



Staying power

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It's lonely at the top, alright. And staying there is ever lonelier. For all the rewards, running a big company has long been something of a solitary endeavor. No matter how well their underlings perform, America's chief executive officers usually receive the bulk of the credit and the blame for the states of their companies. Most CEOs gladly accept that bargain -- and the fat paycheck that comes with it. But increasingly, they are finding it harder to stick around once they arrive at the top.

Powerful political and market forces have made the lives of corporate chieftains ever tougher. Post-Enron market reforms, led by the Sarbanes-Oxley Act of 2002, have immersed CEOs in tiresome legal and regulatory issues. Boards of directors, chastened by turn-of-the-century corporate scandals, are asserting their independence, following accusations that they were too cozy with the chief executives who report to them. Growing ranks of activist investors are challenging everything from executive compensation to environmental and labor policies. And an avalanche of money into hedge funds and private equity is intensifying the market's already relentless focus on short-term financial performance.

No wonder many chief executives are running scared.

"I see a lot of nervous CEOs," says Peter Crist, a 30-year veteran executive recruiter who runs boutique search firm Crist Associates. "You've got activists, the private equity people, hedge funds, just wreaking havoc out there. Every CEO I'm with talks about someone shorting him that day. That's not operating a business. That just causes anxiety."

Many are heading for the exits, voluntarily or not. Last year more CEOs left their jobs -- 1,347 through November -- than in any previous year, says outplacement consulting firm Challenger, Gray & Christmas. About half of the departures were retirements; the other half was made up of chief executives who either stepped down or were fired. (There are about 10,000 public companies in the U.S.) Challenger Gray chief John Challenger attributes the record turnover to CEO frustration and boards of directors that are willing to pull the plug on underperforming bosses much more quickly.

"These pressures may only increase in 2007," says Challenger, citing new Securities and Exchange Commission regulations requiring greater disclosure of CEO compensation, as well as plans by activist shareholders to turn up the heat on corporate America during the coming proxy season.

Indeed, scrutiny from regulators is far from subsiding. According to published reports, the SEC and the U.S. Department of Justice are investigating more than 150 companies in connection with potential backdating of stock option grants. As of the end of last year, 19 CEOs had stepped down following scrutiny of allegedly backdated grants.

Consulting firm Booz Allen Hamilton conducts its own research into CEO turnover and reports that roughly one in six CEOs leaves his or her job every year -- up from one in 11 just eight years ago. "We think this is going to be the new norm," says Paul Kocourek, a senior vice president at Booz Allen.

If merely keeping a job is a notable achievement for today's CEOs, outperforming peers is an even bigger accomplishment. And continuing to do so at an elite level year after year is a feat that none but the most talented chiefs can pull off.

This year marks the fifth time Institutional Investor magazine has identified America's most outstanding chief executives by asking the country's biggest investors to evaluate them. It has been a trying five years. CEOs have had to contend with the bursting of the great 1990s stock bubble, the tragedy of 9/11, a recession, a deep bear market and the seemingly endless parade of corporate frauds that gave birth to today's regulatory and shareholder activism. A select few executives have not only shepherded their companies through these storms but have so excelled that investors have recognized them as the best in the country over and over. Just one, John Chambers, the 12-year veteran CEO of Cisco Systems, has been voted No. 1 in his industry sector for five years running. A handful of others, including George David of United Technologies Corp., Allergan's David Pyott and James O'Connor of Republic Services, boast three or four appearances at No. 1 in our survey to go with long tenures atop their companies. (In all, more than 1,000 portfolio managers and analysts at pension systems, endowments, foundations and money management firms with a combined \$6.9 trillion in U.S. equity assets under management responded to this year's survey; for a complete list of top-ranked executives by industry sector, see table at right.)

What's the secret to such executive-suite staying power? According to these veteran corporate chiefs, as well as those who advise top CEOs, success in today's complex and treacherous environment requires breaking with the traditional command-and-control style that dominated executive suites in the past, owning up to mistakes and moving decisively to fix them. Fostering collaboration among senior executives and maintaining open, honest communication with directors and shareholders is also crucial. So is balancing the short-term demands of the stock market with the need for long-term planning.

"CEOs have to be realistic about opportunities today while, at the same time, planning for market transitions that are often three to five or even seven years out," says Chambers, whose 12-year tenure at Cisco is distinguished by his having steered the data networking company through the technology crash of 2000'02. "The key to longevity for a CEO is to produce results while keeping a keen focus on the future."

Adds O'Connor, who has been running Republic Services since 1998 and makes his third consecutive appearance this year as the top CEO in the Environmental Services sector, "Longevity is about developing a great team and making sure you have operating discipline and don't get overly influenced by periodic criticisms."

One key to avoiding the corner-office revolving door is to acknowledge missteps and decisively change course. Allergan's Pyott, who earns top honors in the Pharmaceuticals/Specialty sector for a fourth time in five years, quickly made the best of a big stumble last year by acquiring rival Inamed Corp., a deal that has been welcomed by investors as one of his best moves in nine years as CEO. Allergan missed out on an opportunity to acquire the rights to popular skin treatment Restylane, now owned by Medicis Pharmaceutical Corp. Pyott wound up coveting a competing drug called Juvederm; its rights were controlled by Inamed, which he decided to pursue.

