An Expose On Panel 2: The CEO: Reconciling Compensation, Values And Value Creation

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Overview

CEOs play an important role in any company's success. Given the huge responsibility and critical role of CEOs, one would expect that they receive fair compensation for their work. Ms Wong Su-Yen, chairman for Marsh & McLennan Companies (Singapore) began the discussion on the topic of "The CEO: Reconciling Compensation, Values and Value Creation" by highlighting how some well-known CEOs were highly paid by their companies. She opined that overall increase of executive pay was due to the focus on succession and leadership development in corporations. She also compared the relative weight of base pay, short-term incentives and long-term incentives in CEO compensation packages with those of other managers and made the observation that weight of basic pay was less in CEO pay packages while short-term incentives comprised a significant portion followed by long-term incentives.

Executive Remuneration And Performance

What is the right level and mix of CEO compensation? The compensation ratio between CEOs of S&P 500 index companies and those of general workers in these companies has sky-rocketed from 201 times in 1992 to 350 times in 2012, causing CEOs to be viewed as being overpaid. Singapore is also experiencing a widening income gap between top executives and general employees. How then, does one justify this disparity in compensation and set appropriate levels of remuneration for top executives?

One suggestion is to focus on the extent to which CEOs target sustainable growth of the company, rather than on whether the CEO is able to keep the company running smoothly. Founding President and CEO of CapitaLand Group, Mr Liew Mun Leong, shared at length how his company leveraged on the Economic Value Added (EVA) system over the past 15 years to redistribute company profits between various stakeholders. Mr Liew emphasized that such profit

redistribution was dependent on the value created by the person, of which 70% and 30% are attributed to short- and long-term realisations respectively. He added that the procedure had to be transparent, approved by independent directors appointed by the board and discussed in the Annual General Meeting (AGM) to ensure fairness.

Similarly, Chairman of Oracle Financial Services Software Pte Ltd (Singapore), Mr Venky Krishnakumar, shared on the matrix he used to determine pay packages. There were objective measures to assess both the past results and future performance of a CEO. This, in turn, would determine the CEO's total remuneration package comprising base pay and short-term / long-term incentives. Additionally, there were subjective or discretionary measures of their performance, such as growth of brand value of the company, cohesion of employees, etc. He mentioned that it was much easier for shareholders to focus on the first criterion of objective measures of past results when assessing the fairness of a CEO's compensation. He emphasized, however, the importance of establishing objective measures of future performance in overall grading of CEO performance and linking this to compensation. This would facilitate the driving of sustainable growth for the company and be more beneficial to shareholders in the long run.

Regulations And Disclosures

Another topic covered by the panel was the different approaches to regulation of CEO remuneration. In response to the Global Financial Crisis, the Dodd-Frank Act was passed in the US requiring the reporting of the ratio of CEO' pay to that of average workers. However, this ratio is dependent on contextual factors such as company size, location of workers and workforce composition. Companies with large numbers of workers in high cost places and those with higher percentages of high paying jobs like biotechnology and finance will have lower ratios. Thus, concerns of potentially oversized compensations may still be inadequately addressed. Australia has a "two strikes" rule which requires a company's entire board to stand for re-election (a "board spill") if 25% of its shareholders vote against a company's report on remuneration over two consecutive AGMs. This, however, may lead to unintended influence over shareholders' decisions at crunch time to avoid board spills which may potentially harm the company. Countries with laws that are too prescriptive may also end up having companies adhering more to the letter of the law than to its spirit.

President and CEO of Singapore Investment Development Corporation, Mr Colin Low, also shared some perspectives on CEO remuneration disclosures in various jurisdictions. US regulations are most open, transparent and prescriptive. In the Middle East, the Abu Dhabi Stock Exchange requires CEO salary to be declared in both annual and corporate governance reports but does not specifically define the reporting format. This results in companies reporting for the namesake of transparency that is neither standardised nor comparable. Culture also apparently plays a part. Board practices in Japan are such that many decisions are made over lunches or evening receptions. CEO salaries are not openly discussed in Germany. In contrast, boards in France are moving towards specific compensation rules comprising equal proportions of fixed salary, long term incentives, and bonus tied to very specific short term targets such as talent management and moving into areas of new businesses.

Risk Management And Sustainability

In order to manage risks in compensation design, Ms Wong highlighted that companies had implemented deferred bonuses, longer performance periods, retention periods, long-term shareholding requirements, clawbacks, etc. She also noted that one of the key elements of sustainability was to incorporate risk management into the governance framework for compensation. Options being explored include increasing the role of the risk officer in incentive plan design and input of performance evaluation.

Amidst the active discussions with the audience, several key issues were raised. Ms Wong believed that CEO tenures which are generally less than 5 years would affect one's frame of mind and behaviour. While boards may strive to moderate CEO pay, Mr Liew viewed that its effectiveness depends on the CEO as one can always find reasons to justify what the CEO is being remunerated. Mr Low was of the view that the vicious cycle of rising executive compensation is due to benchmarking exercises based on industries.

While every board would strive to design or structure an appropriate CEO compensation, the journey is almost definitely fraught with challenges. Market conditions, talent pool issues, supply and demand factors, amongst others, serve to complicate this process further. Clearly, there is no 'magic bullet' solution to this. Perhaps the key lies with the values and character of the CEO. Perhaps it is a matter of principles and common sense. One thing is for sure – there will be no absolutely right or wrong answers. ■