



The risky business of executive remuneration

Executive remuneration took a hit last year, but organisations are now looking to ensure this key group of employees remains engaged. Rebecca Grbin outlines the trends in executive remuneration practices.

While economies around the globe are recovering from the turmoil that was the global financial crisis (GFC), regulators, business leaders and academics are reflecting on what lessons can be learned. This article considers what the GFC fallout has meant for executive remuneration practices locally, and what lessons we can learn.

How did the GFC impact on executive remuneration practices in New Zealand in 2009?

As part of wider cost-cutting strategies, many organisations froze executive remuneration—and, in particular, chief executive pay—in 2009. Seventy percent of chief executives surveyed by DSD Consulting received no salary increases in the year to December 2009, thereby showing leadership and responsibility at a time of great uncertainty.

The decision by organisations to freeze pay had a dramatic impact on actual pay increases for the 12 months to December 2009. Overall median actual pay increases for the year were 2 percent, while for executives the median was 0 percent.

If we exclude those organisations which froze pay, however, the overall median was 3.5 percent, while the median for executives was 4.0 percent—the same median for chief executives as reported in 2008 and more aligned to business-as-usual practices.

In contrast, variable pay practices in the year to December 2009 remained fairly constant when compared to 2008 results. Specifically, areas where there was no material change included plan payouts and target incentive opportunities. For executives, the median incentive payouts as a percentage of base salaries was 17 percent in 2009 (compared with 16.6 percent in 2008). At the upper quartile,

payouts were 29.8 percent in 2009 compared to 25.2 percent in 2008.

Possible explanations as to why bonus/incentive payouts remained stable include:

- Some industries remained buoyant throughout 2009. Strong financial performance in these sectors translated into healthy, and in some cases above-target, incentive payouts.
- The results reflect a lag effect in that some of the incentive payouts occurring in the year to December 2009 related to an earlier period where performance was stronger. It is expected that 2010 results may reflect this lag effect diminishing.
- Achievable realistic targets were set that took into account extraneous pressures beyond managements' control.
- Boards exercised discretion and awarded payouts even where results failed to meet targets. These decisions recognised the extraordinary effort put in by senior leadership teams over a period of exceptional uncertainty and tough trading conditions. Boards may also have recognised that in many instances execu-

tives received no fixed pay adjustments and, additionally, long term incentive (LTI) plans were unlikely to deliver value.

How did the GFC affect executive remuneration practices internationally?

Internationally, executive remuneration practices received a political and media hammering. Practices within the financial services industry were particularly in the spotlight with many commentators pointing the finger squarely at Wall Street and City banker's bonuses as being at the heart of the GFC meltdown.

While the US response was unsurprisingly regulatory (the US has a history of legislative initiatives aimed at curbing perceived executive remuneration excesses), other jurisdictions—like the UK and Australia—have responded with industry bodies (eg, APRA and FSA) releasing principles-based guidelines on executive remuneration.

At the core of these principles is recognition that executive remuneration can be a risky business and the identification and mitigation of those risks is critical to the achievement of reasonable, effective and defensible executive remuneration packages.

Some risk areas include:

- Not having a well-articulated executive remuneration strategy that clearly states how each remuneration element is aligned to strategy and reflects the board's fundamental beliefs around remuneration;
- Failing to balance or take account of key stakeholder perspectives: ie, the executive's desire to be rewarded fairly; the board's need to attract, retain and incentivise top executives; and shareholder's desire to maximise returns;
- Performance measures or design mechanics (eg, uncapped schemes) that are not risk-adjusted, encourage excessive risk-taking, ignore line-of-sight, ignore whole-of-job-performance or encourage short-termism, or incentive plans that do not weather periods of business contraction as well as periods of growth.
- Poorly designed share plans that have the potential to deliver windfall gains unintentionally act as golden handcuffs or consistently fail to deliver meaningful value to participants.

The outlook for 2010—emerging trends in executive remuneration

Based on current research, it is likely that only a small number of companies will freeze executive pay in 2010.

This thawing reflects the steady return to business normality and the need to recognise both performance and market movements for executives over the past 12 to 24 months. As a result, conservative market forecasts indicate median movements for CEOs and executives of approximately 3 – 4 percent in 2010.

Further it is expected that boards will approach variable pay plans cautiously. On-target, short-term incentive opportunities as a percentage of total fixed remuneration are not expected to increase.



