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Subject: Executive pay KISS'd

A few of us have been around long enough to remember that ***every*** time the economy slumps, executive pay gets a flogging. Again, we have seen frenzied statements in the media about unwarranted pay levels when corporate performance is diving; but too often, commentators have benchmarked current company performance with old remuneration reports (including promotions and legal entitlements), which is like comparing apples with lemons.

Selective analysis of very few cases has distorted the reality of the overall situation, as indicated recently by Gary Banks, chairman of the Productivity Commission. Nevertheless, the political consequences include the Federal Government's perplexing approach to executive termination payments: in particular, new legislation will require shareholder approval for termination benefits exceeding 12 months average base salary. Work is still needed on the regulations defining base salary and specifying which benefits to include, but it is inevitable that some companies will be tempted to boost guaranteed pay. The likely outcomes of a boost include a corresponding reduction in variable cash incentives, or an increase in overall remuneration cost – surely neither outcome is desirable.

Adding to the complexity around executive pay, employee share schemes are to be scrutinised by the Economics References Committee, which is to report by 17 August; however, the Federal Government is already proposing to stop the deferral of tax liabilities on vested, but unexercised share options.

Despite this increasing regulation of executive pay, employers should not be distracted from developing a suitable executive remuneration strategy. If reward for performance is a critical objective, company boards should address:

- Maturity of the business and the market sector
- Strategies for organic growth or transformation
- Realistic timeframes for change and sustainable results
- Alignment to market practice – industry and location
- Competitor demand for available talent
- Excellent communication with all stakeholders, despite the challenges of reporting compliance

For example, large companies in complex industries needing a major transformation may have to recruit executives from global talent pools. If the best candidate is found overseas, then this executive will expect a globally competitive compensation package that is often greater than any received by a locally grown executive in the same market sector. Of course, the employer must also establish with the new executive what is expected from such an investment – ie. there should be a performance contract that includes variable pay for variable achievement, and a repatriation strategy.

While performance expectations will vary for every organisation, the enduring principle is ***commensurate reward for shareholder returns over a proper timeframe***. Paying an annual bonus for a target earnings per share is rarely suitable for a CEO; likewise, a share option plan is no panacea for rewarding executives. Share options may suit some developing companies in expanding markets, but they are often wrong for mature companies in stable markets that aim to deliver shareholder returns via dividend payments – and what happens to options now sunk in the Mariana Trench?

Any equity-based incentive program should also address the reward timeframe most appropriate for sustainable results. For example, if a major business transformation will need a few years to prove a return to shareholders, then the executive's reward program should reflect a similar period. However, open communication of such a program is burdened by the annual "value at grant" that must be reported to shareholders.

Of course executive pay not simple, but the aim is to Keep It Strategic & Straightforward – while it's always necessary to align reward strategy with business strategy, the design process should be clear-cut and not encumbered with inappropriate regulation, or a myriad of performance measures and delivery methods that confuse all stakeholders.

Simon Hare

www.haregroup.com.au