



EXECUTIVE REMUNERATION STATE OF PLAY: 2016



Executive pay and termination packages have become a focus of public attention. Particularly in countries such as Australia where the vast majority of people have a vested interest in what companies are reporting and how they are performing financially due to compulsory superannuation policies.

In an economic downturn, where share prices are decreasing and profits missing market expectations, questions are being asked as to why Executives are getting paid what they do!

In Australia, nine out of ten adults believe that Chief Executive Officers (CEOs) are overpaid; 79 percent believe executive salaries should be capped; four in five believe high executive salaries do not increase company performance; and almost two-thirds of people believe high executive pay leads to higher risk taking (Colmar Brunton 2009; Ferguson 2009).

Real CEO pay grew by nearly 500 percent during the period 1971-2008, whereas real average weekly earnings grew just over 150 percent over the same period (calculated from Noble Lowndes Cullen Egan Dell 1994; Shields, O'Donnell and O'Brien 2003; Egan 2009).

So how do Executives get paid and who makes the decision in regards to their remuneration packages?

The press and some politicians tend to compare the compensation of corporate executives with the pay received by the average worker, however, corporate boards and compensation committees typically benchmark against "peer group" pay; they compare their CEO's package with that offered to his or her peers at competing companies.

Board members also go beyond benchmarking and instead use multiple lenses to evaluate compensation via a more complex and rigorous assessment of both internal and external factors.

The Productivity Commission (Productivity Commission 2009:xxiii,73) argued that in aggregate 'executive remuneration has grown at similar rates to company performance' as evidenced by the fact that 'executive pay has tracked the (ASX) accumulation index' with 'a strong correlation between pay and company performance'. The ASX200 is an index of the cumulative value an investor would have after 1 year if they invested in Australia's 200 largest listed firms and, after receiving dividends each year, took none of the dividends as income and instead reinvested the full amount of the dividends in the same companies.

But this is changing...

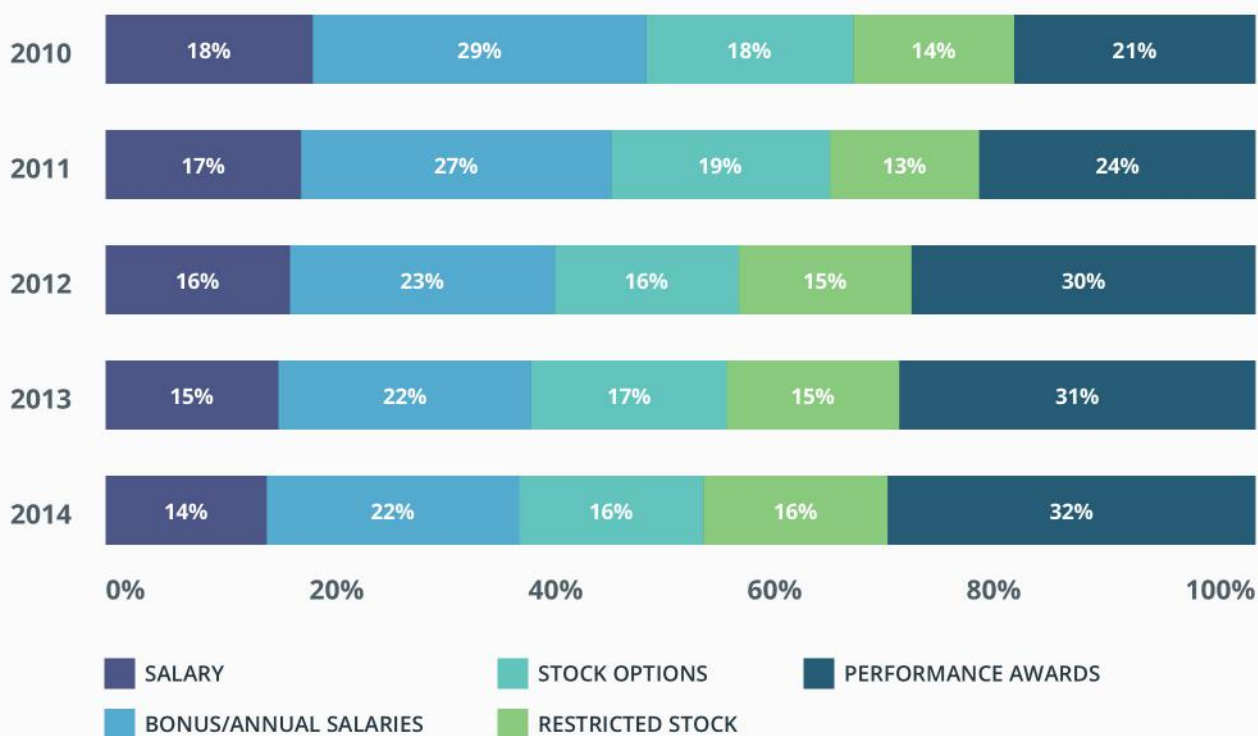
Productivity theories explain this growth in terms of the economic performance of CEOs: it is simply the CEO's fair share of the corporate performance they deliver. There are several variants of this theory. A 'complex job' variant poses that the work of CEOs has become relatively more complex in recent years, requiring higher levels of skill than previously.

The 'complexity' variant has additional problems: CEOs are not the only people who make a corporation profitable. The majority of Australian workers have also faced increased work pressure (e.g. Morehead et al. 1997), and a majority of employees experience overload at work, leading to poor work-life interaction (Skinner and Pocock 2008). All workers within a corporation contribute to its profitability, and if it becomes more profitable it is not immediately obvious why the senior management would be the only ones to benefit. CEOs appear to be extracting gains far beyond those attributable to higher productivity.

With globalisation, the market for senior executives has also narrowed in recent decades, so that Australian firms now have to offer higher remuneration to attract or retain CEOs (Productivity Commission 2009:110-2).

With volatility and immense change across all sectors, board members must determine the specific objectives it has for the CEO and how it will measure and reward the individual for achieving those objectives and milestones. It must also factor in any challenges associated with the role and evaluate the differences and expectations of the CEO relative to the market, such as aggressive growth, IPO, M&A, sale or turnaround.

THE GROWING EMPHASIS ON PERFORMANCE IN CEO COMPENSATION



SOURCE: THE WALL STREET JOURNAL/HAY GROUP | 2014 CEO COMPENSATION STUDY BASED ON A SAMPLE OF 300 LARGE COMPANIES

Personal motivations must also come into play: will an executive thrive on a low-base salary, with high potential payouts from incentives, or would a more balanced pay program be more compelling?

His or her pay should reflect the company's overall compensation philosophy and corporate culture. In our view compensation has to be related to the productivity that the executive provides the company; i.e. they get paid for their performance!

We also believe remuneration needs to be created in the context of how others in the organisation are paid. Neutral metrics, designed by boards that have long-term interests in the health of the company, are crucial. Restricted stocks are increasingly on the agenda where the market itself figures out the value the executives have created.

The world of Executive remuneration is continually changing. If you need any advice as to how to structure a remuneration package for an executive or are an executive looking to know what you are worth in the market or seeking career advice, please contact us at Optimum Consulting.