"We maybe made a big mistake in the beginning, but we ended up with an even bigger and better answer," says Pyott, who has run Allergan since 1998 and is perhaps best known for turning Botox, a drug originally developed as a treatment for muscle spasms and crossed eyes, into the wrinkle smoother of choice for the aging well-to-do. "Often, your most productive times are after the worst experiences."

It's impossible to avoid all mistakes, but one way to minimize them is to work hard at balancing the short-term demands of financial markets with the need to mind long-term strategy and invest for the future.

"Get ahead of the wave," advises United Technologies' David. "That's been my management philosophy my entire life."

It's a philosophy that has served him well through 13 years at the top. David finishes first in the Aerospace & Defense Electronics sector for a fourth time in five years. In 1999, amid a big downturn in the aerospace business, David engineered a massive restructuring, laying off 13,000 employees and taking a \$1.2 billion charge against earnings. The company's shares plunged by 25 percent over the next six months, but the decisive move helped United Technologies better cope with a changed industry. Its stock finished 2000 up 20 percent from when the restructuring was announced. Since then it has climbed a further 83 percent.

"That was tough," says David of the short-term hit to the company's performance and the difficulty of letting workers go. "But it got us ahead of the wave."

Such decisiveness isn't easy today. Not least, CEOs must contend with antsy board members. In the wake of corporate scandals and lawsuits against complacent directors, boards are more likely to question managements about strategies and practices. The options-backdating scandal will only accelerate this trend, particularly after a recent academic study suggesting that directors in many instances had joined top executives in receiving backdated grants.

Because voting in our survey took place as the scandal was unfolding, one of the chief executives that was ousted in connection with alleged backdating makes our rankings: William McGuire of UnitedHealth Group, who finishes first in the Managed Care sector.

Boards have more independent directors than ever, and these outsiders often don't know as much as management about the business. Their heightened role can easily lead to friction.

"Boards need to vote on strategic decisions that are material to the future of the enterprise," says David. "If they get wrapped up in the small things, they miss the big things."

Activist shareholders have become a far bigger thorn in CEOs' sides, capitalizing on the heightened sensitivity of directors to performance and governance issues and pressuring companies to merge, restructure, buy back stock and change myriad corporate policies. And complying with Sarbanes-Oxley -- from small things such as signing off on financial statements to huge endeavors like documenting, certifying and auditing thousands of internal financial controls, as required by the law's infamous Section 404 -- continues to be a headache.

One option for CEOs is to head for the hills. They can certainly afford to.

"These guys make a lot of money, so the idea of leaving to retire is more feasible," says Paul Oyer, an associate professor of economics at Stanford University's Graduate School of Business. "They reach the satiation point on their wealth."

Despite the heat being turned up on chief executives, there doesn't appear to be a shortage of candidates to fill the growing number of vacancies. Joe Griesedieck, head of the CEO practice for headhunting firm **Korn/Ferry** International, says chief financial officers, in particular, are even more beleaguered by the strictures of Sarbanes-Oxley and almost universally tell him how much they would prefer to take a step up to the top job. "They all want to be CEOs," he relates. "I say, 'Be careful what you wish for.'"

Regardless of where they come from, the next generation of corporate leaders would do well to take a page from seasoned veterans like Chambers, David, O'Connor and Pyott, who have adapted to the changed business, regulatory and financial climate. This new environment requires a different kind of leader than the autocrats who historically have dominated corporate America.

"At the end of the day, the CEOs who are starting to succeed, and particularly under Sarbox, are those who are much more collaborative and feel that empowerment is more important than power, and influence is more important than command," says Griesedieck. "They are able to put their egos aside."

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GEORGE DAVID

United Technologies Corp.

Year named CEO: 1994

Number of employees: 220,000 2006 stock performance: +13.4 percent

Annual compensation: \$6.4 million

Stock options: \$193.5 million

What's the secret to CEO staying power? You need to have clear, consistent, mature, repetitive, thought-out operating systems. If I were giving a tip to a new chief executive, I'd say spend less time with the balance sheet and more time with the physical reality underneath. That's what makes the balance sheet, not the other way around. Work on the reality first -- the results will follow.

What has been the impact of Sarbanes-Oxley? We do not complain about Sarbox. We spent \$30 million or so on it. Some people might say that's excessive. But the benefit for us is we redid 30,000 financial processes to implement Sarbox. That tightened up our own internal disciplines and made us a better company.

Is CEO pay out of control? This compensation pressure, especially in terms of changing the elements of compensation for long-term incentive, has gone too far. Stock options work. We have definitely changed to a shareholder-value company since the 1970s, and stock options have been a significant part of that. We, like other companies, redesigned our long-term incentive plan in 2005. We switched to half stock options and half so-called performance share units [essentially, restricted stock]. We're still gaining experience in that. But I think we've lost a little leverage in having management really motivated and fully on top of share price escalation and shareholder-value creation.

