balanced-scorecard/

Mishel, L., Bernstein, J., & Allegretto, S. (2007). *The state of working America*, Ithaca, NY: Cornell University Press.

Mitchell, R.K., Agle, B.R., & Wood, D.J. (1997). Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts. *Academy of Management Review, 22*, 853-886. doi: 10.5465/AMR.1997.9711022105.

Moran, T. J. (Fall 1996). What leaders owe. *Leader to Leader*, 15-17.

Morgan Lewis (2009, Feb 5). President Obama announced new restrictions on executive compensation for financial institutions receiving government assistance. Retrieved June 12, 2011 from http://www.morganlewis.com/pubs/EB_NewExecComp-Restrictions_LF_05feb09.pdf

Murphy, K. J. (Jun 1999). Executive compensation. Retrieved August 1, 2009 from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=163914.

Murthy, K. R., S., & Salter, M. S. (1975, May/June). Should CEO pay be linked to results? *Harvard Business Review, 53*(3), 66-73.

Nichols, D. & Subramaniam, C. (2001, February). Executive compensation: Excessive or equitable? *Journal of Business Ethics, Part 2, 29*(4), 339-351. doi: 10.1023/A: 1010764828523.

O'Donnell, S. (2009, September). Executive incentive practices post-TARP. *Bank Accounting & Finance, 22*(5), 15-51.

المنارة للاستشارات
www.manaraa.com

O'Reilly, III. C. O., & Main, B. G. M (2007). Setting the CEO's pay: It's more than simple economics. *Organizational Dynamics, 36*(1), 1-12. Retrieved July 24, 2010, doi:10.1016/j.orgdyn.2006.12.007

O'Sullivan, A., Sheffrin, S. M., & Perez, S. J. (2008). Microeconomics principles, applications, and tools (5th ed.). Upper Saddle, NJ: Pearson Prentice Hall.

Rainey, D. L. (2006). *Sustainable business development: Inventing the future through strategy, innovation, and leadership.* Cambridge, England: Cambridge University Press.

Randolph-Williams, E. (2010, Summer). The changing role of the compensation committee: Five areas compensation committees should be addressing in 2010 and beyond. *Benefits Law Journal, 23*(2), 17-27.

Rawlins, B. (2006). Prioritizing stakeholders for public relations. Retrieved June 28, 2011 from http://florida4h.org/news/public_relations/files/2006_Stakeholders.pdf

Rehbein, K. (2008). What drives compensation for China's CEOs? *Academy of Management Perspective*, 74-75.

Roberts, D. R. (1959). A general theory of executive compensation based on statistically tested propositions. *Quarterly Journal of Economics, LXX*, 32-35.

Rose, M. (2004). Address to the DFW minority development council. Retrieved on August 1, 2009 from http://www.bnsf.com/suppliers/.

Rousseau, D. M. (2006). Presidential address: Is there such a thing as "evidence-based management"? *Academy of Management Review, 31*, 256–269.

Rumpel, S. & Medcof, J. W. (2006, September/October). Total rewards: Good fit for tech workers. *Research Technology Management, 49*(5), 27-35.

Saunders, M., Lewis, P., Thornhill, A. (2009). *Research methods for business students*

المنارة للاستشارات
www.manaraa.com

(5th ed.). Essex, England: Pearson Prentice Hall.

Schneider, P. J. (2009, September). The post-stimulus bill era of executive compensation. *Journal of Financial Service Professionals, 63*(5), 21-24.

Schultz, M., Hatch, M.J. & Larsen, M. H. (2002). Scaling the Tower of Babel: Relational differences between identify, image, and culture in organizations. *Expressive Organization*, 9-35.

Simon, H. (1957). Compensation of executives. *Sociometry*, *XX*, 32-35.

Slavin, R. E. (1995, January). Best evidence synthesis: An intelligent alternative to meta-analysis. *Journal of Clinical Epidemiology, 48*(1), 9-18.

Starkey, K., & Tempest, S. (2009). The winter of our discontent: The design challenge for business schools. *Academy of Management Learning & Education*, *8*, 576–586.

Stead, W. E., & Stead, J. G. (2004). *Sustainable strategic management.* Armonk, NY: M.E. Sharpe, Inc.

Steinberg, R. M. (2009). On the hot seat with today's challenges. *Financial Executives, 25*(8), 28-31.

Stieb, J. (2009, July). Assessing Freeman's stakeholder theory. *Journal of Business Ethics*, *87*(3), 401-414. doi: 10.1007/S10551-008-9928-4

Susniené, D., & Sargunas, G. (2009). Prerequisites of stakeholder management in an organization. *Engineering Economics, 62*(2), 58-64.

