

Executive Remuneration: Governance Trends and Best Practices

“Disclosure of executive remuneration as a corporate governance control measure in South African listed companies”



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Background to study

- **Main problem:** Corporate governance control measures are ineffective in addressing problems common to the modern corporation.

- Symptoms:

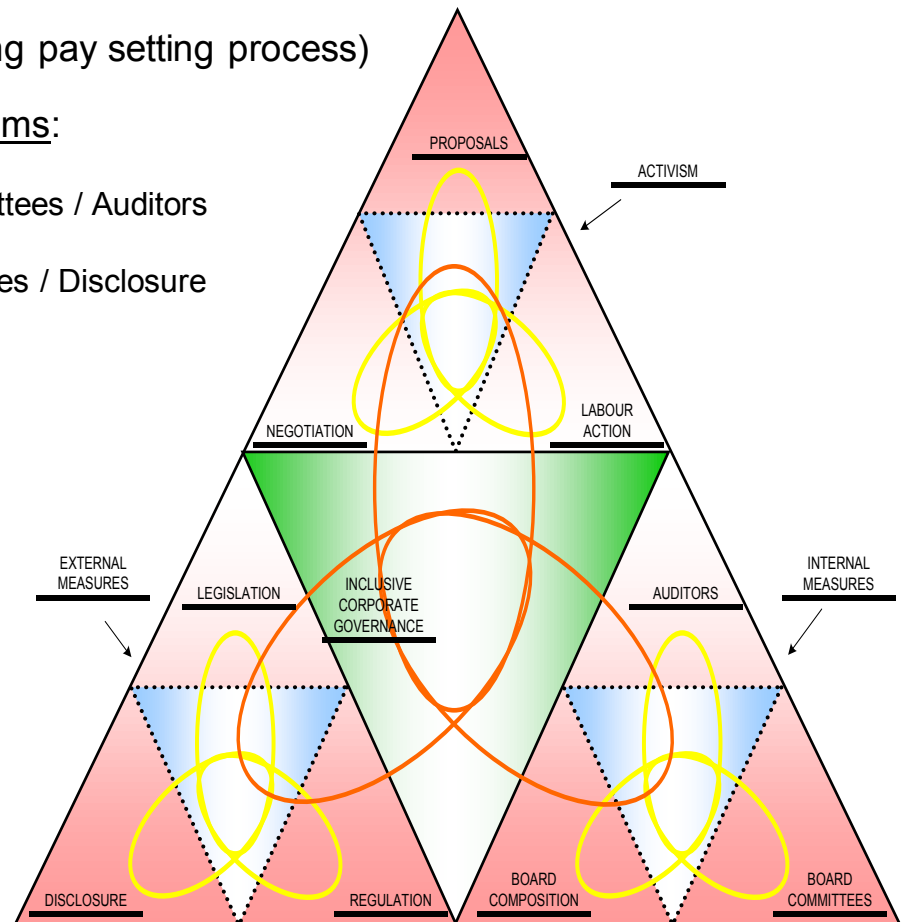
- Excessive executive remuneration
- Conflicts of interest
- Ineffective processes (including pay setting process)

- Measures to address these symptoms:

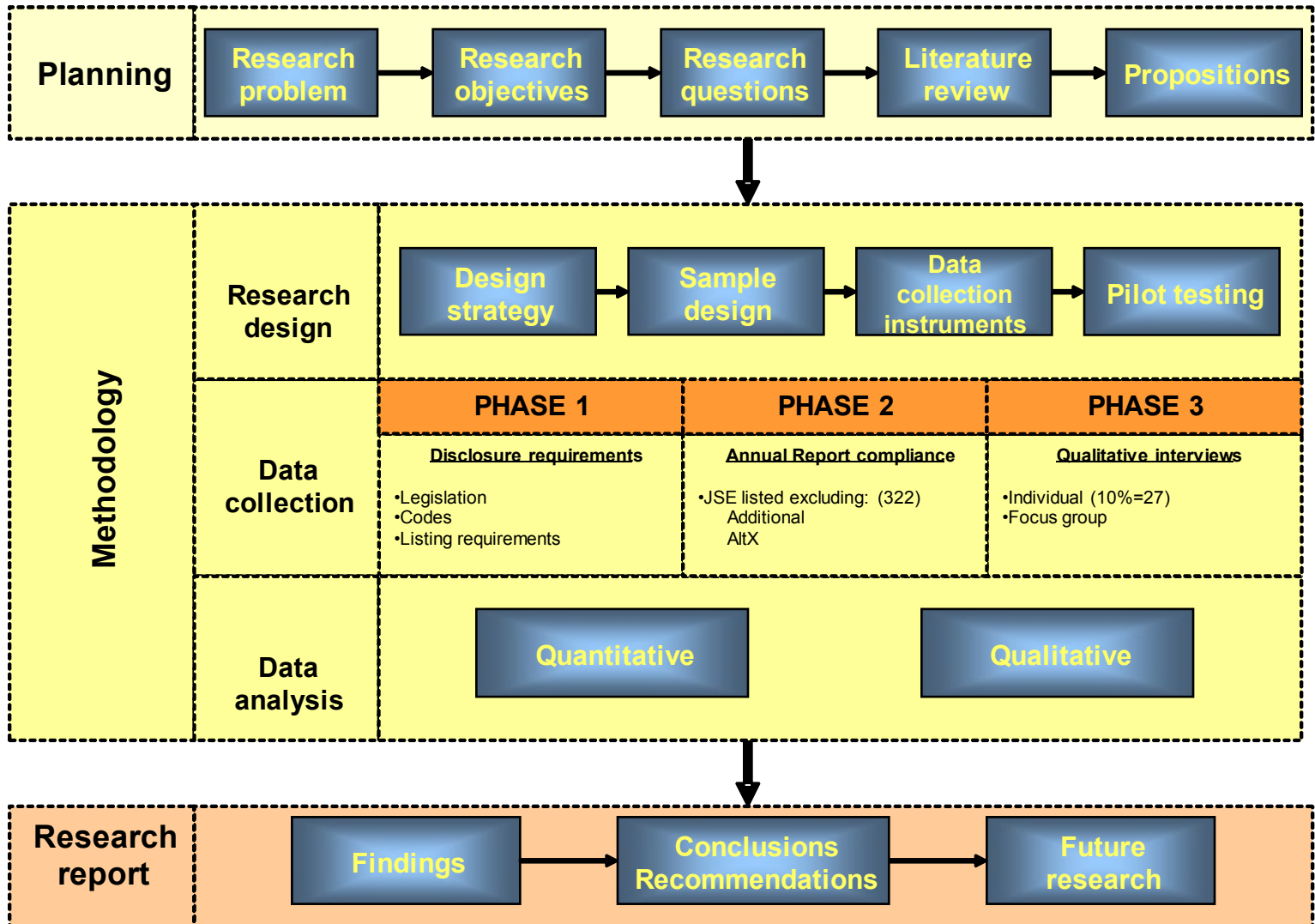
- Internal measures
 - Board composition / Committees / Auditors
- External measures
 - Legislation / Regulatory codes / Disclosure
- Activism

- **Objective:**

To understand how disclosure of executive remuneration could contribute to a more effective corporate governance system



