

# Management

## Modest overhead key to corporate success

CITYBUSINESS -- October 17, 1997

Timing is everything for an instructor wishing to have classes be relevant and on-target. It worked out well for our Management for Profit class this week.

We had devoted a session to “modest overhead” the same week the listings of Minnesota’s highest paid executives appeared in the press. Modest overhead is an important concept for students to learn — old-fashioned traits of frugality, dedication, responsibility and a sense of purpose.

Both successful and unsuccessful companies spend money, but the successful ones spend the money on what the customer is buying and spurn excesses.

Exemplary managers of the past scrimped on nonrequisite expenditures to get their companies through harsh economic times but supported expenditures to improve quality, efficiency and customer satisfaction. They were also evenhanded in their cost reductions — often cutting their own pay before asking employees to sacrifice.

I once interviewed the very talented person who served as secretary to George Romney when he was CEO of American Motors during its golden years from 1957 to 1963. Her description was telling; “I can tell you this about George. When cost reductions were needed, they started with him.”

Similar stories are told about executives who headed Deere, Nucor and other successful companies over time. These historical traits of frugality, dedication, responsibility and a sense of purpose deserve our attention — even today.

Actually, I was pleased with this year’s list of highest paid executives. None of my friends were on there. Over time, I have come to know quite a few CEOs through a variety of associations including serving on 14 corporate boards.

Conspicuously absent was 3M, which typically makes higher profits than all of the companies that were listed combined — over \$1.5 billion in 1996. Also absent were Minnesota’s other large industrial companies; Honeywell, ADC, Medtronic, St. Jude Medical, Horton, Kurt, AgChem, HTI, Pentair, Rosemount and Bermo, even though profits from these companies have been excellent.

The list of 10 highest paid executives included six executives from banks or finance companies, two from Northwest Airlines, one from Dayton’s and one from Ceridian, who finished with the second highest pay.

We know the story on Northwest Airlines. The company would probably not have survived at all had it not been for the emergency loans from the state and the timely concessions from employee unions. That company, with its huge debt, finished 1996 with over a billion dollars of negative tangible net worth.

The case of Ceridian is interesting as well since the cumulative total of company-retained earnings is also negative. All of the shareholder equity that exists in Ceridian has been paid-in-capital. None of it has been earned through profits during the near 40-year history of the company.

Banks are interesting too as the heroic effort to increase fees to customers, along with one of the largest spreads between rates paid on savings and rates charged on loans in recent memory, all combined to make 1996 a good year for banks. It would require a contribution of \$32 from every man, woman and child in Minnesota to pay for the compensation of the six financial executives on the list. But the fees, and the compensation, continue to rise. Perhaps that is why some of us have moved our accounts to Liberty State.

But I have great respect for capable executives and I don’t begrudge them the opportunity to share in the good fortunes of the companies they helped to create.

My point is another one. The better-run companies act more prudently. What we are worth is always subjective — depending whether we work forward from Mother Teresa or backward from Larry Coss. In relation to the world, perhaps we are all overpaid. I can recall discussing the matter of executive compensation with Tom Peters who indicated that his studies found that companies finishing in the first quartile of long-term performance finished in the third quartile of executive pay.

Executive compensation can be appropriate and well-deserved. But perhaps executive compensation has reached the point that the general public does not see it as appropriate — which might not be good for business in the long term.

There are now, and have been in the past, many highly dedicated and capable executives who see themselves as more of a part of a team. I once met Ken Iverson, the long-time CEO of the most profitable steel company in the United States, Nucor. For years he worked with a base pay of \$65,000 per year and then operated under the same incentive program as everyone else in the company. Nucor is still a frugal company with overhead rates well below those of the major steel companies, both domestic and foreign, with which they compete — very successfully. But the Nucor annual report had the names of company employees embossed onto the cover.

Crown Cork moved from being the nation's fourth largest container company to being first with very modest overhead. There are many other examples in the grand business history of the United States.

Executive compensation is certainly not our biggest expenditure, but outlandish compensation, in sports or in business, is usually problematic. Is it necessary to attract talent? The White Sox spent \$11 million for the services of Albert Belle for a year with poor results.

The problem with high compensation is that, in order to carry it off, something has to be lovable — like Kirby Puckett. 3M is lovable with its generous giving through its many foundations, its technical excellence and its favorable treatment of people. Medtronic is lovable with a corporate purpose of saving people's lives.

But, I can recall very vividly the comments of dedicated Control Data employees when top executives received millions upon retirement during the years that the company shrunk in sales, profits, employment and competitive strengths. And I can recall the reaction of the business community to the bailout of leveraged acquirers of Northwest Airlines.

There is more to compensation than just the money spent. That is why so many of the successful companies choose frugality, dedication, responsibility and a sense of purpose as the better path.

# Much treasure was lost when Control Data was saved

Despite shortcomings, the company was the best at what it did

MINNEAPOLIS STAR TRIBUNE -- February 8, 1999

The article on the accomplishments of Larry Perlman in resuscitating Control Data as Ceridian (Star Tribune, Jan. 25) stirred some emotions among the tens of thousands of us who worked at Control Data at some time during its 41-year history.

No doubt, that company is better off than when it teetered on the brink of insolvency a decade ago. But there is one fact that the well-written article failed to consider - 50,000 fewer employees. qc.

Perhaps there were too many people, of course, and perhaps the company did cling too long to the hardware habit. But there is more to the story because at one time, Control Data was the best.

I joined Control Data as a young reliability engineer in December 1963 after several years in five locations with IBM. Big Blue was a good company, too, and it was certainly good to our family. But we were from the Midwest and we had tired of living in New York City and taking the long commute to IBM's headquarters on Madison Avenue in Manhattan. Savages, I thought they were, these New Yorkers on the subway. Nice people at other times, but not during the commute.

Joining Control Data was an awakening, technologically. While in New York, another IBMer and I had written a multi-variate regression program that ran on the large 1410 computer prominently on display at IBM's World Headquarters at 590 Madison Avenue. The program ran for six minutes for 200 observations.

Upon arriving at CDC, I wrote a similar program that processed about the same amount of data on the CDC 1604 in six seconds. Everything except the printers worked better. Control Data clearly had the technological lead.

Control Data did many things well; range switching on transistors, pneumatic capstans on card readers and tape drives, memory banks strategically organized to increase speed, world leaders in the development of high-speed disk drives. The architecture of the CDC 6600 was marvelous when compared with any unit then on the market. Beating the competition.

When I served later as a vice president of another company, we were evaluating the CDC disk drive against another make. We had rigged up a counter to keep track of the "seek errors," which were 10,000 times greater on the competing unit. We had a CDC Cyber 73 computer too, which enabled our service bureau to far outstrip its competition.

Control Data's revenue was \$4 billion in the early 1970s. Ceridian's is \$1 billion today.

As time passed, though, something happened to Control Data. The huge headquarters building was built in Bloomington, which made it possible for most managers and staff to go for weeks without seeing either a computer or a customer.

The Field Engineering organization - which had for so long served as a talent pool for other technical parts of the company - somehow seemed to lose its influence, and maybe even its relevance.

Corporate bureaucrats were often hired from the outside directly into higher positions without accumulating a background in company products and customer needs. Meetings were too numerous and often inconsequential.

Foreign travel became a perquisite rather than being rooted in operational purpose. Many travel junkets became laughable - especially to some of the employees who were expected to play host to an unending entourage of high-level bureaucrats in loosely defined jobs.

The number of vice presidents grew to astronomical levels - many of them ill-prepared for their assignments and ill-equipped to lead. Routine and necessary decisions became almost impossible to achieve. At the same time, acquisitions were often ill-considered and impetuous. People who cared.

Underneath it all, though, there were people who really cared, people who were good at what they did. They worked hard to improve the company and remedy its emerging cost, product suitability and decision-time problems.