Thurm, S. (2010) Oracle's Ellison: Pay king. *The Wall Street Journal*, CCLVI(22).

U.S. Treasury Fact Sheet: Ensuring investors have a "Say on pay." Retrieved July 26, 2009 from http://www.ustreas.gov/press/releases/reports/fact_sheet_say%20on%20pay.pdf

Vroom, V. H. (1964). *Work and motivation*. New York, NY: Wiley.

المنارة للاستشارات
www.manaraa.com

Wally, S., & Baum, J. R. (1994). Personal and structural determinants of the pace of strategic decision making. *Academy of Management Journal, 37*, 923-940.

Weisbach, M. S. (1988). Outside directors and CEO turnover. *Journal of Financial Economics*, *20*, 431-460. doi: 10.1016/0304-405x(88)90053-0.

Williams, A. (2010, April 21). Businesses link sustainability objective to executive pay. *Business Ethics*. Retrieved March 21, 2011from http://business-ethics.com/2010/04/21/1637-businesses-link-sustainability-to-executive-pay.

Wilson Group (2009). Total reward strategy: *What's your philosophy?* (2009). Wilson Group, Inc. Retrieved June 25, 2009 from www.WilsonGroup.com

Wyman, O. (2003). CEO evaluation: Navigating a new relationship with the board. *Delta Organization and Leadership*. Retrieved August 22, 2009 from http://www.oliverwyman.com/ow/pdf_files/CEO_Evaluation_Insight.pdf

www.manaraa.com

Appendix A

Evaluation Form for
DM Student (Patricia Beckenholdt) and (Executive Compensation)

Please rate each of the following questions on a scale of 1 to 5, with 1 being low, and 5 being high. In addition, for each question we request that you prepare a written response.

1. Contribution to the practice of management?
Rating: 4
Comments: Timely, well organized and documented. Concepts are generally not new.

2. Originality of topic or approach, in ways that have the potential to add value to managing organizations?
Rating: 2
Comments: The topics have been well covered in the compensation literature.

3. Quality, including perceived credibility of industry experts such as yourself, of the sources being relied upon?
Rating: 5
Comments: Very credible, well organized and documented.

4. What do you see as the key assumptions being relied upon by the paper? How do you assess the validity of each?
Rating: 4
Comments: Assumptions are well thought out. See comments that follow this evaluation sheet.

5. Rigor (theory, argument)?
Rating: 5
Comments: Well thought-out and concepts defended.

6. Thoroughness, timeliness, relevance of this paper?
Rating: 4
Comments: Very thorough, extremely timely and relevant. See comments that follow this evaluation sheet.

7. Validity of conclusions/propositions?
Rating: 4
Comments: Highly valid; See comments that follow this evaluation sheet.

المنارة للاستشارات
www.manaraa.com

8. From the perspective of a senior manager involved in the subject areas of relevance to this paper, how do you assess the quality of the writing in meeting the standards of acceptable professional (business) English?
Rating: 5
Comments: Far better written than most papers in the professional field of compensation.

____

Reviewer's Signature

Thomas J. Ettinger

Thomas J. Ettinger

Date – 17 July 2010

Comments

Page Number	Comments
6	In the late 1980s Bud Crystal, a former executive compensation consultant, concluded that the CEO's compensation was generally not correlated to the performance of the organization and the many boards were failing to exercise control over CEO's compensation.
8	I would suggest adding the concept of risk mitigation to this section.
11	You may want to consider defining the difference between a bonus and an incentive I believe that the Latin root meaning of bonus is a gift.
18	You may want to explore a fundamental problem associated with comparative studies (e.g. compensation surveys). For instance, should a Board elect to pay their CEO at the 75 p% of the market; other boards will feel compelled to match their CEOs to the same level. The result is to continuously increase the compensation of all the CEOs to match the market pay point.
41	Self esteem is a major element in compensation levels getting too high for the value contribution by CEO's. See comment above.

المنارة للاستشارات

www.manaraa.com

Comments - continued

52	The Balance Score Card is an excellent approach to measuring the performance of a CEO (and other executives too). Care must be exercised in identifying only those key factors that contribute to company performance without making the process too complex to the point that a CEO may not focus on the correct factors.
56	The board represents the organization's constituents and it must exercise control over the CEO's compensation. This cannot be accomplished, in my opinion, if the CEO is a member of the board.
66	I would suggest adding two factors to your balanced scorecard: 1- Regulatory compliance 2 - Risk mitigation (this is a very broad factor, but important in protecting the interests of the stockholders)
General comments	What risks/rewards are associated with the board's performance? Excellent paper! I will be happy to discuss my comments with you.

