

Executive remuneration: Leadership required

By Paul Kelly

In the midst of the AGM season, the predicted rebellion by many shareholders with respect to perceived excessive executive remuneration is underway. Retail shareholders, stung by capital losses, diminished yields and, in some instances, diluted holdings, are casting a jaundiced eye on the REM report and they're not buying it.

There are a lot of players in this game – boards, politicians, the Productivity Commission, the AICD, remuneration consultants, institutional and retail investors and, of course, the managers themselves.

But, if you trawl through the many comments, you can boil the issue down to one overriding grievance – the payment of large packages to managers who have not performed. Some have ridden the share price all the way down and then, on the basis of contractual obligation, have departed with fat wallets or been granted a remuneration increase, an outcome completely at odds with what the agreed contract was meant to deliver.

This is mostly justified on two grounds:

1. the contract required it; and/or
2. if we're not prepared to pay, we won't get the quality of management we need.

Retail shareholders are mostly driving this debate and the platform on which they're standing is, for the most part, a moral one. "How can this be fair" and "have some Board Chairs and/or CEOs no sense of what's right, in particular given the financial climate of the past couple of years?"

There is a sense that at least some corporates have decided simply to tough it out. Wait for the good times to return, watch the share price recover and it's back to business-as-usual. If that's true, it is a pity because there will be a significant disconnect between companies (Boards) and investors on a critical topic that, in my view, will not simply fade off radar screens. Resentment is high, it will have stamina and, notwithstanding any regulatory impost, the rubber stamping of REM Reports is over.

To date, there has been a significant missing ingredient, viz. leadership on the issue from the CEOs themselves. Executive remuneration is such a 'hot button' that you might have expected more CEOs to address the reality of the GFC and to ask 'what's fair?' Perhaps some have, but they've been pretty quiet.

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In a notable interview with George Negus on “Sixty Minutes” many years ago, the then British PM, Margaret Thatcher, said that when you take something for nothing, you take it from someone else. That is as true of a thief, or a wage increase without productivity gain as it is of an under-performing CEO.

It is long overdue for CEOs who’re paid extremely large sums of money relative to the wider community to ask themselves what would be the right thing to do from a shareholders’ point of view instead of addressing entitlements under a contract that failed to serve the company well.

Let’s simplify and improve the transparency of remuneration structures so that shareholders can more easily understand them. Let’s see some remuneration sub-committees send signals that they’re willing to support the strength of shareholder views. Let’s see some boards and management elect to defer bonuses where current corporate performances don’t merit them and let’s do this, when warranted, simply on the weight of shareholders’ opinion.

What is also required is a deeper dialogue between Boards and all their stakeholders. It’s acknowledged that executive remuneration is critical to the fortunes of companies; but the days when investors simply acquiesced to whatever a Board determines to be appropriate are now gone and they may never return. Nor should they.

We’ve heard the argument about peanuts and monkeys – unfortunately, this argument hasn’t always borne fruit. There will never be a perfect remuneration arrangement, but Boards need to accept that “fairness” and “reasonable” are now two indispensable words in any discussion on aligning the interests of the owners of the company with those charged with running it.

It may be that this re-orientation does not suit some potential executives. Too bad. The agenda has been set and boards and managers can either be dragged along, or they can influence the outcomes.

Retail investors have discovered they have more support than they thought and they’re winning hands down in the court of public opinion.

Incidentally, the word rem in Dutch means brake. It is time to apply it.

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