I know of one general manager who paid a great deal of money out of his own pocket to buy dinners for the families of people considering leaving the company. He was never reimbursed for this. The company had a ban against employee entertainment, which he honored while some of his superiors did not.

For these dedicated people, I have the most profound respect. Some were in engineering, some were on the staff, some were maintenance people, some were in sales.

I referred to Control Data when I wrote the book, "The Turnaround Experience," which McGraw-Hill published in 1991. Two points are worth repeating here:

- There are some good people in every troubled company. We can't go in like a white knight and change everything because everything may not need to be changed. Our job as managers is to appreciate the good that exists. That did not always happen in the long years of Control Data history.
- What concerns me more in this age of high executive compensation and huge stock escalations is that we have underplayed the need for stewardship in the performance of the managerial task. We managers have a job to do - to keep the company competitive - because many people have a stake in it. Today, it seems somehow OK to change strategic direction to the point that the personal investment made by so many is discounted or ignored. High-quality service.

That happened to my friend, Pete, who was laid off abruptly after 23 years of faithful, high-quality service. It happened to Bill, whose operation was sold. Mild-mannered and polite Bill has a description he used to describe the Control Data executives who exited with millions as the company veered toward oblivion - "pigs at the trough."

What happened to Pete and Bill also happened to many of the 50,000 employees who used to work at Control Data and now no longer do.

We all have our ways of recalling events and I would agree that Larry Perlman has certainly improved the fortunes of Control Data in recent years.

But, over its long history, could it have done better? I think so.

For me, the real heroes of Control Data were the people like Duke Bernier, who worked on printers, Bob Anderson, who kept track of sales, Sam Slais who developed some of the smaller computers and Mike Riggle, who worked on tape drives. My hat goes off to them. They, and many others there, could make computers work when no one else could. They built what at one time was the best computer company in the world.

Too bad we couldn't have kept it.

# Companies with real strategies experience real results

Successful execs focus on details to keep customers, employees happy

MINNEAPOLIS STAR TRIBUNE -- May 3, 1999

Many years ago, while working at IBM's headquarters - then, it was in Manhattan - I frequently joined my coworkers for lunch at the local delicatessen.

IBM had excellent factories, but the delicatessen was even more efficient. The volume of people served and the efficiencies of the micro-movements of those behind the counters were something to behold.

I got to know the owner quite well. He was sending his son to Columbia University to study business. When the father asked what his son had learned, the son reported that he was studying business strategy but was having trouble grasping exactly what it was. The father then said something like this:

*"Business strategy? What's business strategy? When I come to the shop in the morning, I check to see that the sidewalk is hosed off and the tables are clean. That's important in the food business. I see that the bagels are fresh and the pickles have enough salt. I put the cigars with the best markup next to the cash register.*

*"I tell the waiters not to give anyone menus between 11:30 and 1:30, because most people know what they want and they will order right away so we can serve more people.*

*"After lunch, it's OK, we've then got the space. I tell the cook to hurry up. I ask him if he wants I should go broke. I make sure all of the regular customers get a little something extra. Some of it we might not sell anyway.*

*"I manage this business in little pieces. That's business strategy."*

## Genuine approach.

There was something very genuine about the delicatessen. The owner was there. Tangible work was being done. There was an intrinsic appreciation for the contribution made by employees and true respect for the clientele. I enjoyed and learned from the experience.

Some of us still are studying business strategy, but it seems less real.

The owners aren't there anymore. The managers are not close to the work being done. In-depth understanding of how the company works often is missing. Some corporations are doing things they may not know how to do. Strategy statements seem abstract, off-target and too global to be useful.

My friend, George Gleeson, an adjunct professor at the University of St. Thomas, has a phrase for obscure strategy statements: "It's like trying to paint the Mona Lisa with a 4-inch brush."

Unlike the delicatessen, there does not always appear to be a recipe for success.

The economy has been the best it has been for at least 30 years, of course, so we should not complain. But we should be concerned for our medium-term future. The trade deficit reached yet another record in February - \$19.4 billion in one month - a fact that ultimately will trouble both U.S. companies and U.S. workers but seems to get little attention.

Meanwhile, an unprogrammable initiative in the Balkans threatens not only U.S. prestige but also the only balanced budget we have enjoyed in several decades.

Banks are acquiring other banks for more money than the banks are worth. Companies are merging and staffs are being reduced. Debt continues to increase. Bankruptcies are very high.

On the one hand, we read that we are prosperous. On the other hand, this virtual prosperity seems to be neither real or widespread.

### **The genuine article.**

Real business strategy is in place in some companies, however. For instance, my students experienced the dichotomy of calling Nucor Steel and Bethlehem Steel during the same week.

Calling Bethlehem was like calling another planet - very difficult. But when they called Nucor to ask for CEO John Corrente, he answered the phone and cheerfully answered the students' questions.

I've visited plants of both companies. Quite a difference. Nucor is modern, considerate and in touch. Bethlehem is rusty and losing money. Nucor made \$61 million last quarter, while Bethlehem lost \$23 million and LTV Steel lost \$61 million.

They all claim to have business strategies, but Nucor has well-equipped plants and minuscule headquarters. Bethlehem has a well-equipped headquarters and unimpressive plants.

Winnebago took an unusual step regarding its own corporate headquarters a few years ago. It gave it away. All the officers and staff moved into a mezzanine over the factory. The corporate offices are now 12 feet above the sales offices, 100 feet from engineering, a block from the prototype lab and adjacent to 2.8 million square feet of well-automated production space. After several difficult years in a tumultuous industry, Winnebago is rapidly developing into the premium company in the recreational vehicle industry. Revenue is up. Earnings are way up. The company has no debt. Quality is terrific. The stock price has doubled, and it's all being run by the people who came up through the ranks.

Winnebago has a nationally recognized employee suggestion program and the CEO knows most of the people in the company. The production employees conduct a dealer appreciation day every year to show how its vehicles are made. Customers enjoy the highest-rated service in the industry.

That's business strategy.

Liberty State Bank in St. Paul has a strategy too - not unlike the delicatessen. The president, Tim Macke, opens the place in the morning and has an open office on the bank's main floor, where he can see and be seen by customers. Real people answer the phone - usually on the first ring.

People are friendly, and when the place gets busy everybody helps out. Loan rates are a bit lower than average. Rates paid on savings are a bit higher. The bank is a sterling community citizen and very successful.

It's refreshing to see companies do well, and many of our companies are doing well. But the good ones seem to be more enthralled with their responsibilities than with their own importance. The executives come to work, pay attention, handle the problems of the day and prepare meaningfully for tomorrow.

They promote investment, cheerfully greet customers and employees, and listen to their ideas and then implement them. They share center stage. They manage their businesses in little pieces.

That's business strategy.

## Worry but don't organize

**When academics and policy makers try to plan for the future, there's no guarantee of a positive outcome**

**MINNEAPOLIS STAR TRIBUNE -- June 5, 2000**

Recent articles in the press have drawn attention to the thesis that Minnesota might not be ideally positioned for the international economy that is emerging so rapidly.

A grade of "C-" rendered by the Great North Alliance contrasts with a rosier picture outlined by others. And proposed remedies range from strong support for the University of Minnesota to more of a laissez faire approach: Leave things alone.

Perhaps there is a third position: Worry, but don't organize because we may do it incorrectly.

I can recall discussing the future of Minnesota's then-burgeoning computer industry with businesspeople and some state officials in 1982. The point was made that an increasing technical trend toward much more powerful chips would increase the advantages of distributed processing over main frames and that this emerging reality was quite likely to alter where computers were produced.

At the time, we had Control Data, Sperry Univac, Honeywell and other companies, plus the IBM plant in Rochester, focused on the mainframe business but the circuitry was produced elsewhere.

The almost universal response was disbelief. Bank officials, public officials and many people in business pointed to how well Minnesota had fared in the early 1980s recession and said it was quite unthinkable that these noble companies would not prevail in such an important industry.

Now, of course, the companies have severely downsized and part of IBM's Rochester business has been sold to a contract manufacturer.

