ARE YOU PROVIDING THE RIGHT PAY PACKAGE FOR YOUR C-SUITES?

Tan Yong Fei, Senior Consultant, Executive Compensation, Towers Watson South East Asia

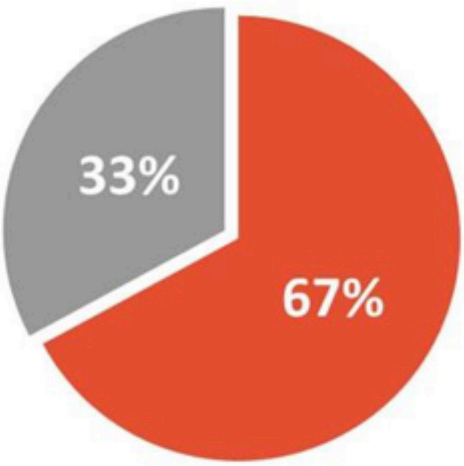
Singapore, through its Code of Corporate Governance, encourages companies to provide long term incentive schemes for directors and management that are aligned with the firm's long term interests and risk policies to attract, retain and motivate talent – without paying excessively.

3-part compensation model

Increasingly, a three-part compensation model pegging compensation to a firm's long-term financial performance is becoming the norm. In addition to basic pay and the annual bonus, the trend now is to include as executive compensation, a third variable component dependent on the firm's financial performance over a multi-year period.

Towers Watson's research on public disclosure for Top 70 SGX listed companies shows that around two-thirds of these companies have adopted this compensation model in 2014.

Prevalence of 3-Part Compensation Model within Top 70 SGX Companies



Source: Towers Watson's 2014 research on public disclosure for Top 70 SGX listed companies (i.e. Market Capitalisation of SGD2b and above

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Long-term incentive plans

However, deeper insights would reveal that a significant number of them (37 per cent) have approved Long-Term Incentive (LTI) plans but do not utilise them. This could be due to lack of experience, bad experience, or cost concerns and dilution concerns (for equity-based LTI). In Singapore, performance share plans are typically linked to market-based metrics such as absolute and relative total shareholder return. There are also restricted share plans which are usually linked to operational metrics.

One application of long-term compensation is when a loss-making firm that cannot afford to pay bonuses wants to retain and motivate key executives. The company can provide an employee share option scheme with vesting condition subject to the company regaining profitability. The accounting expense can be reversed if the company underperforms.

This approach was used by a publicly listed company in the food manufacturing and distribution business. The company's financials were on a downward trend with losses incurred in a recent financial year. Retention of key executives was crucial to ensure proper execution of the turnaround strategy.

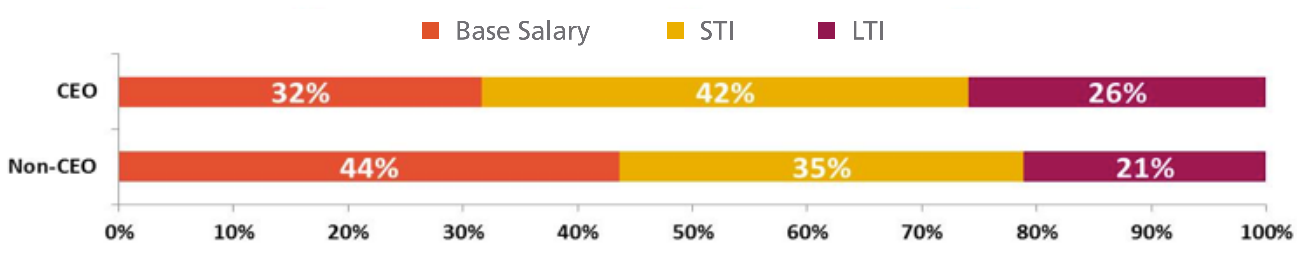
A second application is in the incentive plan for a fund management company using total shareholder return as a metric. The company wanted to align its fund manager's compensation to the fund's performance instead of the parent company. It was decided to use phantom share grants with an initial price set using Net Asset Value per share. The performance metrics included three-year cumulative net profit after tax growth target (in terms of fund management fees collected), net third party injections (raised from investors) as well as change in market value of the fund between vesting and grant of the phantom shares.

Pay mix

From a pay mix perspective for top executives, we expected at least a 50 per cent: 50 per cent mix of fixed versus variable compensation. This was validated by data for SGX's top listed companies as more than 50 per cent of CEO and C-suite's total compensation is provided in variable components (denoted by STI and LTI).

However, the focus on STI or annual bonus has always been lopsided relative to LTI. This may suggest that heavier emphasis is being placed on short-term performance at the expense of longer term performance.

3-Part Model



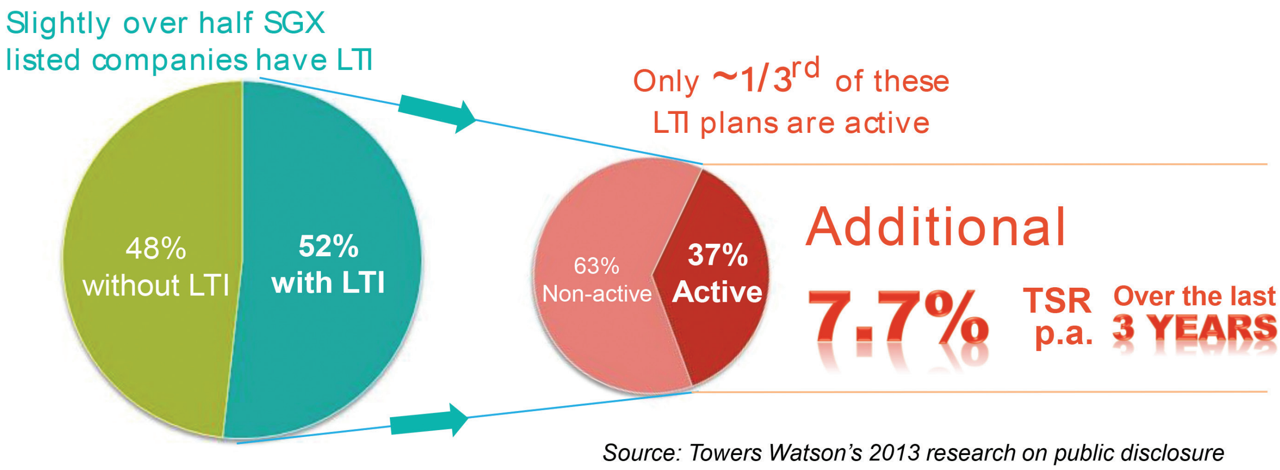
Are you providing the right pay package for your C-Suites?

Pay for performance

Finally, we analysed the performance of all SGX listed companies over a three-year period to find out if companies who have active LTI plans do actually outperform those who do not.

Indeed, the results were as expected. Companies with active LTI plans outperform those who do not by a significant 7.7 per cent p.a. on Total Shareholders Return.

While there are many other factors that may have contributed to the outperformance of these companies, there is reason to believe that an appropriately designed and well executed LTI plan is one of the key drivers of a companies' longer term success. ■



Source: Towers Watson's 2013 research on public disclosure