Research design

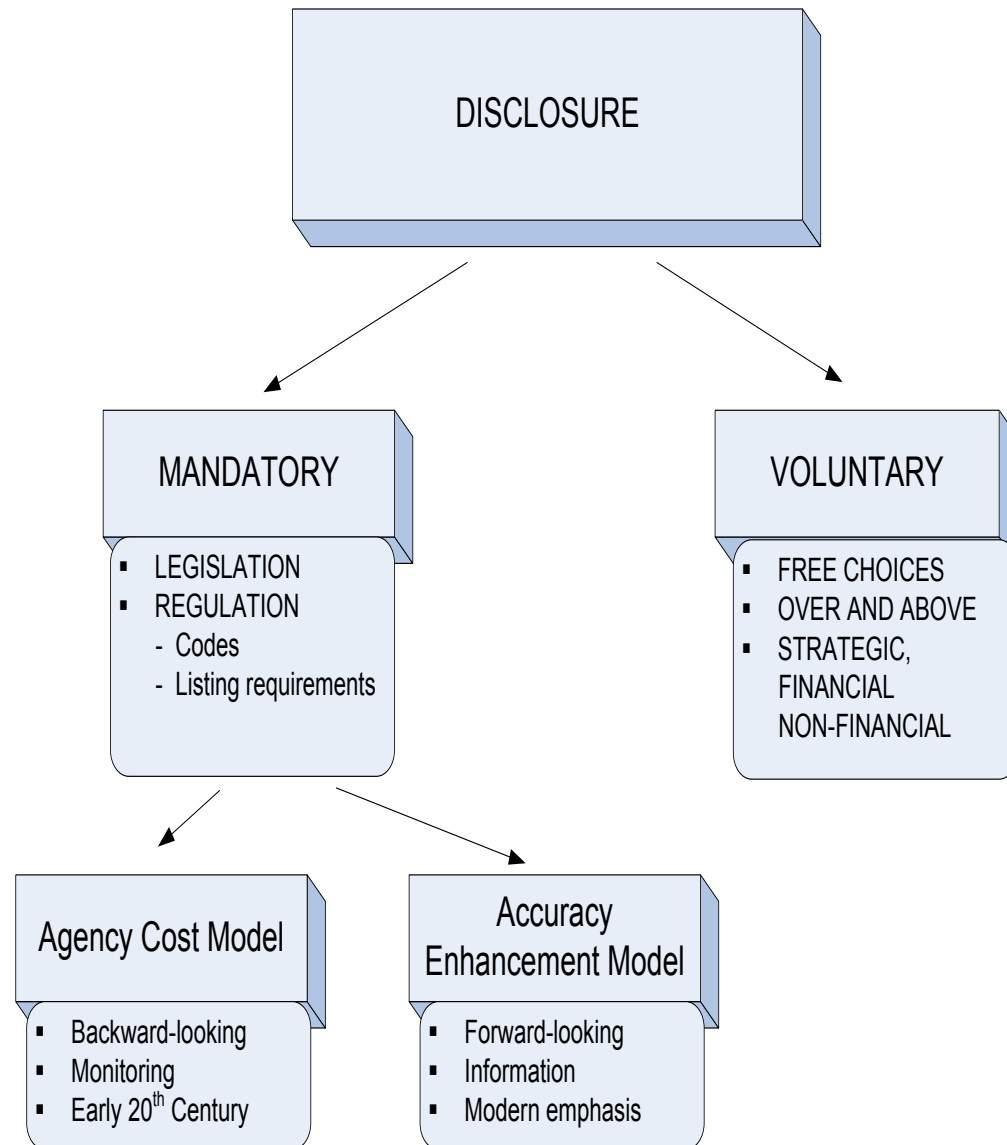


Understanding Disclosure

- Information asymmetry and agency conflicts create the need for disclosure

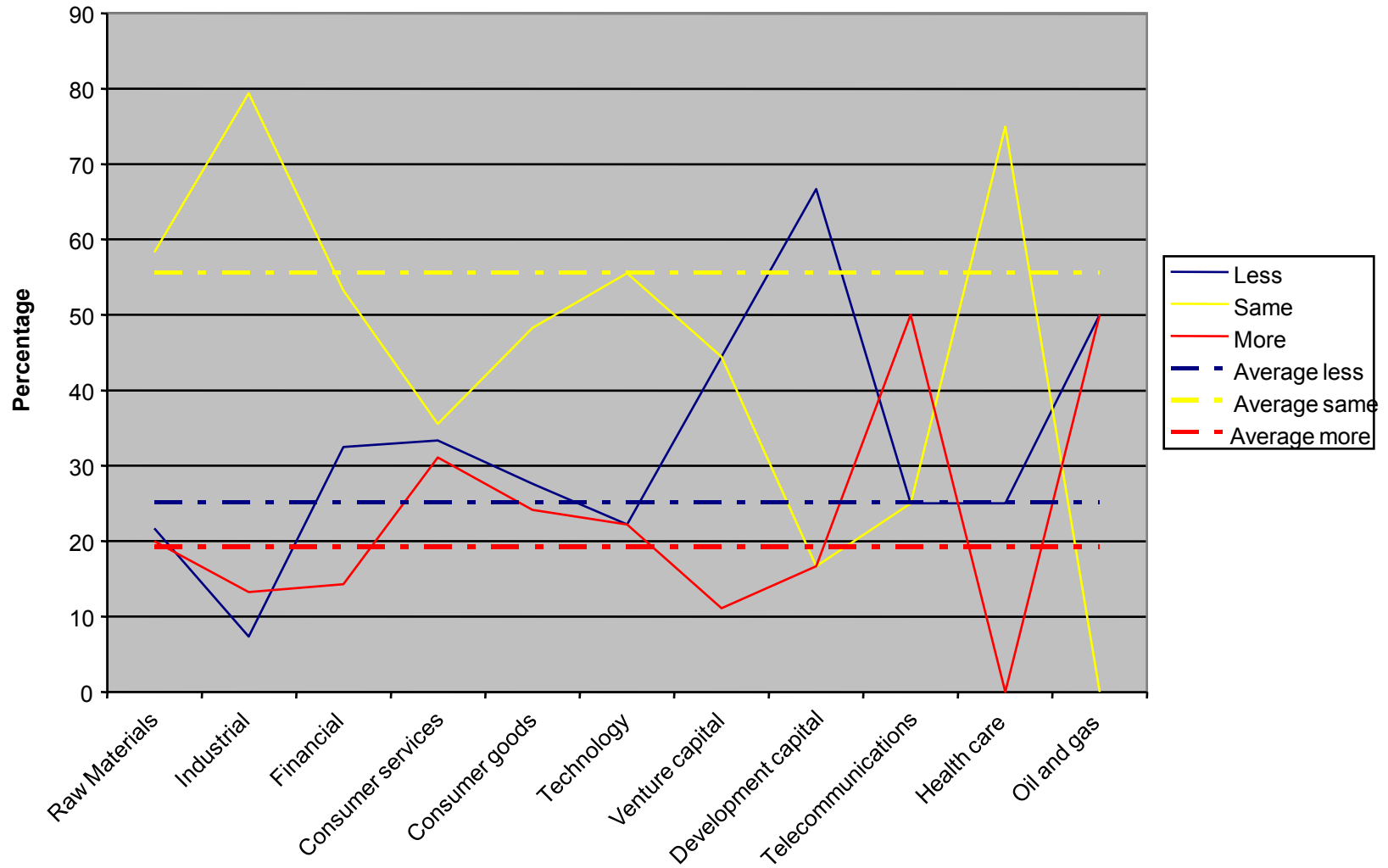
(Healy & Palepu, 2000)

- Intended vs Unintended consequences
- Full vs Limited disclosure
- Forward vs backward looking disclosure
- “Comply or explain” is still rules-based