A central feature of today's international economy is that things happen quickly. So it is right for us to worry about whether any of us are prepared for the competitive challenges we have before us. The pressures of worldwide competition already have caused a shrinking of margins in some of our important companies.

There is so much price pressure from major end-product aerospace, automotive and electronic companies with access to Asia that some respected Minnesota companies are having difficulty sustaining profits even during boom times. Any slowing of the economy will worsen this situation.

### **But what to do?.**

Minnesota has many strengths, but it is not invincible. A harder question is what to do about it.

Education frequently is mentioned as something we should strengthen, but the discussion often focuses on the money provided rather than the effectiveness of the educational process.

Minnesota's K-12 system is not stellar when compared with systems in place in other countries where school years are longer and more intense. World competition might require us to do something more creative than to pour money into a system that seems not to achieve very good results.

Yet perhaps we could better support the teachers who do achieve good results.

Higher education is more difficult. Universities do interact with the industrial community to enable stronger economies for the future. But it's hard to organize universities.

Many universities across the country have had the development of bellwether technologies aimed at strengthening local economies as a principal objective. Research activities, though, often follow the interests of individual faculty members.

In general, organizing faculty is a little bit like herding squirrels. But it is particularly hard when a consensus regarding what to do is required. Margaret Thatcher once described consensus as “the gradual process of surrendering all standards and principles.”.

The problem with reaching consensus at any university is that many of the best faculty members often are busy on other things. This has prompted a description that has informally circulated at St. Thomas: “Faculty committees get wrong answers slowly.”.

So if we fostered any initiative to mobilize university activities in support of the state’s economy, we have little assurance how it would turn out.

Yet there is a connection between university research and economic well-being. At places such as North Carolina’s Research Triangle, cooperation between state and private universities has helped to create nearly a million manufacturing jobs.

Other schools such as Purdue, Ohio State, Harvard, Texas, Wisconsin and Princeton - some public and some private - have measurably added to the prosperity of their regions.

The question is, was it a managed outcome?.

### **The innovation journey.**

In his excellent book, “The Innovation Journey” (Oxford Press, 1999), the esteemed University of Minnesota professor Andy Van de Ven describes the innovation process as being a mixture of divergent and convergent forces, which combine to produce results that are not always fully predictable.

The divergent forces are creativity, freedom to explore and multi-disciplinary perspectives. The convergent forces are organization, accountability and management. Both forces are needed, but at different times.

Specialization, which may be the foundation of many academic careers, may not be exactly what is needed to create innovation or support an economy. Good fundamental education might be.

A complicating factor is that public opinion often is on the wrong side of what to do anyway.

If we were to attempt to organize entrepreneurial efforts at the moment, for instance, I suspect that the Internet would receive a lot of attention. Yet this is an industry with more costs than revenue and probably in line for a great fallout. I suspect water, materials and energy will be seen as some of the key opportunities in the future. But nobody seems to be talking about them now.

It also is true that public funding might not always be necessary to technology development. Minnesota has an institution of higher learning, a collection of colleges and universities, most of them public, about every 30 miles - many more than in Wisconsin, for instance.

Minnesota’s private colleges, however, account for about 28 percent of the students, 35 percent of the graduates and nearly half of the science and math majors.

Although very healthy at this time, Minnesota’s economy, along with other states’, will face more competition in the future. Minnesotans are a bit too smug.

The efforts of academia, business and individuals will be needed for the state to retain its competitive edge. Academia contributes to economic well-being of society, but its direct involvement in the economy is difficult to program and organize.

David Kidwell, dean of the University of Minnesota’s Carlson School of Management, deserves some real credit for pointing out that Minnesota’s economy is not invincible. Art Rolnick, research director for the Federal Reserve Bank of Minneapolis, deserves credit for reminding us of the efficiencies of market forces.

Minnesota needs to be concerned about its future, but market forces may provide the most dependable organizer of entrepreneurial initiatives.

## Disturbing Disparities

**A daughter's visit to one of Africa's poorest nations leaves this corporate board member coping with executive compensation in a world of .. Disturbing disparities**

**MINNEAPOLIS STAR TRIBUNE -- July 16, 2001**

Well, once again I was done in by one of our kids.

Our daughter, Brigitte, and her friend, Christina Saunders, just returned from teaching school for three weeks in Malawi, Africa, as their senior project in high school.

They came back with many pictures and some vivid memories of a country with an average life expectancy of 39 years, a per-capita gross domestic product of \$750 and with nearly one-third of the people over the age of 10 infected with HIV.

In the mornings, they taught in a church-related international school. In the afternoons, they taught orphans in Chimbaleme village with 200 kids in the class, as explained in one of her e-mails:

"We brought the children markers and paper, and they colored and did math yesterday. They have amazing attention spans. I wrote problems on the board and they worked at them for about 1.5 hours, some of them kneeling in the dirt when there wasn't enough space on the benches.

". . . When I gave one girl named Ruth the markers, she said in broken English, 'God bless you, oh God bless you so much. You are wonderful!' It was so touching. Today they are throwing us a party. I know I will cry. They are so sweet."

When she returned, Brigitte fixed a typical Malawian meal for us - rice, beans and a bland form of cornmeal. She explained that the orphans get only the cornmeal once a day. Yet they still share and take care to make sure the younger children get something to eat.

### **Income disparities.**

I anticipate that someday our daughter will be asking why some people have such high salaries while there are so many poor people in Africa. Such a question causes me to reflect because of my role as a corporate director, and, in particular, because I was recently appointed chairman of the compensation committee at one New York Stock Exchange company.

The question is, how should we evaluate the executive compensation this year? Should we use as our reference the often-excessive executive compensation being awarded in other companies?.

Somehow, the experience of these two young high school students makes this task more difficult.

In January, Chuck Denny, retired CEO of ADC Telecommunications, authored one of the Star Tribune's most memorable articles. In "Silent no Longer," he lamented the outlandish executive compensation awarded to some CEOs.

"Regretfully, these incidents are reported to a public already soured by brazen corporate practices such as showering obscene wealth on the executive class while afflicting lower-level employees with massive layoffs and parsimonious compensation."

This said by one of the most successful CEOs in Minnesota history.

In an earlier news story, columnist Neal St. Anthony chronicled the executive receipts awarded to Larry Bossidy and Michael Bonsignore for what might be charitably described as the sub-optimal merger of AlliedSignal Inc. and Honeywell Inc. Allied's Bossidy received \$46.9 million, while Bonsignore made \$12.2 million.

The principal questions we should be asking ourselves are what compensation do we deserve, what do others deserve, and what obligations do we have to use our gifts for the productive good?.

Fortunately for me, the company where I have the committee assignment does not have ostentatious executives. Low-key, honest and replete by years of up-through-the-ranks preparation, the executives at this company are at the top of their game.

The company is respected for the high quality of its products, has the highest profit rate in its industry, ranks first in dealer satisfaction, has no debt and has tens of millions in excess cash. The company has a program of sharing the company's good fortune with employees, and base salary increases for officers and employees are the same - all at the request of the CEO.

Even though the economy has been soft this year, this company has done far better than any other company in the industry.

### **The pay dilemma.**

But there still is a dilemma. What should these executives be paid? One could argue that they certainly are more deserving than Bossidy or Bonsignore. On the other hand, there are the people in Africa.

Influential CEOs of the past have helped frame our thinking in this regard. 3M Co. was Minnesota's undisputed profit leader under Lou Lehr and Alan Jacobson, yet neither of these two people figured prominently among the state's highest-paid executives.

Several of the best-run U.S. companies, such as Deere & Co., Crown Cork & Seal Co. Inc. and Nucor Corp., have been headed by people who spurned excessive compensation. So it can be done.

In fairness to the executives being compensated, there are a couple of things that should be considered. Corporate executives pay a lot of taxes, and many corporations now require executives to own company stock of some multiple of their annual compensation - often two to four times and sometimes more. It is not impossible that after buying the required stock and paying the various taxes, a comparatively young CEO is quite likely to have less disposable money than before he or she was appointed.

