"Confusion Reigns on Remuneration"

It is time to go back to the drawing board on executive remuneration. The current system is so complex that shareholders are totally confused. Even worse, boards of directors have eschewed creative solutions in favour of pandering to proxy advisers.

An analysis of executive incentive programs in Australia published at the weekend by BlackRock shows that boards who play by the rules set by proxy advisers get 95 per cent shareholder support for remuneration reports at annual meetings.

Caution among boards has resulted in inappropriate performance measures being used for remuneration payment hurdles, according to BlackRock’s head of corporate governance, Pru Bennett.

She says relative total shareholder return is not appropriate for many of the companies that utilise it. Bennett urges companies to break out of the straitjackets and not just structure packages to please the proxy advisers.

However, despite an apparent cookie-cutter approach to pay in many boardrooms, the oversight of remuneration is absorbing an increasing amount of time. One prominent chairman says his board now spends 30 per cent of its time on remuneration. This reduces the time that can be spent on more productive issues, such as strategy.

Remuneration and its management have become unwieldy partly because of government regulation. Boards are ticking the boxes to avoid the prospect of a strike against their company’s remuneration report.

The “two-strike” rule has forced engagement, but it is being used for purposes that were not intended.

Much of the blame for executive pay getting out of control rests at the feet of executives who are always willing to put out their hands for more money.

When the smartest people in the room focus on lifting their pay, the boards of directors often don’t stand a chance.

How else to explain the record numbers of executives joining the millionaires’ club? The number of chief executives in the S&P/ASX 300 who had total annual remuneration of more than $1 million rose 16 per cent to a record 226 in 2012,
according to *The Australian Financial Review*'s 14th annual survey of executive salaries.

Executives have become adept at convincing boards to agree to packages that include significant incentive payments despite poor financial performance or poor share price performance.

The so-called "balance scorecard" has been used by companies to boost executive pay when financial objectives have not been met or losses have been incurred. The scorecard involves tying incentive payments to strategic initiatives, leadership mentoring, cultural change and brand and reputation enhancement.

In some cases, long-term incentives have been structured to increase the amount of deferred equity incentives. For example, some companies are allocating shares on a discounted market value based on accounting valuations that incorporate the risk associated with performance hurdles. These valuations bear no relationship to market prices.

The Australian Securities and Investments Commission needs to revisit the issue of executive remuneration disclosure.

The disclosure of remuneration in annual reports is now a hotchpotch of statutory disclosures, voluntarily compiled “take home pay” tables and, in some cases, a mix of both.

The vast majority of companies in the S&P/ASX 300 are trying to make it easier for shareholders to understand how top executives are remunerated, but many companies are enjoying the atmosphere of confusion to make it harder than ever to understand what executives are paid.

Staff researchers who compiled the *Financial Review*'s 14th annual executive remuneration tables came across many examples of companies seeking to obfuscate and block any clear understanding of who was paid what.

These techniques range from not publishing the prior year numbers in the same table or even on the same page, not adding up the rows of numbers that make up total remuneration, running remuneration tables vertically rather than horizontally and excluding non-cash benefits from disclosures.

Shareholders’ confusion is growing thanks to the shift in the composition of pay packets to more deferred share incentives and less cash.

The value of short- and long-term share incentives that vested in the year just passed is often impossible to find in annual reports.

Bennett says more thought needs to be given to performance hurdles that are suited to individual industries and not adopt “one size fits all”.

John Egan, the founder of executive remuneration consultants Egan Associates, ran some numbers for Chanticleer and found that the tougher times in the economy and
the market are being reflected in lower bonus payments to chief executives of the S&P/ASX 100.

He found that a higher proportion of bonus payments were being deferred.

In the financial services sector, which is the driving force for higher pay, the level of deferral under annual incentives is higher than in most other sectors, at 50 per cent.