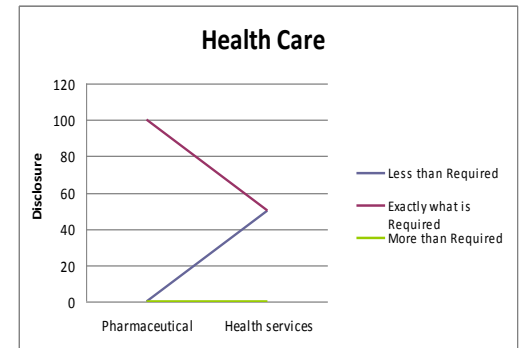
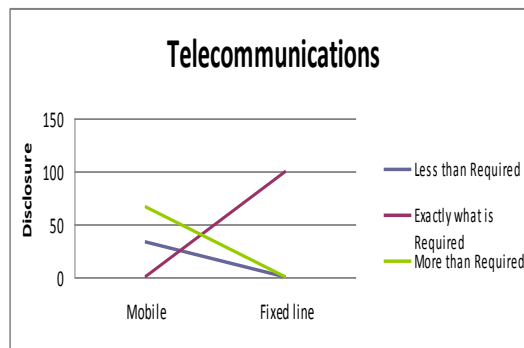
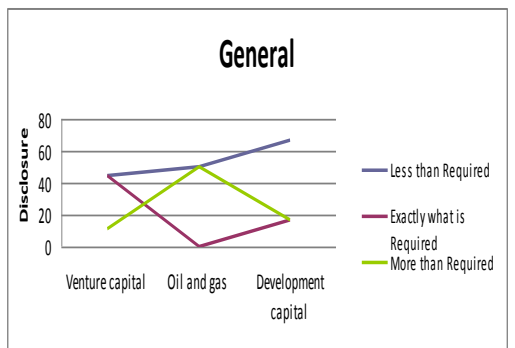
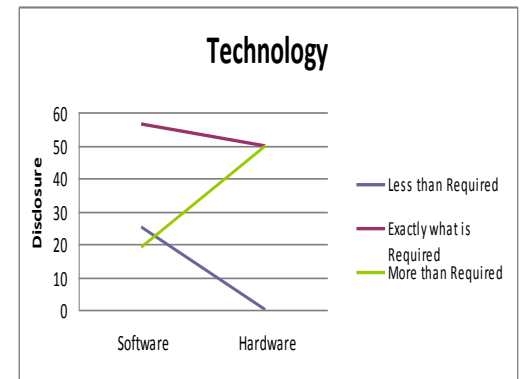
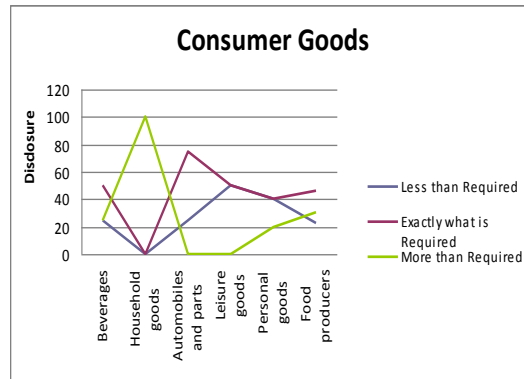
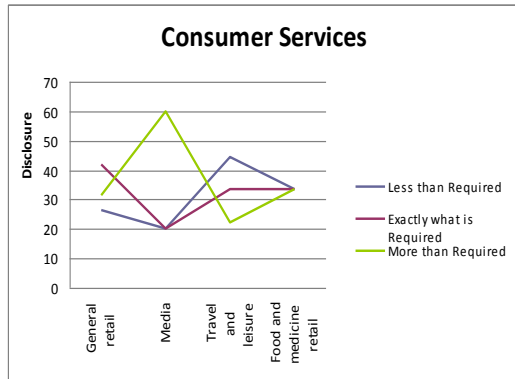
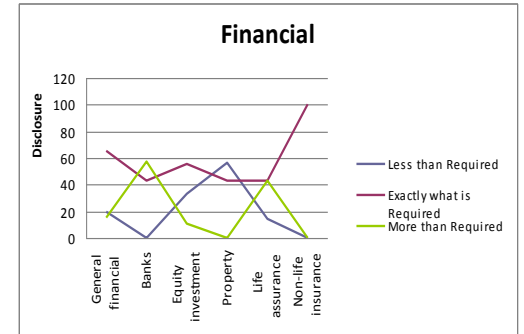
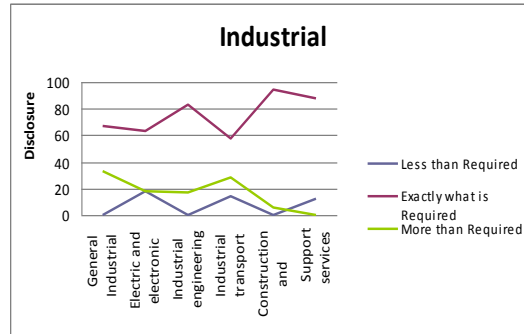
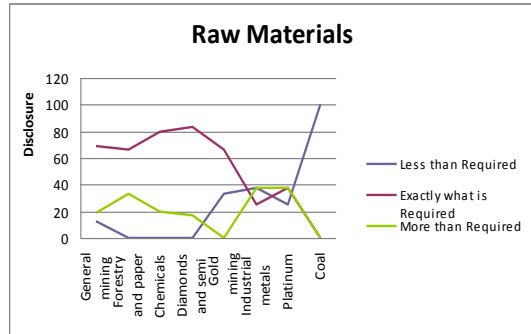