Yet in compensation as in other matters, we should resist the temptation to conclude that the solution to all problems is the modification of someone else's behavior. There are other forms of excessive compensation that should concern us.

In the spirit of Denny's article, I have been somewhat embarrassed by the complaints about funding issued by some people in education this year.

Let's face it - very few people in education are truly underpaid. We teach few classes, have a lot of time off and, if we are public school teachers, we can retire in our mid-50s.

If we work in academia, we have one of the few jobs in America where we can do nearly anything we want as long as somebody will print it.

Here's a medical example. Some years ago, I had orthopedic surgery on my knee at about the same time that one of our sons had exceedingly complicated surgery for cancer performed by two of the most highly regarded surgeons in this part of the country. Couldn't tell it by the price, though. The two famous surgeons charged only one-sixth as much per hour as the fellow who snagged a small piece of cartilage from my knee.

Variation in compensation exists in all fields - and sometimes we are the beneficiaries. Yet there are ramifications to overpayment. Companies become less competitive - especially in world markets. Other people in the hierarchy begin to think they should be paid excessively, too, and costs rise generally. Respect from employees is reduced.

Of course, there are corporate executives, teachers, surgeons and people in all professions who honestly attempt to deliver good value for what they do.

Yet we have been fortunate as a country. Christina's and Brigitte's trip to Africa has caused me to think just a bit.

Perhaps we should all focus a bit more on our responsibilities and what we have to offer and then recognize that, by world standards, we all probably are overpaid.

.

.

# Serving as a Director of a Manufacturing Company: 10 Principles of Success

## DIRECTORS MONTHLY - NATIONAL ASSOCIATION OF CORPORATE DIRECTORS -- March 2003

Manufacturers have seen a variety of environments in recent years. Over time, I have seen them take many steps to adapt to rapidly changing conditions. Below are some ideas that seemed to work, though never without the need for fine-tuning and modification. The suggestions are written for directors. I hope they will be helpful to those people entrusted with the sober responsibility of working with management to keep their company viable—not an easy task in this highly competitive global economy.

### 1. Start with quality

Most companies assume quality is high; good companies make quality an overriding first principle—in action, not with slogans. Top executives visit customers, visit dealers, understand their problems. People at good companies like customers and want them to enjoy the company's products. These well-run companies try to improve quality even when they are already the best in the industry. Profits, sales, and incentives all come later. Quality must be achieved first.

### 2. Worry about results, not plans

Some companies spend too much time planning. Plans can be helpful, but in an uncertain world, plans must be adaptive. Instead of spending precious time developing a highly precise plan, just pick something that seems about right and move on. Then gear incentive programs, bonuses and employee compensation to actual results in profits, quality and development.

### 3. Invest

It takes a lot of money to keep a company competitive in the 21st century. The average machine tool in the United States is nearly twenty years old. Many factories are older still. A rule of thumb is that if a manufacturer is not spending several thousand dollars per employee in capital equipment every year, it will be difficult for the company to remain competitive in world markets. Many Asian companies receive massive support from their governments in the form of equipment or facility loans or grants. Many companies spend money on big offices, high executive compensation, and grandiose corporate meetings. Good solid investments that improve product quality, reduce costs, and spur prompt delivery benefit customers; frills do not.

Director Summary: A veteran director shares his expertise on board service when your company still makes something other than money. Invest in equipment and employees; keep executive compensation and acquisitions in check.

### 4. Manage by subtraction

Most well-run companies prune routinely rather than axing into the meat of the organization whenever a crisis develops. They look over what is being done, reduce non-value-added tasks, and then reallocate resources. This takes wisdom, empathy for the people involved, and enough tact to enlist the support of the organization. The managers of the company, together with its directors, are ultimately purveyors of justice. They have to judiciously decide what is necessary to keep the company in business for the benefit of stakeholders. This awesome task will not be fulfilled unless the company systematically withdraws resources from tasks unessential to the main business.

### 5. Advance the dignity of employees

Virtually every corporate mission statement says employees are important but corporate behavior does not always walk the walk. Yet the evidence is clear. When employees believe their tasks are important, companies are almost always successful. Fostering an atmosphere of dignity does not mean running a loose ship. Quite the contrary, the employees of most well-run companies resent it when someone who is not doing their job is kept on. Fortunately, the remedy is low-cost. Provide enough dignity to the team and the team will make sure things go well, even if personnel changes have to be made.

## **6. Keep executive compensation reasonable**

The best CEOs are reserved in articulating their accomplishments and modest in their pay. Most of the good ones came up through the ranks and can easily identify what life was like at lower levels. And they appreciate the contributions of all. Executive compensation in the United States has been goofy. Even the people who deserve what they get do not believe high compensation is an ingredient to success. Directors have a responsibility to be practical.

The managers of the company, together with its directors, are ultimately purveyors of justice. They have to judiciously decide what is necessary to keep the company in business.

## **7. Resist the temptation to acquire**

Very few acquisitions work out and even fewer of them are worth the cost. Do the math. Figure how much the acquisition will cost and then figure out what would happen if you put the money into product development, quality improvements, and marketing initiatives. Usually the acquisition is unnecessary. There have been a few good, investment-driven acquisitions; they differ from bad ones in an important way: one company acquires another and then invests to improve the competitive position of its newly acquired property. Cost-driven acquisitions show less promise and are often wealth-destroying rather than wealth-enhancing. Cost savings, justified by illusory economies of scale, become necessary for the acquisition to pay for itself; costs must be quickly reduced to show that the merger has the “synergistic” potential promised to Wall Street. Instead of investing in a valued property or building new capabilities, managers concentrate on reducing the cost of what was done before in order to pay for the acquisition. They place relatively less value on their workers as a part of the company, despite rhetoric to the contrary.

## **8. Be cautious about outsourcing**

With the onslaught of reverse auctions and the flood of component parts from overseas, a lot of people are talking about the advantages of outsourcing. Unfortunately, they may not have thought the matter through. Good, reliable suppliers are always a blessing and it pays to cooperate with them and to fully utilize their strengths. However, a company that farms out all of its proprietary capabilities may sow the seeds for its own ultimate destruction. What remains may be too simplistic and too easily duplicated. The bankruptcy of onetime pacesetter Schwinn Bicycle, after extensive outsourcing to Asia, provides a good example. If a company outsources its important competitive strengths, rather than building upon them, the company compromises its future reason for existence.

## **9. Ask the same question of many people**

Successful directors are rarely absolutists and do not claim to be quick learners. They have to think about things for a while and they appreciate different perspectives. Successful directors have an appreciation of what they do not know. Therefore, they need multiple interpretations.

## **10. Remain as a helper in the background**

Directors do not represent the company. They have no official role other than to provide advice and counsel to the management team on behalf of the shareholders, whom they do represent. Directors can be most helpful if they are available when needed, candid in their observations, true to the mission of the company and appreciative of the difficult role managers have in this era of intense global competition. They may have a good idea but, if they are smart, they will not take credit for it. A good director has a lot

in common with John the Baptist—firmly grounded in what is important, but appreciative of more essential roles. Once in a while, directors have to make a difficult call. When that happens, the task will be made easier by humility, study, prayer, and a sense of obligation. Good luck to all.

## Some modest, and not-so-modest, exec pay comparisons

High pay often a red flag; Legal reforms would help

MINNEAPOLIS STAR TRIBUNE -- May 25, 2003

Along with many others, and as chairman of the compensation committee for a successful company listed on the New York Stock Exchange, I read with interest the 2002 Executive Compensation Survey in last Sunday's Star Tribune. After serving as a director of many companies in the past 30-plus years and after reflecting on my time in industry, I am often intrigued by the compensation questions raised by the St. Thomas students and others.

What level of compensation is appropriate?.

Any review of executive compensation is likely to result in respect in some instances, and utter disbelief in others.