المنارة للاستشارات
www.manaraa.com

Appendix B

Patricia Beckenholdt
Designing an Effective Executive
Compensation System Using a
Stakeholders' Model

Please rate each of the following questions on a scale of 1 to 5, with 1 being low, and 5 being high. In addition, for each question we request that you prepare a written response.

1. Contribution to the practice of management?
   Rating: 4
   Comments: The executive compensation topic is very timely; the paper is well researched and constructed. While the topic is not new to the practicing field, the paper provides food for thought to board members on how to establish executive goals, monitor progress, and provides a good tracking mechanism with the scorecard.

2. Originality of topic or approach, in ways that have the potential to add value to managing organizations?
   Rating: 2
   Comments: Executive compensation has been extensively written about by the trade associations, consultants, and professional organizations.

3. Quality, including perceived credibility of industry experts such as yourself, of the sources being relied upon?
   Rating: 4
   Comments: The document is very credible and well constructed.

4. What do you see as the key assumptions being relied upon by the paper? How do you assess the validity of each?
   Rating: 4
   Comments: The author laid a very well thought out foundation on which to build her assumptions for a balanced scorecard program. See additional comments section.

5. Rigor (theory, argument)?
   Rating: 4
   Comments: The author argued and defended her position based on case history and laws enacted since the early 1800's.

6. Thoroughness, timeliness, relevance of this paper?
   Rating: 5
   Comments: This paper was timely and very thorough in view of the scandals that have been brought to light over the past several years.

المنارة للاستشارات
www.manaraa.com

7. Validity of conclusions/propositions?
   Rating: 4
   Comments: Valid. See additional comments section.

8. From the perspective of a senior manager involved in the subject areas of relevance to this paper, how do you assess the quality of the writing in meeting the standards of acceptable professional (business) English?
   Rating: 5
   Comments: This paper was well thought out, followed a very logical flow, and was easy to read and comprehend even if you are not in the compensation field.

Other Comments
This paper is an excellent, well written and researched document that would provide a board of directors of an organization with a good template of a balanced scorecard approach to executive compensation. As the complexities of organizations have grown over the past several decades due to technology advancements and globalization, the use of a balanced scorecard approach is an important means to assist organizations in managing the enterprise.

Using the executive scorecard approach, boards may be able to more effectively address several significant areas where organizations still struggle to find acceptable solutions, including the following three examples:
Retention of Top Executives: While the business schools are providing organizations with many highly educated and talented executives, the need for continuing education at the executive level is a career long process. There are two avenues organizations should have in place as retention tools: executive career development programs and meaningful succession planning programs.

Compliance and Regulatory Statutes: Many industries are now heavily regulated by state and federal statutes, including: Financial/Banking, Medical/Health Care, Automobile, and Government Contractors to name a few. Each of companies in these industries is mandated by law to be in compliance with some very complex laws and regulations. To be in violation of or out of compliance, could, depending on the severity of the infraction, put the company out of business. Internal and external audits are valuable instruments to aid executives on the operational side of the business.

Code of Professional Conduct (Code of Ethics): One of the major concerns facing the business community today is a code of professional conduct or code of ethics as evidenced by exorbitant executive severance packages for non-performance or managerial fraud/manipulation of company records for excessive bonuses. Not only is there public outrage, but neither the stakeholders nor the shareholders are well served when these incidents occur. A well documented Code of Ethics policy should be controlled by the Board of Directors. The policy should include a progressive discipline section up to and including dismissal. Going hand-in-hand with the Code of Ethics should be a provision regarding severance packages predicated on performance during the executive's tenure and be capped at a certain level. Violations of the code of Ethics policy should have an impact or negate the severance payment.

Other: Text Observations/Corrections

المنارة للاستشارات
www.manaraa.com

1. Table of Contents, page 2, Section III.2.2, *Discussion of the Uses of the Balanced Scorecard.* On page 50, the section is labeled as III.2.1. Shouldn't the Table of Contents be labeled III.2.1?
2. Table of Contents, page 2, Section III.3, Designing an Executive Scorecard. The section is labeled as III.2.2 on page 52. Shouldn't the section on page 52 be labeled III.3 to agree with the Table of Contents?
3. On page 11, second paragraph, third line, shouldn't the word "face" be replaced with the word "faced"?
4. On page 28, first line on the page, the word "state0" should be replaced with the word "state".
5. On page 60, third line from the bottom of the page. Shouldn't the word "shareholders" be replaced with the word "stakeholders" to conform to the context of the discussion of the section?

