Executive pay needs more attention

Without disclosure of performance measures and targets, it is impossible to assess if top-level remuneration is fair

By MAK YUEN TEEN

SOME years ago, I was participating in a panel discussion on remuneration and some panelists argued that disclosure of executive remuneration was necessary to ensure that key management personnel pose a security risk because it makes executives the targets of kidnappers.

I replied, rather facetiously, that it was good that someone was reading annual reports, even if it were kidnappers. The point that I was really making is that kidnappers don’t really read annual reports to identify kidnap targets, just as companies and newsreaders don’t read them to identify poisoning targets.

Another time, I was told that a CEO did not want his pay to be disclosed because he did not want his wife to know how much he was paid, “perhaps so that she does not find out how much he was giving to his other ‘wife’.” Yet another told me that one CEO’s wife was complaining that he was paid much less than another CEO because the two CEOs were comparing disclosures in the annual reports.

It seems that when it comes to avoiding transparency in remuneration, there is no shortage of excuses. Most, however, simply cite “proprietary concern” or “need for protection” as reasons to avoid disclosure. These reasons are particularly absurd in cases where those whose remuneration is hidden are themselves major shareholders in the company. Seriously, who would want to pay someone who is a major shareholder of a founder- or family-controlled company to be an executive of another unrelated company?

Companies that cite “need for protection” for not disclosing remuneration may be fearing something else — perhaps fear of adverse ramifications from being seen as too high or too low that disclosure would cause in-hospitalization within the company due to perceived inequity.

In any case, a report published with December year-ends had revealed the latest annual reports, the Singapore Exchange (SGX) was busy querying companies about their failure to fully comply with rule 1207(12) relating to the guidelines in the Code of Corporate Governance on the disclosure of remuneration of directors, key executives and employees who are immediate family members of directors or CEOs.

Rule 1207(12) states: “The issuer should make disclosure as recommended in the Code of Corporate Governance, or otherwise disclose and explain any deviation from the recommendation.”

I counted 51 companies which were queried by the SGX, while another 61 companies responded with additional disclosures which allowed compliance with the Code guidelines. The other 32 did not make the additional disclosures necessary to comply with the guidelines. Of these, four did not disclose the names and/or percentages of breakdown of remuneration components for their key executives, citing competition, fear of poaching or confidentiality reasons. Twenty-one did not disclose remuneration information for fewer than five executives (as recommended in the Code) because they pointed out that other than directors and the CEO, the company did not have five key executives or key management personnel. The remaining seven declined to disclose remuneration for directors and/or key executives beyond a top band of $500,000 and above, citing competition or fear of poaching.

Let’s first look at the 21 companies that disclosed remuneration for less than five executives. Clearly, these companies have taken the Code’s reference to “key executives” (2005 Code) and “key management personnel” (2012 Code) to mean that they only need to disclose for the number of “key executives” or “key management personnel” that they have other than directors and the CEO. The term “key management personnel” is defined in Financial Reporting Standard 24 (FRS 24) on Related Party Disclosures to mean “those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of the entity”.

Many may interpret “key executive” and “key management personnel” to extend only as far down as those who report directly to the CEO. It would be true that many companies will not have five people directly reporting to the CEO. Perhaps the Code should be amended to cover the top five highest-paid executives, instead of top five key executives or key management personnel.

The SGX should also review rule 1207(12) which states: “If or if a person served in the capacity of a director or key executive for any part of a financial period, disclosure is required of the person’s annual remuneration for the period that the person had served as a director or key executive.”

It is probably not the first time that the SGX is asking for a higher standard of remuneration disclosure in its listing rules than what is in the Code. However, rule 1207(12) as it is written may be interpreted to require the disclosure of the exact amount of remuneration, at least for individuals who have served as a director or key executive for part of a financial period. The issue is whether such information is of any value to the Code. The issue is whether such information is of any value to the Code.

The sky’s the limit

It is the seven companies that continue to maintain the use of a top band of “$500,000 and above” which concerns me most. It is like me saying that I weigh more than 50 kg when asked about my weight. In these seven companies, executive directors are substantial shareholders, collectively owning from around 10 per cent to over 70 per cent of equity. In one case, these companies, they would have a significant influence over how much they get paid, for example, through their ability to influence the appointment of independent directors.

While we look at the key management personnel’s remuneration disclosed in notes to financial statements, it ranged from $4.4 million to nearly $40 million. Thanks to FRS 24, information on total key management personnel’s remuneration is available for scrutiny by shareholders, although the “principle-based” definition of “key management personnel” in the standard means that there is considerable variation in number of individuals included as key management personnel, and this number itself is not disclosed.

In two of the seven companies, key management personnel’s remuneration was 30 per cent of dividends paid, in another it was just over 65 per cent and in another two (which are related companies) it was almost or more than 100 per cent. In one key, looking at the dividend itself, remuneration to key management was high. We must understand that such information is important for shareholders in understanding the remuneration of key management personnel. As companies draw up their remuneration packages, they must consider the actual duties the executive performs and the work that has to be performed.

Executive remuneration deserves a far more detailed set of rules that takes into account the nature of the business, the risk that is taken and the remuneration of shareholders in several of these companies.

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All companies, whether in developed or emerging markets, must disclose remuneration in a clear and concise manner. As companies work on remuneration packages, they must consider the actual duties the executive performs and the work that has to be performed. They must understand that such information is important for shareholders in understanding the remuneration of key management personnel.