The Star Tribune accurately pointed out past mismatches between pay and performance: Larry Coss of Green Tree Financial, Bob Price of Control Data Corp., Kenneth Lay of Enron Corp. and many others.

But the offensive situations of the past, along with many on the current list, are in disrepute. There are companies that behave better.

Take Nucor. As the CEO of the nation's most profitable steel company, Daniel DiMicco's total compensation would rank him about 30th in compensation, were the company in Minnesota. Nucor, based in North Carolina, has been profitable every quarter since the 1960s, while once-larger competitors such as Bethlehem and LTV entered bankruptcy.

Why? The the company's regard for it's people is reflected in the cover of the annual report, which lists the name of every Nucor employee. Nucor's consistent profitability in a slow-growth, tough industry, together with its highly automated plants and its no-layoff policy have garnered international respect, even though the executives are not listed as highly paid.

Steel Dynamics, the nation's other well-run big steel company with a similar philosophy, had record revenue, earnings and earnings per share during the tough market of 2002. The picture of modestly paid CEO Keith Busse received 3.5 square inches of print space in the annual report vs. 305 square inches for company employees.

I still have some stock in Eden Prairie-based ADC Telecommunications Inc., left over from when it was one of the best-managed and most-promising companies in Minnesota. As I was recently reviewing the proxy statement, I noted that the cost to relocate ADC's CEO from the East Coast to Minnesota (about \$780,000) was about equal to half of the base pay for the entire management team at Winnebago Industries Inc., the Iowa-based recreational vehicle maker. (I know those figures well, as I am a Winnebago director and a member of the compensation committee.).

ADC's CEO is No. 12 on the Star Tribune compensation list - slightly ahead of far-more-profitable and much-better-run 3M Co. ADC lost about \$1 billion and half of its equity last year. Winnebago is the most profitable company in its industry, has the highest quality and continues to receive awards and accolades from customers and dealers.

You can see the differences in these two companies in the pictures. One company has a smashing new headquarters. The other a smashing new factory. The corporate headquarters of the second company can barely be seen. It is in an attic above part of the factory.

At Winnebago, no executive has a window and no executive has obscene compensation but the CEO personally hands out the award checks for the nationally recognized employee suggestion program.

## Employee voting.

I have long felt that Liberty State Bank in St. Paul is the best bank in the world. Although Liberty is deep in talent, it doesn't take much to be the best bank in the world these days. Real people there answer their phones. They talk to you. Interest rates are reasonable. Extra charges are almost nonexistent. The bank sponsors numerous community activities. When you enter the bank, Tim Macke, the president, is likely to wave to you from his glass-walled office with no door. People are friendly and there is free popcorn on Fridays. What else defines a good bank?.

I suppose there are other good banks, too, but none of them come immediately to mind. First Bank (now U.S. Bancorp) merged and changed its identity. Norwest (now Wells Fargo & Co.) merged and left town. Liberty will soon enter into a friendly affiliation with a Wisconsin bank, but there is something different. All of the employees get to vote on the merger.

I wonder how the Honeywell employees would have voted had they had the chance to cast ballots on the merger with Allied Signal?.

Perhaps the most interesting example of compensation is St. Mary's Hospital in Rochester. With proceeds from their knitting and the unused dowry of the mother superior, the Sisters of St. Francis built Rochester's first hospital, which gave rise to the Mayo Clinic.

While William McGuire comfortably counts his \$9.5 million in compensation, plus \$28 million worth of new options, the founders of the best-known hospital in the world, who also ran it for the first 100 years, operated with the vow of poverty.

Compensation for all of us might be more than it should be. Business is not alone in its propensity to overpay for mediocre performance. Maybe the Minnesota Vikings' Dante Culpepper isn't worth \$102 million either. Some public retirements are permitted at too-early an age. People in education should work a full year. There are other examples.

But as we look at the economy we have before us - the trade deficit of \$500 billion, our growing fiscal deficits, our country's situation as the world's largest debtor, and the much-lower compensation of our emerging competitors - we have cause to reconsider. As a nation, we can do better.

Below are some measures that might help bring compensation into line and reduce further instances of the corporate scandals that have plagued U.S. industry for too long.

- - Lift the ceiling on the FICA payroll taxes and have them apply to all forms of compensation; wages, salaries, bonuses and bonuses to retire early. This should raise \$13.6 million from one quarterback and his employer alone.
- - Change security laws to require shareholder approval of total compensation packages and all executive severance agreements of more than \$1 million per year.
- - Adopt FASB Accounting Standard 106, which requires the booking of future retirement obligations as liabilities, for all units of government. This would make governmental units use the same accounting systems as private industry.

The assertion that high compensation levels are necessary to attract talent is without foundation. Some of the most lasting institutions in the world, in business and outside of it, have been run by people who did not make very much.

Some of the best companies in the country are run by people with modest pay. And some of us, who have been following companies for years, are increasingly of the opinion that high executive compensation is a telling mark of a poorly run company.

## Executive rationalization gets in the way of ethical conduct

MINNEAPOLIS STAR TRIBUNE -- December 15, 2003

Being of advanced age and having been a part of the business community for many years, I have had the displeasure of observing ethical problems, and I have long wondered about the disparity in effectiveness in addressing these problems.

Some companies take effective action right away. Others seem to yodel in the broccoli.

Deeply rooted and extensive rationalization is common within ethically challenged organizations. Delusion becomes a major theme.

*"These are minor problems, but in the large context, we are effective." Or, "We deserve the compensation we are receiving, and other executives make even more." Or, "I am trying to build a great company here. These problems are a distraction."*

The human power to rationalize and justify behavior, even in the most despicable circumstances, is a long-enduring trait. One of my favorite quotes from the 1920s was attributed to Al Capone:

*"I've been spending the best years of my life as a public benefactor. My booze has been good and my games have been square. The recent Business Forum piece on "Ethical Re-engineering" by Ken Goodpaster, Dean Maines and Arnie Weimerskirch underscored the need for a more systematic approach to appraising ethical conduct and managerial responsibility."*

Recent experiences have made it clear that we cannot assume that responsibilities will be carried out. Corporate and individual behavior will need to be systematically assessed with the same attention to detail that we now employ in the production of world-class products. Then, when deviations occur, corrective actions will need to be taken or the product of American business enterprise will lose ground in the world market. Public service is my motto. I've always regarded it as a public benefaction if people were given decent liquor and square games. And all I get is abuse."

Executive rationalization remains in full swing today. Billions have been lost and whole companies have been destroyed, but nobody admits either negligence or wrongdoing. To the contrary, the brazen looting of corporate and shareholder assets occurred even during times when mismanagement of the firms involved was widely acknowledged. The tokenism seemed pathetic. After selling \$730 million of Global Crossing stock before the company declared bankruptcy, CEO Gary Winnick announced he would pledge to set aside \$25 million in a trust fund for Global Crossing employees who lost their savings when the value of the company's stock plunged.

Nearly 20 years ago, I conducted a review of cornerstone themes in the classics of management literature written from the late 19th century through the 1950s. These writings stood the test of time and still are reviewed today in the beginning chapters of most management textbooks. Four prominent themes emerged:

- - The enterprise is an integral part of the community.
- - Success depends upon a coincidence of interest between workers and organization.
- - The effective practice of management requires a high degree of integrity on the part of both managers and employees.
- - Shared value systems, objectives and beliefs must be established and inculcated within the organization.
- These are not difficult concepts, nor are they new. In spite of business history interspersed with occasional transgressions, these basic concepts have worked well for many companies for a very long time. When we deviate from them, the attainment of objectives becomes much more difficult.

The recent Business Forum piece on “Ethical Re-engineering” by Ken Goodpaster, Dean Maines and Arnie Weimerskirch underscored the need for a more systematic approach to appraising ethical conduct and managerial responsibility.