Reviewed by:

James P. O'Brien, Jr.
July 28, 2010

المنارة للاستشارات
www.manaraa.com

Appendix C

Evaluation Form for
DM Student (Patricia Beckenholdt) and (Executive Compensation) – Liliana Meneses

Please rate each of the following questions on a scale of 1 to 5, with 1 being low, and 5 being high. In addition, for each question we request that you prepare a written response.

1. Contribution to the practice of management?
Rating: 4
Comments: The topic is timely and certainly of importance to practice and management, especially in light of the national debate and financial crisis around executive compensation. The only reason I did not rate the contribution a 5 is because there is no empirical research to support the proposed model. Right now it is an excellent literature review and a conceptual framework that could lead to a grounded theory research dissertation, however, it needs data to support it.

2. Originality of topic or approach, in ways that have the potential to add value to managing organizations?
Rating: 4
Comments: The approach to executive compensation is based on existing literature and theory. I did not see a new variable in the model or discussion. The balanced scorecard has been extensively discussed and used. On the other hand, the originality of the approach is in the use of the metrics that specifically align the executive's performance to organizational goals and objectives, as well as tie to the stakeholders' expectations and desires. I think this is a novel and creative solution to the issue of executive compensation and is the strong point of this paper. There is also an inherent issue of competing values that comes up when trying to align all the different stakeholders' interests, that is perhaps beyond the scope of this paper, but could lead to another interesting topic.

3. Quality, including perceived credibility of industry experts such as yourself, of the sources being relied upon?
Rating: 4
Comments: All sources were credible and well cited. The literature review seems to be comprehensive and pertinent. There are a few sources that I would have expected to see included when certain topics were brought up:
Stakeholders and organizational image: Hatch
Competing values: Quinn and Weick
Agency theory:
Motivation theory:

4. What do you see as the key assumptions being relied upon by the paper? How do you assess the validity of each?

المنارة للاستشارات
www.manaraa.com

Rating: 4
Comments: Most assumptions were thoughtfully laid out and explained. Most assumptions were also based on scholarly literature, which gave them credibility and validity. There are a couple of assumptions that need to be argued further:

1) There is a global/domestic assumption that is not quite clear. It seems to me that this paper basically addresses a domestic (U.S.) issue. Is this an issue in other countries? I am not sure. It seems that the literature supports the fact that this is a US phenomenon, as seen by the difference in salaries of CEOs/average employee in the U.S. versus other countries.
2) There is an assumption that CSR is important for both the stakeholders and the organizational performance. I am also not sure this is true. If the goal of the organization is to create wealth for stakeholders, how does CSR play a role in this? I believe CSR plays a role in organizational identity and image (again, see Hatch) but does this translate into performance? If this is the argument you want to make, I think you can make it, but you need to add data to corroborate it.
3) There is an assumption that this model can be used not only for CEOs but also top executive officers, and for non profit as well as for profit organizations. Again, I think you can make this argument, but you need to add the premises that support it.
4) This might not even be an issue here, but normally I would expect to see laid out in the beginning the researcher's assumptions stated in the language of ontology, epistemology and methodology. For example, there seems to clearly be a functional approach to this topic but it is not stated anywhere in the paper.

5. Rigor (theory, argument)?
Rating: 4.5
Comments: The literature review is very tight, and flows together well. The main points are well supported. This question goes back to items 1-4. I would say that in terms of theory, sources, and arguments, there are a few edits or clarifications to be made that are normal to any paper.

6. Thoroughness, timeliness, relevance of this paper?
Rating: 5
Comments: Very timely and relevant. I think this paper could have a broader contribution to practice as it not only evaluates CEO compensation but also proposes an assessment model that allows organizations to effectively measure performance as it relates to the organization's goals and objectives. This is one of the hardest things to do in an organization, and the whole pay for performance conversation could benefit from this paper as well.

7. Validity of conclusions/propositions?
Rating: 3
Comments: This is a hard item to score because the paper is a theoretical/conceptual framework paper. As mentioned in item 3, the rigor of the theory and argument is very high, however, it is hard to evaluate validity when there is no empirical data to support the conclusions. In other

المنارة للاستشارات
www.manaraa.com

words, this seems like an excellent chapter 1 and 2 of a dissertation, but there is no research upon which to base an evaluation of the conclusions.

8. From the perspective of a senior manager involved in the subject areas of relevance to this paper, how do you assess the quality of the writing in meeting the standards of acceptable professional (business) English?
Rating: 5
Comments: Extremely well written and very clear to follow. The arguments are laid out very clearly and the language is not only appropriate but also enjoyable to read. I am also impressed with the care given to citation and APA formatting, which, even at a doctoral level, is quite often lacking in so many papers.

_____Liliana Meneses_______________

Reviewer's Signature

_________July 12, 2010___________

Date

المنارة للاستشارات
www.manaraa.com