Meeting employee needs in challenging times



seed Employee Assistance Programmes *seed* Career Coaching
seed Trauma Support *seed* Conflict Resolution
seed Change and Outplacement *seed* Wellness Programmes

Telephone: 0508 664 981
Email: theteam@seed.co.nz
Web: www.seed.co.nz

FBSEE007

Navigating a new environment

Changes to the business environment in recent years mean a new set of challenges for career specialists. Kaye Avery discusses the need for new approaches to career development.

A new paradigm for career development has come about as a result of the massive change that has happened in the business environment over the last five or so years. For the applied psychology, coaching, career counselling and mentoring fraternity, this means that we need to rethink our approach to doing career work with clients.

Organisations and individuals who use the services of career practitioners come to us with a very different set of challenges than they did five years ago. People are now dealing with enormous amounts of complexity.

Traditionally, where work environments were stable and roles defined, career assessments based on 'sound' career theory provided us with a level of understanding about the career congruence potential for an individual. Career theory was rooted in the assumptions that personal traits are stable and that career development follows a sequence of predictable life stages.

Although assessments and inventories are very useful, the competencies and confidence required to navigate the work environments of today require so much more than understanding an individual's values, interests and career drivers. So much more is also required from the practitioner to assist the client to transform the contextual limitations and issues they experience.

The knowledge economy of today calls for new approaches and much more dexterity and wisdom from practitioners. No longer is it enough to do an assessment or two, arrive at some idea of what career congruence might mean to the individual, and then leave them to get on with it.

Now, we need to enable our clients to construct lives that are meaningful by opening up the possibility for higher levels of control and flexibility and helping them to recognise that meaning is co-constructed; that is, that identity is formed through relationship and context. Career identity is not separate from whole-of-life reality.

A recent paper published by Mark Savickas et al in *The Journal of Vocational Behaviour* (April 2009), suggests that practitioners should develop the "discipline of change". In other words, they need to be 'change agents' who deliver 'life-design' interventions that help people to deal with and actualise a personal identity that supports their meaning-making in a chaotic world.

We know that change is constant now, but more than that, it is difficult to identify any stability in life, regardless of life stage. This lack of stability presents the need for a whole new framework for career development.

This new framework focuses on:

- **Adaptability**—being open to addressing developmental tasks, workplace traumas and transitions;
- **Narrativity**—identifying through story, subjective experience, life themes, vocational personality and resources;
- **Activity**—engaging in diverse activities and feedback to build new life and career dimensions;
- **Intentionality**—imposing meaning on experiences and future aspirations by patterning a life-theme.

In summary, career work now requires a process that offers more in-depth work with clients to enable them to cope and respond to the challenges we face in this new world with greater confidence.

Kaye Avery is a career coach and the director of Career and Transition Consulting. Visit www.career-coach.co.nz for more information.



In addition, it is expected that the philosophical shift from old-school bonus/profit sharing plans to true incentive schemes tied to performance will continue to gain momentum in the private sector as these schemes work more effectively in periods of business growth and contraction.

Based on international trends, executive incentive plans will increasingly include both financial and non-financial measures to provide a balanced 'risk' profile. Within the financial services industry, boards are already considering the impact of the APRA guidelines and whether they have an obligation to comply or whether the guidelines represent best practice that should voluntarily be adopted.

This will also flow through to other private sector organisations with remuneration committees who have an interest in establishing robust governance criteria for managing executive remuneration.

The long-term view

There is an increasing trend towards long-term deferred cash plans. These plans defer part of the annual incentive provision (typically the above-target portion) and lock it in for a period of up to three years. At the end of the term, the rewards are paid in either cash or shares. These plans are simple to manage, don't require complex equity arrangements and act as an effective retention mechanism for senior employees.

Increasingly, new share-based plans in both New Zealand and Australia are in the form of performance share right plans. Some of the advantages of these plans are that they have an inherent value, so even if the share price slips back below their grant value they still have the potential to deliver some value to participants (provided performance hurdles are met); shares are acquired at the end of the vesting period thereby avoiding messy issues that can arise where shares are acquired upfront and subsequently devalue; and, something shareholders like, they deliver no value to participants until vesting.

The final word

Although executive remuneration took a hit in 2009, most organisations will once again wish to ensure this key group of employees remains engaged and ensure that the remuneration offering is competitive. This will also include reviewing current executive remuneration practices with a view to ensuring incentive schemes can weather periods of business contradiction and have strong risk mitigation elements.



Rebecca Grbin is a senior consultant with DSD Consulting. See www.dsdconsulting.co.nz.