Recent experiences have made it clear that we cannot assume that responsibilities will be carried out. Corporate and individual behavior will need to be systematically assessed with the same attention to detail that we now employ in the production of world-class products. Then, when deviations occur, corrective actions will need to be taken or the product of American business enterprise will lose ground in the world market.

## Is your boss genuine or synthetic?

MINNEAPOLIS STAR TRIBUNE -- May 17, 2004

A few decades ago, I was visiting our British subsidiary with the objective of gently cajoling them into collecting more of the money that was due our company. The phone rang while I was in the visitor's chair in the managing director's office and I encouraged him to take the call.

Meanwhile, I observed the splendid collection of business books on his shelf, which seemed strategically placed to be of notice to all visitors. After the managing director finished his call I remarked, "Peter, those are some very interesting books. Which is your favorite?"

Without hesitation, he replied; "Oh, my good man, we don't read these books. We have a service that comes in and stocks the shelves."

This true story illustrates an awkward problem that plagues many companies today: the synthetic manager. The synthetic manager might project competence, confidence and understanding of important issues - but these precious qualities are not internalized to the point that the manager is held in high regard in his own organization. Organization members are almost universally well-equipped to sort out the genuine from the synthetic.

A few weeks ago, some longtime friends invited my wife, Joannell, and me to a charity fund-raising event. While chatting with a son of our hosts, I asked the young man how the CEO of his company was treating him. This particular CEO ranked very high in the Star Tribune's recently published 2003 executive compensation survey.

The response was interesting and telling. "You know, we bring in one-fifth of the company's revenue and a larger percentage of its profits, and we never see him. He makes several hundred times what the rest of us make, but he is not well-liked internally."

Some business and government leaders are very sincere, dedicated and unobtrusively genuine. These are the people who earnestly care for people, care for their communities, and possess a deep enough understanding of their industries to keep their companies competitive. They have that rare combination of professional will and personal humility that Jim Collins so skillfully describes in his classic book, "Good to Great: Why Some Companies Make the Leap and Others Don't."

The leaders also possess the qualities capable of meeting the challenges outlined by Bill George in his book, "Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value."

We seldom see the genuine managers in headlines. They rarely make the top ranks of executive compensation lists. They spurn gigantic acquisitions. They are not featured on TV shows. They just do their jobs.

Synthetic managers get lots of publicity because of mega-mergers (many of them poorly thought-out), high compensation, dramatic reductions in staff, great changes in strategy and, occasionally, encounters with the law. But name recognition rarely coincides with business success.

The difference between genuine and synthetic managers is apparent in their use of time at the company. Genuine managers meet with customers, walk through the operations, greet employees and listen to their ideas. Data from outside the firm help situate the company's role in society and improves the quality of planning. These processes are informal but quite thorough.

Synthetic managers try to sound intelligent at meetings. However, limited attention to data external to the firm, the lack of familiarity with key company processes, disinterest in the ideas of employees and inattention to the needs of customers usually limit both organizational effectiveness and employee morale.

There are some bright spots. It was a great pleasure to visit a major plant of Charlotte, N.C.-based Nucor Steel several years ago, now the most profitable steel company in the United States. At the time, the revenue per person at that plant was \$1.3 million per year and it was clear that the company was positioned for greatness. The late Ken Iverson, the company's well-regarded chairman, flew coach, did

not allow reserved parking spaces or company cars, answered his own phone and operated on the same incentive plan as the rest of the employees.

Steel Dynamics, Park Industries and many other companies operate similarly with quietly performing, stage-sharing CEOs who take more pride in their skills as listeners than they do as speakers. These companies exhibit broadly based genuine qualities. Their cultures demand it and employees and customers recognize it.

### **Corporate who-done-it.**

Over the years, I've thought many times about the British managing director and his books with the idea that this experience would make a good plot for a play. Imagine the setting - the manager of a troubled company who will not read the books, but the employees develop an interest. They sneak into the manager's office after hours, take the books, and exchange them for a discarded old book, which they then wrap in the jacket from the original book.

Then the employees read the books, get many ideas and improve the company until it is highly profitable. But an ethical dilemma develops. The employees are having fun being a part of this success, but the dramatic upturn in the company's fortunes threatens to uncover their plot. How can the sudden surplus of money be explained? And, of course, there is the question of who should share in the bounty.

However, perhaps such a scenario would not make the cut with Donald Trump and the producers of "The Apprentice." The larger point is that people invariably know leadership when they see it. Conversely, synthetic managers are rarely able to fend off under-the-table criticisms within their own companies. Neither are politicians.

A few years ago, one of our sons had a pet parakeet. One of us had to take care of the bird when he was in the hospital, so I volunteered to line the bottom of the cage with newspaper pictures of a particularly synthetic politician from that era. It doesn't matter which one because there are synthetic and genuine politicians in both parties.

There are, however, hidden advantages in being a genuine, as opposed to a synthetic, manager. The annual report picture of Keith Busse, the highly regarded CEO of Steel Dynamics who was mentored by Ken Iverson, is only about 1 square inch - the same size or smaller than the pictures of the many Steel Dynamics employees who are also shown. A picture that small would be pretty hard for a bird to hit.

And, I do wonder if the rankings in the Star Tribune's executive compensation survey could be rearranged to reflect the best value executives, rather than the ones who make the most money.

## Management by getting out of the way

MINNEAPOLIS STAR TRIBUNE -- August 1, 2004

The organizational structure of church ushers is appropriately streamlined.

There are no meetings. There is no executive direction. There are no detailed job descriptions. Nobody tells the ushers what to do.

Nonetheless, since our particular parish was founded in 1959, everyone has had a seat and no collection has ever been missed.

Good companies are organized like the ushers. By virtue of dependable people knowing their jobs, the essential tasks of creating success are accomplished - in part because no one interferes.

Many years ago, I served as a field engineer in three branch offices of IBM before moving on to other assignments. Most of our managers were quite good, but there was one whose section was chronically burdened by reduced productivity, low morale and sub-optimal customer service.

For a few weeks I worked in that manager's section, and it was easy to see why there were problems. The manager, who had previously been demoted from a higher position by IBM, was in charge of everything. He would tell us where to go, what to do and when to do it. Unfortunately, he did not have enough specific knowledge to handle these responsibilities effectively.

On the other hand, there are companies that achieve outstanding things with minimum levels of executive intervention. The people know their jobs and the executives are smart enough to not interfere.

The late Kenneth Iverson, longtime CEO of steelmaker Nucor Corp., explained this principle in his book, "Plain Talk: Lessons from a Business Maverick."

*"Shaping the work environment has always been an acknowledged part of the manager's responsibility. But to my way of thinking, it's the manager's primary job. Instead of telling people what to do and then hounding them to do it, our managers focus on shaping an environment that frees employees to determine what they can do and should do, to the benefit of themselves and the business. We've found that their answers drive the progress of our business faster than our own."*

Iverson's approach reveals a time-tested managerial secret. Managers and executives must actively prevent the vast organizational bureaucracy from impeding the creativity and best efforts of employees.

Chester Barnard, the oft-quoted classical author of business philosophy and himself a high-ranking executive in the 1930s, saw the functions of the executive as limited to three important tasks:

- - Formulate and design a purpose for the organization.
- - Provide a system of communication.
- - Promote the securing of essential personal efforts.

In Barnard's view, it was management's job to define a purpose and maintain communications in such a manner that the securing of essential personal efforts could be achieved. The employees would take care of the rest.

Perhaps with empowerment schemes, job enlargement, quality circles and Six Sigma, we have somehow misunderstood the true nature of employee contributions. Managers often see meetings as a way of getting people involved in these programs. But sometimes the managers are not trusting enough to permit employee responsibility on major events - only minor events. Meaningful responsibility is therefore not achieved. Too often, a broad consensus on trivial issues is all that is achieved and employees yawn.

Pointless, irresponsible, time-wasting meetings permeate companies, government and academia. Importantly, these meetings often have the effect of impeding organizational progress rather than advancing it.