Disclosure analysis per industry

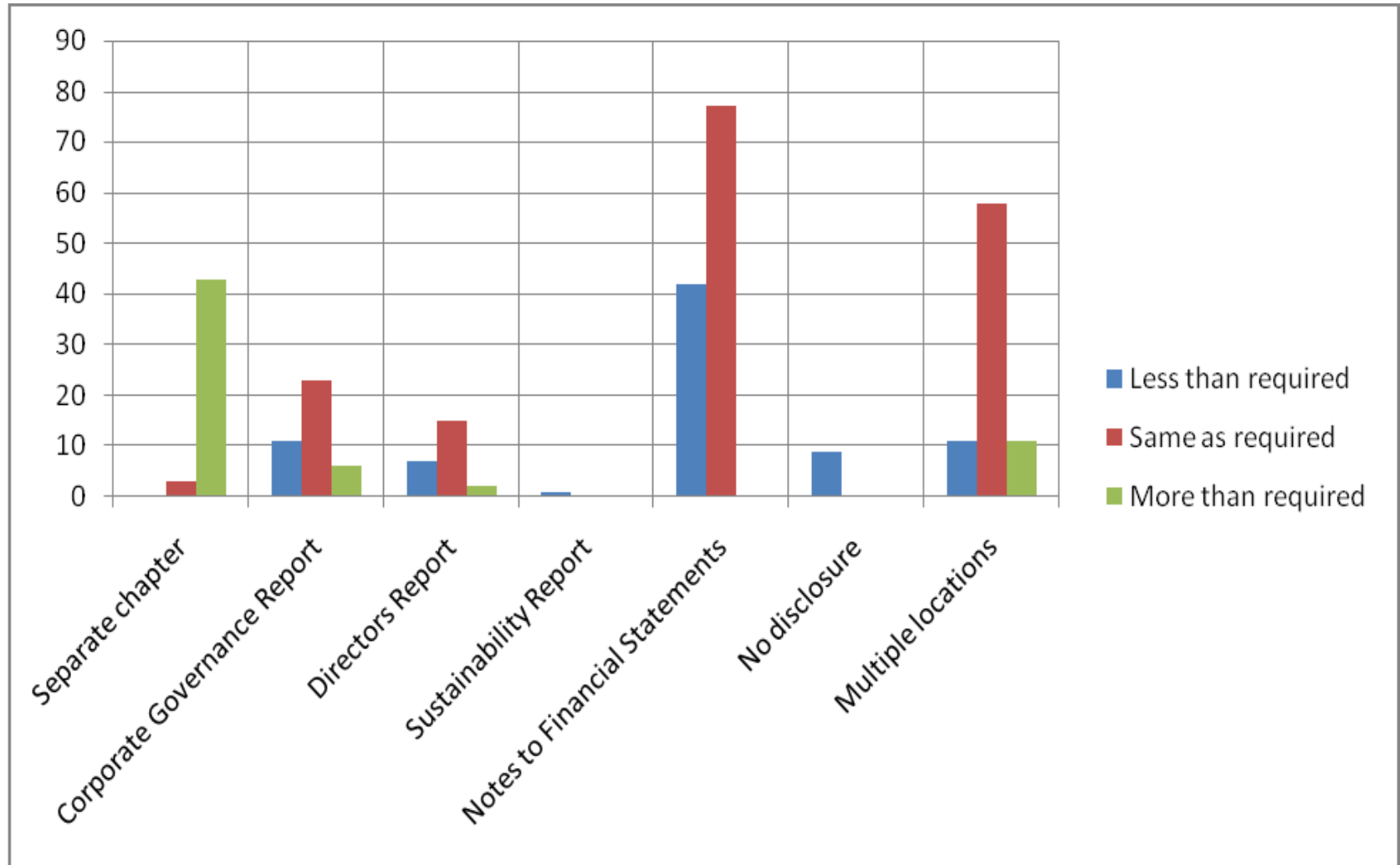
Annual Report Disclosure Analysis



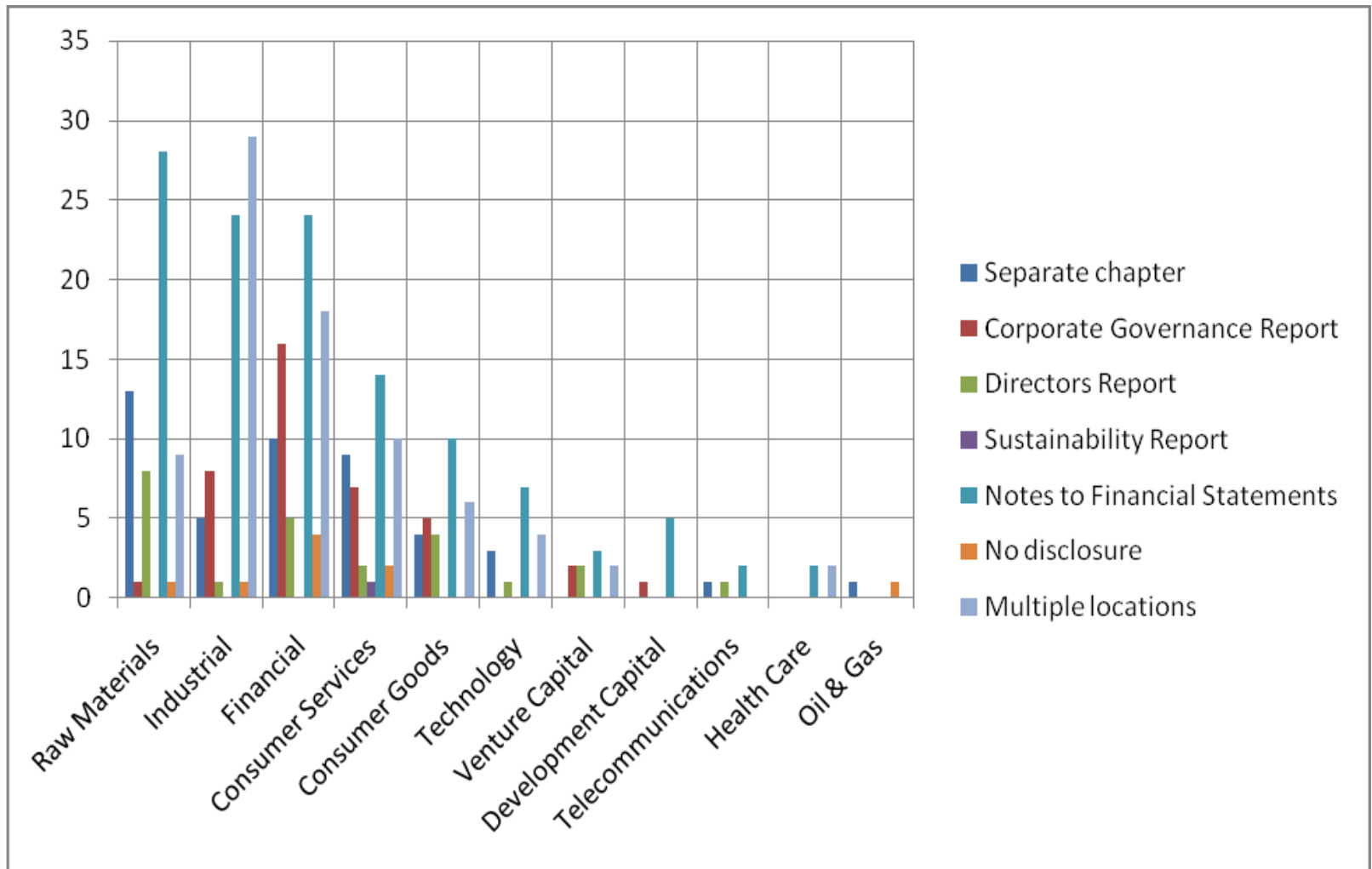
Disclosure analysis per sector



Quantitative analysis (Location of disclosures)



Quantitative analysis (Location of disclosure)



