Why remuneration committees need independent advisors

Recent reports of shareholders voting against executive remuneration structures have again highlighted the need for increased transparency in the disclosure of not only the amounts paid, but how the amounts were calculated and the link to performance. Many companies have made significant progress with the disclosure of executive pay and the quality and content of remuneration policies and implementation reports.

Laurence Grubb, Master Reward Specialist and executive committee member of the South African Reward Association

However, the improved transparency of certain excessive executive pay packages has also fuelled the perception that all executives are paid exorbitant amounts of money, causing an ever increasing pay gap.

Laurence Grubb, Master Reward Specialist and executive committee member of the South African Reward Association (SARA), says a handful of executives are still able to manipulate remuneration committees, despite notable efforts to follow the principles set out in King IVTM and the association's guidelines.

Committees agree to targets which are a little too soft or potential remuneration that is out of line with industry. "Although these executives are in the minority, it remains a concern and needs to be contained."

Independent advice needed

Grubb says remuneration committees should be entitled to obtain independent advice from their own remuneration consultants to validate what has been presented to them by the executives. The cost for this service should be borne by the company.

SARA published guidelines on the drafting of a remuneration policy and the implementation report at the beginning of the year which follows the principles set out in King IV.

Some ‘old’ long term incentive schemes may have awards which were not linked to performance. Those shares may now be vesting, and with no performance linked to them, it is quite possible that shareholders will vote against such schemes.

Grubb says companies need to confirm the performance criteria for vesting before making any awards for long term incentives. Failing to do so, will undoubtedly annoy shareholders.

Barclays Africa experienced this first hand when shareholders voted against the company’s policy and implementation report earlier this month (May 2018).

In terms of the King IV principle on remuneration, the policy should record the measures that the board commits to when 25% of the votes are exercised against either the remuneration policy or the implementation report, or both. These actions should then be communicated in the background statement in the following year.

South Africa is the only country in which the threshold for these remedial measures is as low as 25%. In Australia, the UK and Belgium, among others, remedial measures are only mandated if 50% or more of the votes are cast against the remuneration policy and implementation report.

Pay gap realities

The pay gap in South Africa remains a burning issue, although companies have been trying to address it by offering larger annual increases for lower level workers and smaller increases at executive level.

However, an increase of 5% on R2 million will always make a bigger gap than 8% on R100,000. Several companies have also introduced the minimum wage, and in some instances, wages which exceed the minimum wage.

In countries where the pay gap is much narrower, the level of skills, education and productivity of the lower end workers are much higher than in South Africa.

Grubb says companies operating in those countries are typically able to pay much higher rates to their lower level employees because of the higher skills and productivity levels.

“Unfortunately, in countries where education is severally limited and not at the right standard, the impact is felt mostly by those whose skills and level of education do not offer them the opportunity to increase their earning potential.”

Companies find it difficult to continually pay higher salaries to lower levels and, inevitably where that does happen, there are job losses.