



UNDER THE MICROSCOPE: EXECUTIVE REMUNERATION

The rise of deferred incentives may go some way towards solving the issue of executive accountability but at the same time it is making the process of executive remuneration reviews increasingly complex and time consuming. *Phillip Evans* outlines a potential solution

Fear of accusations about fat cats lining their own pockets with little regard for employees have haunted executive remuneration decisions in the past few months. Ever since last year's spectacular falls from grace by just a few US financial institutions, Australian executive packages have come under increasing media and shareholder scrutiny.

In April, the issue made national political headlines when the Federal Government announced a productivity commission inquiry into executive remuneration in Australia. While releasing the accompanying issues paper, commission chairman, Gary Banks AO stated, "The inquiry will specifically examine whether the current remuneration arrangements are effective in driving corporate performance or whether they have the potential to lead to undue risk taking or other actions that may not be in the best interests of shareholders or the wider community." With the final report not due until December 2009, interest in executive remuneration is unlikely to disappear in the near future.

Also in April, Insync Surveys released the study CEO remuneration – a boardroom perspective, in which 625 directors were asked for their views on executive remuneration. Only 55% of those surveyed considered that their CEO's remuneration packages were appropriate. When it came to assessing senior management remuneration, that figure dropped to 50%.

The business environment has changed. The economic situation calls for cost cutting, and fixed remuneration increases

and incentive programs make a good target for immediate dollar savings. From a public relations perspective a new, cautious approach to remuneration makes sense.

The challenge is to be able to show direct benefits for the incentive payments being made. It's about transparency and traceability. If a benefit isn't demonstrable in the year the incentive payment falls due, defer the payment until the benefit has been shown.

A question of measurement

It seems obvious that executive remuneration has climbed well ahead of the consumer price index (CPI) over the last five years or so, but so too have the returns of the companies these executives are managing. Shareholders are not going to be satisfied with a CPI rate of return on their investments. How do you measure the contribution of a particular executive to a company's overall outcome, and how should that be reflected in your incentive compensation strategy?

Ideally executive performance bonuses should be structured to include both tactical and strategic elements. Just like key performance indicators (KPIs) for other employees, the mix of tactics and strategy offers a greater chance of deriving some measurable outcomes and provides a basis for evaluating executive performance. Even with this in place, however, it is important to realise that many of the real effects of executive performance may

not show up in a 12 month review cycle. There is still a need for medium-term incentives considerations.

One trend that is starting to emerge and which attempts to resolve this problem is the use of deferred short-term incentive (STI) payments. These work by staggering performance measurements and payments over time. For example, a notional STI payment of \$100,000 may be split into three payments of \$10,000 immediately; \$40,000 payable at the end of financial year; and the remaining \$50,000 to be paid at the conclusion of the following financial year. Each of the deferred payments could be subject to further performance evaluation and validation against the executive KPIs.

Deferred STI leads to increased complexity

While deferring STI payments does much to resolve the need for a medium-term proof of benefit, it does raise another problem. We are well past the time of opaque executive remuneration. Each decision must be justifiable, repeatable and transparent. This increase in visibility of the decision-making processes necessitates deeper analysis of employee performance and more advanced performance modelling. In short, deferring payments complicates an already complex process.

This increase in complexity has led to the emergence of a new class of transactional HR tool: enterprise compensation management (ECM) technologies. The aim of such tools is to automate compensation planning and administration. They support line managers as they make individual employee compensation decisions, and they instil a discipline and set of processes that are indeed justifiable, repeatable and transparent.

Typically, ECM tools are based on a series of modules, including: planning which covers job pricing and budgeting; decision making including review work flow and manager self service tools; integration to existing HR information and payroll systems; and reporting. Together, the modules assist managers in their decisions and walk them through the complex process of allocating annual compensation increases, bonuses and even long-term incentives. They also provide a means of tracking and recording the process throughout the company, providing a ready record should decisions ever be challenged.

Deployment of such solutions can become a form of proof that an organisation takes the question of remuneration seriously. It reassures staff that compensation decisions are carefully considered and take into account job performance and skills. Deployment also affirms to stakeholders and the public at large that executive remuneration follows a consistent and defensible policy.

Keeping it reasonable and achievable

As stated at the outset, public sensitivity to perceived remuneration excesses has created a minefield, particularly for public companies that must disclose details of executive packages in their annual reports. As the economic environment puts more pressure on companies' financial results as some businesses inevitably fail, and while the Federal Government's Productivity Commission Inquiry continues to receive

submissions, the intensity of this scrutiny will increase. The rise of deferred incentives may go some way towards solving the issue of accountability but at the same time it is making the process of executive remuneration reviews increasingly complex and time consuming. For HR, what is already a difficult annual process is turning into a major management headache.

Tools such as enterprise compensation management solutions can help. Good tools enable good decision-making processes and allow whatever level of remuneration your organisation pays to be unequivocally substantiated and justified. The right tools will also help to instil fairness, consistency and accountability into the remuneration review process.

Make sure your next remuneration review cycle doesn't hit the press, or if it does, make sure it gets you there for all the right reasons. **HC**

About the author

Phillip Evans established boutique software development company Evanscorp in 1999 and today he is the managing director. Evans also developed Remunerate, an award-winning employee compensation management solution. For more information visit www.remunerate.com.au





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