

The task wasn't easy. Chair the comp committee of Tyco International, whose former CEO Dennis Kozlowski was facing federal charges for looting the company. The potential for failure and embarrassment was significant.

"Mackey had the courage to say, 'I will take on the Tyco challenge,' which in those days was not an easy thing to do," explains Tyco Chairman and CEO Ed Breen. Mackey McDonald, chief of the successful apparel manufacturer and marketer VF Corporation, joined the board in November of 2002 and agreed to chair the new compensation committee as it completely revamped compensation at Tyco.

"Tyco paid just outrageous amounts of money to everybody," Breen continues. "Mackey led the charge and did a clean sweep."

Lead director and former DuPont CEO Jack Krol, who asked McDonald to join the Tyco board, notes, "We were working to save and fix the company all at the same time. We had to regain credibility fast." Krol had known McDonald for years. "Mackey was really responsible for the growth of VF Corp.," Krol says. "Knowing his business sense and his personality, I thought he'd be good on Tyco."

With McDonald as CEO, VF Corp. has grown from \$4.7 to \$6.4 billion in sales. The company's brands include Lee, Wrangler, The North Face, Nautica, JanSport and Vans. VF has become known for successfully integrating acquisitions and building brands.

"What interested me was the fact that this was a company with a good solid business platform, with 300,000 employees who were doing a good job, who were in dire straits," says McDonald. He decided to accept the challenge.

With his new compensation committee, McDonald had to streamline pay structures—and the philosophy behind them. "We really wanted to zero in on pay for performance and to be sure we were inspiring the right kind of

performance," he continues.

Laurie Siegel, senior vp of human resources at Tyco, says McDonald and his committee had to start from scratch. "With the exception of certain benefit programs, everything was redesigned," she notes.

They spent an ungodly amount of time that first year," adds Breen. Pay would now be based on metrics such as earnings and cash flow. Individual performance as well as company performance was factored into an executive's compensation. The message the new pay structure sent, says Breen: "You've got to hit the numbers, but we want you to do it the right way."

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ED BREEN • CHAIRMAN AND CEO, TYCO

Cash flow was a critical measure of results because Tyco had to clean up its balance sheet. At the time, Tyco had \$30 billion in debt. Today, that number is down to \$10 billion.

Under McDonald, all compensation was designed to reflect leadership attributes such as personal integrity. "Up to 25% of bonuses today are based not on what you did, but on how you did it," explains Siegel. "The goal is to be sure people model great leadership in the process of achieving financial results."

Tyco's compensation system emphasizes behaviors by assessing executives against nine criteria, which include "champions trust and integrity," "managerial courage" and "builds effective teams." Each executive is plotted in a matrix of results against behaviors, and the highest equity grants go to individuals who are high on both axes.

Tyco had driven growth by making more than 900 acquisitions but hadn't successfully integrated those companies. Instead, whenever the company's numbers needed a boost, the executives bought something else—whether it was related to the core businesses or

not. "We set the compensation up so that acquisitions weren't rewarding," McDonald relates.

The compensation committee capped the salary and bonus ranges. Total expenditures on annual bonuses at Tyco were reduced by roughly \$150 million per year. The annual run rate for equity grants went from 3.9% of shares outstanding in 2002 to 1% of shares outstanding in 2005 and 2006. And the top five executives' three-year total compensation under McDonald's leadership—2004 to 2006—was 46% lower than the total compensation levels for the last three years of the previous compensation committee.

Krol notes that McDonald had to do more than lead a compensation overhaul. Managing the committee—during a time when Tyco was under great scrutiny—was a job in itself. "Here we were trying to make a huge change in the comp structure," Krol explains. "There was a lot of debate about which way to go, and it was tough to come up with a consensus."

McDonald remained level-headed, notes Siegel. "For Mackey, every problem has a solution. He would say, 'We'll take this one step at a time.'" Shrugs McDonald, "It was a matter of trying to understand why we were where we were and not get frustrated."

After Dennis Kozlowski left Tyco, the old board recruited Ed Breen to take the helm. Breen had been president and COO at scandal-free Motorola. The board devised a hearty pay package—including a golden hello and tax gross-ups—to entice him. When McDonald joined the Tyco board, he inherited Breen's recruiting package.

"The previous board gave new executives significant equity packages to attract them," McDonald says. "So

A photograph of Mackey J. McDonald, a man with short grey hair and glasses, wearing a dark suit jacket over a light blue striped shirt and blue jeans. He is standing in front of a large, illuminated Tyco logo, which consists of a stylized 'T' and 'Y' in white on a blue background. The background also features a brick wall on the right side.