Why? Because the wrong people attend. Good people, contributors, have work to do. They meet customers, satisfy their needs, design appropriate products, produce efficiently and ensure high quality. Contributors are often busy with tasks more important than the meetings.

Who attends the meetings? Often people who are not busy - chronic bureaucrats who lack the skill to accomplish the essential tasks listed above. Or, worse, politically oriented conniving charlatans aimed at insulating their own positions from the burden of improvement.

Not all meetings are bad, of course, but some are quite slow. A recent meeting took eight people more than an hour to change two minor words in a document. If Tolstoy had achieved such productivity in the writing of "War and Peace," he would have had to start the book during the time of Charlemagne.

More important than the matter of efficiency, leaders must ensure the meetings support organizational purpose and are not corrupted by people with other agendas.

As Nucor's Iverson observed, shaping the work environment is the manager's primary job. Yet, the in-depth understanding of purpose and the corresponding link to impediment removal seems to be missing in some organizations. Like ushers, organizational members want to accomplish important tasks. They do not want to be impeded because their activities are naively over-orchestrated or because they do not happen to be a "black belt" or because managerial direction competes with true organizational purpose.

Virtually every corporate mission statement says employees are important, but some executives do not walk that talk. Yet the evidence is clear. When employees believe their tasks are important, and are not impeded from high achievement, their companies are successful.

## Fair play in compensation game

**Even 5-year-olds know a raw deal when they see one. It's time for boards of directors to correct the unfairness.**

**MINNEAPOLIS STAR TRIBUNE -- August 7, 2005**

The 2005 Executive Compensation survey published in the Star Tribune in May should interest all of us. Companies are integral components of our communities and the ultimate font of most of our prosperity. As citizens, we all should be concerned as to how these important members of our society are governed.

Executive compensation is crucial to effective corporate governance. If the matter is handled well, employees, suppliers, creditors and shareholders will be enthusiastic supporters of the company and its management team. If it is handled poorly, disorganization, plummeting morale and reduced effectiveness are the nearly inevitable consequences.

I've seen executive compensation handled well and handled poorly during my own business career, which includes 30-plus years as a corporate director and several years as chairman of the compensation committee of a highly successful company listed on the New York Stock Exchange. Boards of directors are supposed to be effective stewards of corporate assets. Yet boards created the list published in these pages May 14.

A few weeks ago, I was invited to participate in the Fortune Boardroom Forum, a colloquium of corporate directors held in Chicago. It was an excellent program organized by Geoff Colvin, an editor and columnist with Fortune magazine and the co-host of "Wall Street Week with Fortune" on PBS. Several of the speakers had taken over troubled companies in the aftermath of scandals.

Jeffrey Rodek, who led the turnaround at Hyperion, said he "likes to see if the out-of-company lifestyle of the management is consistent with the values of the company." Ed Breen described some of his earlier duties at Tyco after taking over from the now-convicted Dennis Kozlowski. Breen found a check to Trump Towers for nine apartments, another check to Tiffany & Co. jewelers for \$100,000 and 14 corporate jets. Robert May, who took over from scandal-plagued but ultimately acquitted Richard Scrushy, then added; "HealthSouth had 14 jets, too."

The excesses described by the speakers are both offensive and ridiculous, but they also provide testimony to the fact that our collective performances as directors have room for improvement.

Robert Bennett, the prominent corporate attorney and special counsel to the U.S. Senate Special Committee on Ethics, offered some sobering advice for directors: "I would think long and hard about going on a board with a larger-than-life CEO - one of these messianic type of people." Earlier he had warned; "You have to go beneath the information that is provided to you in a pretty box with a ribbon on it."

### **Questionable rationale.**

The conventional arguments in favor of high compensation have little evidence to support them. Is the high pay what the market demands for talent?

Baloney. What did Rick Roscitt ever do for ADC? Did the \$45 million signing bonus and other multi-million-dollar payments for CEO Gary Wendt stave off bankruptcy for Conesco? Did the compensation of Robert Price bring prosperity to Control Data?

Simultaneously, with a base salary of less than \$100,000 per year, Kenneth Iverson was building up what is now the country's largest and most profitable steel company in a tough industry. His disciple, Keith Busse, also modestly paid, has put in place another good steel company, Steel Dynamics.

The formation of Minnesota's leading health care institution, the Mayo Clinic, was initially spearheaded by Sister Alfred, a nun with a vow of poverty. Using proceeds from their knitting and unused dowries, the Sisters of St. Francis built St. Marys Hospital in Rochester in 1889.

With an insignificant salary and minuscule net worth, A.P. Giannini built Bank of America (initially the Bank of Italy on the San Francisco waterfront) into the largest bank in the world. He articulated his attitude toward high compensation with this statement: "No man owns a fortune. The fortune owns him."

Clearly, the talents of any of these modestly paid executives would outshine many of the people on the Star Tribune May 14 list.

### **Execs aren't the only ones.**

Yet, any discussion of executive compensation should include two more important points.

First, our excesses in compensation are not limited to executives. If any of us retire with a defined-benefit plan at age 55, as many public employees do, the imputed cost for the remaining 30 years of life expectancy is a multimillion-dollar transaction for most positions. Retirements for school superintendents and higher governmental positions would be much more.

Athletes usually are paid even more than executives and many of them still want subsidized stadiums. College football coaches are highly paid, too - even those at public universities.

Many of us are part of the high compensation problem. It isn't just executives. Perhaps we all should take less from the system.

Second, executives often pay a large share of the taxes we need to run our society, and many of them are quite generous in their charitable giving.

Minnesota long has benefited from the charitable giving of executives from 3M, Honeywell, Dayton's, Best Buy, Waldorf Paper, Bremer Bank, Blandin Paper, Andersen Windows and many others. Many of our best executives see charitable giving as part of their jobs as stewards of an important community asset.

Yet, in the aggregate, the process of executive compensation remains troubling. Seeking a more fundamental understanding of how compensation works, I conducted an experiment with three of our grandchildren, who then were 5 years old.

### **Paid in M&Ms.**

Peyton became the worker and she received one M&M. Cooper was the manager and he received two. Emma, who was the executive, received a whole bag. Then we videotaped their responses.

The experiment produced predictable anguish on the part of the manager and worker, but none of them, including the executive, thought the system was a good one.

Now, my wife and I always knew these three wonderful children were exceptionally talented. However, I did not think that at such a young age, they were smarter than corporate boards of directors.

The United States has many good companies and many responsible corporate directors who do see their role as stewards of important community assets. But our compensation systems, probably for all of us, are in need of review.

The high levels of U.S. compensation are no doubt contributing to our mushrooming and unsustainable trade deficit and probably to our fiscal deficit as well. It will be very hard to remain in business if we pay ourselves substantially more than our competitors. In this regard, the boards of directors of American firms could lead the way by establishing reasonable compensation levels for their management teams.

It is time to correct the unfairness that Emma, Peyton and Cooper so wisely detected at the age of 5.

Emma, Peyton and Cooper are the grandchildren of Fred and Joannell Zimmerman. For use in his classes, professor Zimmerman filmed a short segment on executive compensation after the Star Tribune's Executive Compensation Survey was published in 2005. To view the video, visit [www.startribune.com/348](http://www.startribune.com/348).

## Filling the need for competitors

**The U.S. economy is going to need people with skills and companies with imagination and integrity**

**MINNEAPOLIS STAR TRIBUNE -- August 21, 2004**

Recently announced anemic job growth has reignited anxiety among workers and business owners about the security of their jobs and their incomes. In reality, total U.S. nonfarm employment for July stood at 131.3 million, within 771,000 of the all-time seasonally adjusted high for July and nearly 2 million higher than any year of the 1990s.

But the United States is not alone in its anxiety over an increasingly competitive world economy. Just last week, articles appeared describing the anxieties of Germany (Volkswagen needs to cut labor costs by 30 percent), Korea, Austria, Taiwan, Australia, Japan and several other countries. The days when the U.S. economy could be considered a single entity are over. Like it or not, we are now all part of a world economic system that has the power to curb our excesses, spur our efficiencies, make us more competitive or deliver us consequences.

