Executive compensation plan, no doubt, is an enabler for driving corporate objectives and ensuring alignment of interests. However, there are inherent risks and challenges in this setup and management that, if not properly addressed, can undermine their effectiveness in achieving desired objectives.

The issues that those responsible for executive compensation
to address in their remuneration management include:

1. Continuing growth in total CEO pay over the past five (5) years
2. Increasing reliance on equity-based compensation
3. Growing trend towards “at-risk” pay
4. Growing awareness of pay-related risks
5. Increasing focus on ESG and impact

In respect of STI schemes, major companies use income-related metrics such as metrics per share (EPS), net income, operating income, or gross margin. However, there is a growing trend towards the use of cash flow metrics such as net income, operating income, or gross margin. In respect of LTIs, companies use a variety of metrics such as net income, operating income, or gross margin.

Another key feature of executive compensation is the growing awareness of pay-related risks. This includes “at-risk” pay, where the compensation is linked to the performance of the company or a specific project.

In respect of alignment of interest, major companies have introduced share-based plans for executives. In the US, the most prevalent threshold and maximum TSR for their LTI plans is around 10%.

As part of measures to enhance corporate governance and curtail excessive risk taking, companies in the global market are now required to introduce Clawback policies to provide a framework for recouping excessive / erroneously paid incentive earmarking from misstated financial results. Wells Fargo has recently clawed back $150 million from its former CEO and other top executives as a result of the bank’s false accounting.

An increasing attempt by businesses, shareholders, regulators, and other relevant stakeholders to strengthen the link between performance and rewards, ensure better alignment of interests and corporate governance, amongst others.

6 times Base Pay, to be acquired over an average period of five (5) to ten (10) years, using Fortune 100 companies, as an example. Executives are also required to hold vested stocks for a year or two before they can begin to dispose of them.

Executive compensation has evolved significantly over time and will continue to evolve as stakeholders continuously seek ways to ensure better alignment of interests, stronger link between pay and performance as well as promoting corporate governance.

Previous implemented changes become today’s lessons for enhancing the overall objective of driving corporate objectives, leveraging well-tailored and effective performance-sensitive pay programmes.

The complexities and pace of developments, however, continue to evolve as stakeholders continuously seek ways to ensure better alignment of interests, stronger link between pay and performance as well as promoting corporate governance.

About KPMG People Services
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