How do you cope with market pressure for short-term results? Get ahead of the wave. We had a big restructuring charge in 1999, a very large employment displacement (see story). That was tough. But we got our cost base down low enough that we had earning power a little ahead of where shareholder expectations were.

What's your favorite way to unwind? I race big sailboats -- in California and Florida in the winter, and on the Long Island Sound and around Newport, Rhode Island, in the summer. An hour and a half race in a big sailboat is like a year in business in slow motion.

DAVID PYOTT

Allergan

Age: 52

Year named CEO: 1998

Number of employees: 5,200

2006 stock performance: +11.3 percent

Annual compensation: \$3.2 million

Stock options: \$89.7 million

What have been the effects of Sarbanes-Oxley? In our company, fortunately, we've always had very strong standard operating practices, so we've used it as an opportunity to further strengthen and to shore up some of those procedures. I think we got some good things out of it.

How has the relationship between CEOs and directors changed? The change at Allergan was pretty small. This was always a very involved board and a very challenging board. The people we've brought on since I came are very much on the challenging end of the spectrum, and I think that's great. We want people who are positively critical, not people who just throw rose water at me. From what I've observed at the boards I've served on, I would say those companies that have been around for a while have had a real change in atmosphere where boards really stepped up and started digging into the details.

How do you deal with market pressure for short-term results? The real key to balance it is to set up goals that are attainable and then regularly produce. I don't want to jinx myself, but I'm now up to 35 quarters in a row where we've at least met expectations for the bottom line, and in almost all of them we've exceeded the top line as well. That's how you keep out of trouble.

What accomplishment are you most proud of as CEO? The most obvious one was discovering the little jewel lying around in the California desert called Botox. The year before I joined Allergan, it had only \$18 million in sales. As we turn this year, we may hit the \$1 billion mark.

How do you unwind? I'm still quite European, even in the land of BlackBerrys. We have a house in the Bavarian Alps; it's right beside the glaciers there. I can literally go there for days at a time and I don't check voice mail or e-mail, and that surprises people here. But walking through the woods there, I've had some of the best ideas ever. You just disconnect from the day to day, and I think people really need to do that to be creative again.

JOHN CHAMBERS

Cisco Systems

Age: 57

Year named CEO: 1995

Number of employees: 51,840

2006 stock performance: +59.6 percent

Annual compensation: \$1.7 million

Stock options: \$107.7 million

What's the secret to CEO staying power? I never lose sight of what I see as the three roles of a CEO: to determine the vision and strategy of the company, to develop and build the leadership team to implement that strategy and to create a winning culture that drives results. In an environment where there is pressure to meet short-term expectations, it's important to balance that with the long term and communicate your goals to shareholders, employees, customers and partners.

What's the best part of your job? Interacting with customers, employees and shareholders. I love bouncing ideas off of them and, in turn, listening to their points of view. Their insights and knowledge help me validate transitions that I see occurring in the marketplace.

What's the toughest part of your job? When one of our employees, their spouse or family member gets sick or passes away. We have 51,000 people in our company, which is the size of a small city, and yet I still believe we should act like a family. As a company, we try to do everything we can during the difficult times.

Since Enron and Sarbanes-Oxley, has your relationship with your board changed? My relationship with the board is stronger and better than ever. We're stronger as a team because of evolutionary changes, which have been constructive. In 2005 we named [former Autodesk CEO] Carol Bartz lead independent director. In many cases change can be positive.

What's your favorite way to unwind? I love golfing with my wife. Elaine and I have been married 30 years, and we enjoy getting out to play. She's got one heck of a swing!

JAMES O'CONNOR

Republic Services

Age: 57

Year named CEO: 1998

Number of employees: 13,800

2006 stock performance: +9.9 percent

Annual compensation: \$4.4 million

Stock options: \$8.8 million

What's the secret to CEO staying power? Longevity is about developing a great team and making sure you have operating discipline and don't get overly influenced by periodic criticisms. You have to have respect for the people who get the job done, day in and day out. I try to do that by being an effective communicator with our 13,000 employees and letting them know exactly where they're at, how they're performing, where the company sits among our competitors and what we need to accomplish. I think that has not only made the company successful but given credence to my leadership capabilities.

How has your relationship with your board changed post-Sarbanes-Oxley? Management has had an open-door policy with the board. We've tried to get the board knowledgeable about what we do and about the risks related to our business. The company is still relatively small, and that allows us to really talk about a number of issues, even ones where, by policy, I'm not required to go to them. That develops trust and allows the board to be much more effective and a much better participant in strategic planning.

How do you cope with market expectations for short-term results? I'm not much different than anybody else -- I'd like to get a good report card every quarter. But if you really have a good plan and stick to it, Wall Street will eventually reward you. Short term, you may get knocked down once in a while, but over the longer term they all jump on the bandwagon again.

What's your favorite way to unwind? Playing golf is one of the few times that I actually turn off the phone. I usually play with people in other professions so the dialogue doesn't become business; it becomes social or political or something else.

Is it true that it's lonely at the top? When I was coming up the ranks, I was like everybody else -- I found myself at the copy machine or the water cooler complaining about the boss. Now I have to go there and talk to myself.

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