If the world wants to hire some people to make trucks, it can choose between the highly capable people at the heavily automated Twin Cities Ford plant, which is 79 years old, or at newer plants elsewhere, also with impressive automation and capable people. I have a lot of friends at the Ford plant, and the company is near to my heart. So, I do not take a detached view. I very much wish the best for one of the most significant promulgators of wealth in Minnesota.

But we must compete, and the Ford organization does a pretty good job. We have less capable competitors in some industries, such as consumer electronics, and other capable competitors in a few industries.

But the list is shrinking. The United States is home to many fewer world-class competitors than it was 15 years ago.

Part of the blame can be placed on company managers who have often concentrated on mergers, acquisitions or just plain mediocrity as they overpaid themselves. But part of the problem rests with those of us who are employees as well. Have we prepared ourselves for the intensity of world competition? Are our skills adequate to the task? Are our costs reasonable? Are our attitudes and expectations realistic? If we were running the world, would we hire us?.

The United States must do (and is doing) some soul searching.

Our education system is not strong enough. The costs for our support services are too high, and we have too much wasteful litigation. But, we have some talented young people coming into the workforce. The United States has 80 million people under the age of 20, the fourth-largest of any country behind India (440 million), China (415 million) and Indonesia (90 million).

Unfortunately, as a nation we have not prepared all of these people for the competitive realities they will be facing.

Before joining academia in the mid-1980s, I spent nearly 30 years at three computer companies; IBM, Control Data and NCS. I was a group vice president at NCS and had responsibility for about 40 percent of the company. Quite a few of the new hires came through that part of the company. I quickly noticed that some managers hired very promotable people while others did not seem to enjoy the same success. One day, while trying to get a better handle on our recruiting, I wrote to six of the best recruiters and asked them what they looked for.

It was an amazing list. Some managers liked immigrants. Several sought people who fixed their own cars or had experience building houses. The recruiting questions became somewhat bizarre and might not conform to hiring procedures today.

We sought measurements like the wrench-to-stereotape ratio; we wanted people who owned more wrenches than stereo tapes. We asked them where they went on spring break. We liked answers such as: "I went home and helped plow," and we were not too interested in people who visited Fort Lauderdale.

At NCS, we adopted the IBM dress code in a manner that seemed to enhance respect for our organization.

Perhaps such procedures are out of style now - but I am not sure. Somehow, it seems important to convey to our young people that preparation is important. Skills must be developed. Professionalism is appreciated by customers. Individual contributions help make our country competitive.

In contrast, we seem to be promulgating expectations of entitlement. High school graduation might be a little too automatic. Colleges permit too much grade inflation. Employers and governments make promises they cannot fulfill.

The highly competitive world will not be that simple. We are doing no one a favor by allowing them to nurture a belief in the unrealistic.

My good friend Bud Ruvelson, one of the first federally chartered venture capitalists in the country, has visited my classes at St. Thomas several times. He explains the four "Bs" that cause companies to lose focus and become investment "losers." These are bucks (people dipping into the till), boy-girl problems (or other inappropriate behavior), booze (or other substance abuse) and ballots (people more disposed to office politics than to productivity). The students always enjoy these sessions as practical testimonies to the characteristics we should avoid if we want to remain competitive.

It is possible, I believe, to address our concerns about job creation in a nonpolitical way. We have no God-given right to the prosperity we enjoy. We are going to have to earn it by better preparation, more extensive investment, less frivolity, better work habits and more lasting character traits.

Regarding the concern for job creation, we can borrow an ancient phrase from the comic strip "Pogo": "We have met the enemy and he is us."

## History teaches what's best in a leader

Choosing a chief executive is a major challenge because it's easier to "look good" than to "be good." But history and experience offer a template for finding the truly successful ones.

MINNEAPOLIS STAR TRIBUNE -- December 12, 2005

*"I belong to the common people and I'm proud I do. I honestly treasure the goodwill and the respect and the confidence of the people working with me, and for me, more than all of the money I have ever made. If I didn't have that - if I gave them cause to lose it - well, I guess I wouldn't sleep nights."*

So said one of the nation's most successful industrialists, Charles Nash, the very capable president of General Motors from 1912 to 1915 and the founder of what later became American Motors. His concept of executive stewardship is one that can benefit companies today.

The United States has produced some exemplary, innovative and duty-conscious chief executives. It surprises me, though, that there has been such a wide variation in the caliber of management. There have been many competent executives with the sense of stewardship displayed by Charles Nash. But regrettably, there have been others with a less-cultivated sense of responsibility who lack the competence necessary to build the industry of our country.

Several companies in our region, and elsewhere, are searching for new chief executives, and one of them, 3M Co., named one last week.

History offers valuable lessons about which types of people might be best to lead America's companies during this era of intensified global competition.

And some very good books might serve as guides, too. "Good to Great" by Jim Collins, "Authentic Leadership" by Bill George, "The Functions of the Executive" by Chester Barnard and "Plain Talk" by Kenneth Iverson all provide well-thought-out templates for what characteristics might be most important to truly genuine long-term business success. Note that three of the above authors, George, Barnard and Iverson, were highly respected and successful CEOs themselves.

It is easy, of course, to find people who look the part of a CEO. A lot of people are impressive on paper. But if we read deeply the above books and couple them with our own experiences and the verdict of history, the profile of the successful CEO that emerges is often counterintuitive.

Instead of being pre-eminent, successful CEOs often work quietly in the background. They are not always articulate speakers but they are good listeners. They make time to listen to new ideas, technologies and insights.

Consequently, crowded, hectic schedules are rarely the mode of the effective CEOs. Such schedules would interfere with their listening.

Successful CEOs are available when needed. Bruce Hertzke of Winnebago, Keith Busse of Steel Dynamics, Kenneth Iverson of Nucor and others answer their own phones. No screening takes place. Customers, employees, suppliers and members of the community are all welcomed to communicate personally with the top managers in these companies. The idea is not new. In the early days of the auto industry, Walter Chrysler would walk about the factory informally chatting with workers. One of his favorite questions was; "How can I help you?"

The successful CEOs are comfortable sharing center stage. Instead of drawing attention to themselves, they provide the environment for others to excel.

They welcome the notoriety and success of organization members. They avoid the frailty of assuming they have most of the answers. Instead of being certain about what will happen in the future, they are more inclined to nurture many smaller and more cost-effective projects, which will be useful under a wider variety of unforeseen conditions. Thus they are tolerant of setbacks.

Highly successful William McKnight of 3M would say: "You can't stumble if you are not in motion." Importantly, effective CEOs are frugal - spending money on activities most likely to be appreciated by customers and spurning pointless excesses.

"Oriental rugs and administration buildings with imposing granite columns and uniformed office attendants have no place in the successful conduct of business," Charles Nash proclaimed as he articulated his lasting corporate philosophy.

By being frugal on superfluous things, more resources are available to make their companies great.

Good CEOs are effective champions of milestone ideas - often initiated by others within the organization and often emanating from unprogrammed experimentation.

Honeywell's unfortunate acquisition by AlliedSignal, the implosion of Control Data, the recent bankruptcy of Northwest Airlines and rumors circulating about the closing of U.S. auto plants all should cause us to wonder about the strength of our economy going forward.

It is a bit alarming to see the number of CEOs that have been sacked in recent years. Some of them are in jail. But during a time when infamous scandals were unfolding and many companies could not compete, there was another class of hardworking, sincere and dedicated chief executives who saw their roles as stewards of the one of the community's most precious assets - an effective and competitive company. The world longs for genuine CEOs who can help build solid companies for the long term. We've had enough of the impressive-looking CEOs who "always make their numbers" (even when they should not be made). Now we need leaders who will nurture innovation, provide employees with a platform for achievement and enable our companies to perform effectively over longer periods.