Quantitative analysis (Disclosed content)

Less than required	Exactly what required	More than required
Aggregate disclosures	Fragmented disclosures in Reports	Comprehensive remuneration chapter
No stated remuneration philosophy	Weak statement of remuneration philosophy	Detailed remuneration philosophy
No performance criteria	Weak link between performance and reward	Details of link between performance and reward
Different locations	Different locations	Single location in reports
Lacking details of LTI's	Details of LTI's awarded	Details of LTI criteria and awards

Qualitative analysis (P1)

Corporate governance failures result from ineffective internal and external control measures and systems

- Corporate governance frameworks
 - Agency theory followed in SA (King II) – 75% compliance
 - SA Regulations focus on symptoms: What – not WHY / HOW
 - Multinationals follow stricter international listing rules
- Unequal positions of shareholders and managers
 - SA executives hold the power over shareholders
 - Abuse of surveys and advice
- Board and Board Committee members
 - Lack of knowledge, experience, assertiveness, independence, skills
 - Rubber stamp / tick box compliance mentality
 - Strong following of “Comply or explain”
- Lack of capacity
 - Dedicated corporate governance & executive remuneration staff
- Quality of management data
 - Poor / manipulated proposals
 - Lack of independence of consultants
- General consistency in the appreciation of the reasons for corporate governance failures, but significant differences in addressing it

Qualitative analysis (P2)

Both the levels of executive remuneration and the process for determination thereof are symptomatic of the failure of corporate governance control measures

Impact of ineffective corporate governance on executive remuneration

Research category	Impact on levels of pay	Impact on pay setting process
Disclosure less than what is required	Unfair increases	Subjective process
	Irrelevant factors used as basis for increases	Process driven by self-service
Disclosure same as what is required	Over- or underpaid executives	Abuse of process
	Pay ratcheting	Self-interest drives process
	No/weak link between pay and performance	Failure to apply mind
		Selective use of surveys
Disclosure more than what is required	Pay for underperformance	Absence of link between pay and performance
	Pay ratcheting	Manipulation of corporate structure to avoid disclosure

Qualitative analysis (P3)

Effective disclosure of executive remuneration determination processes and levels contribute to more effective corporate governance control measures

Factors influencing companies' disclosure choices

Research category	Disclosure choices
Disclosure less than what is required	Risk aversion (personal and corporate)
	Intended recipients of disclosed information
Disclosure same as what is required	Regulatory requirements
	Shareholder needs
	Historical practices (old habits)
	Shrinking effect of transparency
	Unwanted attention and risks
	Multiple listing requirements
	Strong compliance culture
Disclosure more than what is required	Understanding of potential value add
	Regulatory codes and requirements
	Knowledge and participation rate of Board and Board Committees
	Balance between commercial sensitivity and transparency
	Ethics
	Corporate culture

Conclusions

- Research problem : Corporate governance control measures have become ineffective
- Research objectives : Determine / understand how disclosure of executive remuneration could contribute towards a more effective corporate governance system
 - Balance internal and external corporate governance control measures
 - Apply backward and forward looking aims of disclosure
 - Disclose levels, determination process & measures, and philosophy of executive remuneration
 - Balance positive and negative consequences of disclosure
- Disclosure of executive remuneration in SA
 - Focused on WHAT more than on WHY and HOW
 - Fair compliance, but with inadequate disclosure requirements
 - Need to see disclosure and executive remuneration as strategic tools rather than merely a compliance issue
 - Training required for Board and Remuneration Committee members



Practical implications

- Combination of regulatory tools required for effective corporate governance is optimal – there is a role for each (legislation, codes, listing requirements, shareholder control)
- We need to understand the strategic role and value of these control measures
- Combination of internal and external corporate governance control measures is required
- Balance positive and negative consequences of full disclosure
- Board and RemCo must be vigilant, independent, trained and experienced enough to withstand attempts by executives to capture corporate governance processes
- Disclosure must be meaningful to shareholders (change requirements)
- Balance information needs of shareholders and other stakeholders with the interests of executives
- Use dedicated and professional capacity to drive executive remuneration and disclosure strategies in organisations



“Thank you”