PAYMASTER

Under McDonald, up to 25% of Tyco bonuses have become based not only on what you did, but also on how you did it.

BORN: November 1, 1946, in Moultrie, Ga.

EDUCATION: BA, English, Davidson College; MBA, Marketing, Georgia State University.

CAREER HIGHLIGHTS:

Chairman/CEO/President, VF Corporation; various senior and middle management positions at VF including VF group vice president responsible for the company's Lee, Wrangler, JanSport and Healthtex divisions and assistant vice president, merchandising services.

HOMETOWN: Greensboro, N.C.

FAMILY: 2 daughters; 2 sons; 2 granddaughters.

MOST MEMORABLE SUMMER JOB: Construction, raking concrete.

MOST RECENT BOOK READ: *Freakonomics* by Steven D. Levitt and Stephen J. Dubner.

FAVORITE ARTIST/COMPOSER/POET: daughter Pamela O'Hara

FAVORITE CHARITY(IES): Educational institutions.

SOMETHING MOST PEOPLE WOULD BE SURPRISED TO KNOW ABOUT ME:

"Beneath the calm exterior is a lot of passion."

WON'T LEAVE HOME WITHOUT: Morning exercise.

FAVORITE QUOTATION: "Problems are someone's opportunities."

CURRENT PUBLIC COMPANY BOARDS: The Hershey Company, Tyco Intl. Ltd., Wachovia Corporation, VF Corporation.



how do you incentivize people who are already well compensated?" The new comp committee decided to grant premium options to Breen in an effort to tie his pay more closely to the company's turnaround. If, for example, Tyco's stock was trading at 25, the options wouldn't come into play until the stock hit 30, then 33, and then 35. There were three different grants at gradually increasing targets. "In effect," says Siegel, "Ed Breen's long-term compensation is zero without appreciation in the stock price."

Breen's "other compensation," which includes perquisites, personal benefits and gross-ups, has declined significantly since he joined the firm. In 2003, it was worth nearly \$425,300. In 2005, it had dropped to \$186,400. "We really wanted to get those into good governance practices," McDonald acknowl-

edges. "Ed has been very supportive of that. It hasn't been pushed on him."

When McDonald joined Tyco in 2002, he already had been a member of The Hershey Company's board since 1996. But at that time Hershey's largest shareholder, The Hershey Trust Company, had asked the board to pursue a sale. "I accepted Tyco because I thought Hershey would be sold and the board disbanded," says McDonald.

As the board began looking for a buyer, McDonald—compensation committee chair at the time—had another big task ahead of him. "Hershey was a company that had assumed it would never be sold," explains Marcella Arline, Hershey's senior vp and chief people officer. "Our change-in-control plans were very old and not at all competitive." McDonald and the compensation committee started from scratch to be

sure Hershey's employees would be taken care of in the event of a sale.

"We started with a change-in-control for hourly employees," says McDonald. "We had to go through change-in-control agreements at all levels to be sure we did the right thing by our employees." On the one hand, he says, the committee didn't want to create an overly rich plan that would prevent shareholders from benefiting from the sale of the company. Yet they wanted to know that employees would be protected.

From March to July, McDonald and the committee put severance plans in place for every employee. "It was a lot of eleventh-hour work," says Rick Lenny, Hershey's chairman, president and CEO since 2001. "Mackey, the compensation committee and the full board did what had to be done."

Eventually, however, the community outcry and an investigation by the Pennsylvania attorney general changed the Trust board's mind. In September 2002, 10 of the Trust's 17 board members reversed their decision, the Trust retained its Hershey shares, and the company continued on as is.

McDonald, an early proponent of moving production to lower-cost markets, has also been a prime mover on the board of Wachovia Corporation, where he encouraged outsourcing. As CEO of VF, "he did that before many companies did," says Krol, "and that helped VF stay in business while a lot of manufacturers failed."

At a Wachovia board retreat, CEO Ken Thompson remembers the topic of outsourcing creating a heated discussion. "He really broke a logjam for us when he said, 'You've got to do this. The board will support you.'" According to Thompson, "Mackey is one of those guys that doesn't dominate discussions, but when he says something, everybody listens. There's a deep well of respect for his perspective, knowledge and insight."

"I believe you have to have board members who help to resolve issues," McDonald demurs. "I'm low-key, but at the same time I want to come to a decision." ○