CEO performance and remuneration: A boardroom perspective

An Insync Surveys study in conjunction with Board Benchmarking

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Introduction

This is the second in a series of boardroom perspectives based on the views of 625 directors who sit on 79 different Australian and New Zealand boards. It deals with boardroom perspectives on CEO performance and CEO and senior management remuneration.

Remuneration and in particular the bonus packages of CEOs and senior management have been in the spotlight across the globe in recent times. It will probably take some time before the community, shareholders, boards and management get on the same page in terms of what constitutes an appropriate remuneration package. The Global Financial Crisis provides organisations with a good opportunity to recalibrate their thinking. Boards must provide leadership and direction in relation to this very important issue.

Key findings

The overall findings in this study are disappointing. Boards seem to have a long way to go in ensuring remuneration packages are appropriate and setting high standards of organisation performance. Specifically this study has found that:

- positively, 71% of directors say their CEO is highly effective; as one of the most important tasks of the board is to select, remunerate, develop, assess and where appropriate, replace the CEO, this is encouraging (page 7)
- less than half (only 44%) of the 625 directors believe the performance appraisal of their CEO is handled well (page 8)
- only around half consider their CEO's (55%) and senior management's (50%) remuneration packages to be appropriate; boards need to do more to recalibrate the remuneration, including bonus expectations of the CEO and senior management, to ensure they are appropriate and linked to organisation performance (page 9–10)

About this study

This study is the second in a series on board performance. These studies will focus on the views of directors regarding the major areas of the effectiveness of boards, based on Board Benchmarking's WhatWhoHowDo™ Framework.

Insync Surveys is an authorised distribution partner of Board Benchmarking's Board Effectiveness Survey.

About the sample

This study is based on the views of 625 directors who sit on 74 Australian and 5 New Zealand boards. They have responded to 120 hard-hitting, best practice survey statements of Board Benchmarking, formerly Leblanc Diagnostics. The boards included in the study represent a broad cross section of organisations ranging from ASX organisations (including in the top 10), to private companies, associations, not-for-profits and government entities.

The data was gathered between January 2006 and September 2008. The majority of directors in the research sample are males, non-executive directors and with the largest age segment being over 64. The sample is almost evenly split between organisations with a profit versus a not-for-profit motive.

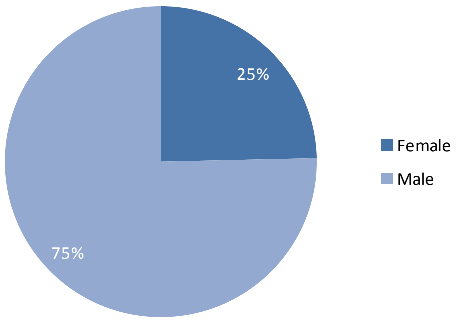
Females are more likely to:

- be under 45 years of age
- be directors in not-for profit organisations
- have less experience as a director

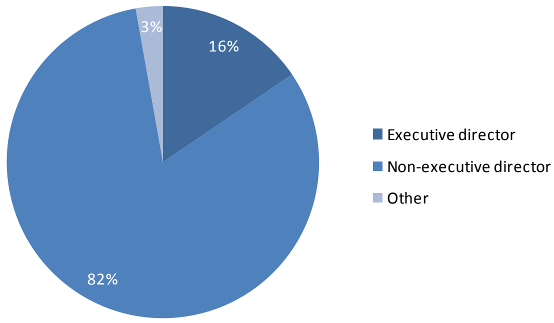
Males are more likely to:

- be over 64 years of age
- hold a director position in a corporate organisation
- have more experience as a director

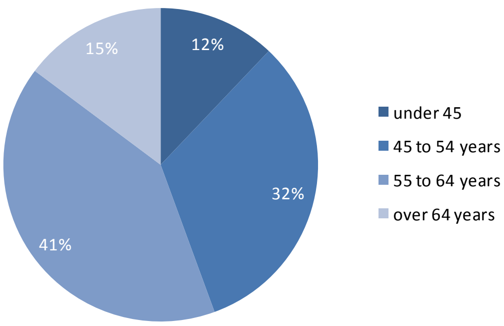
Gender



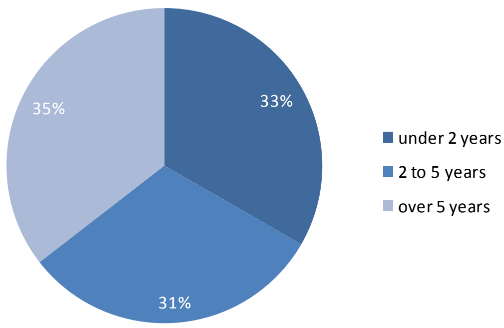
Independence



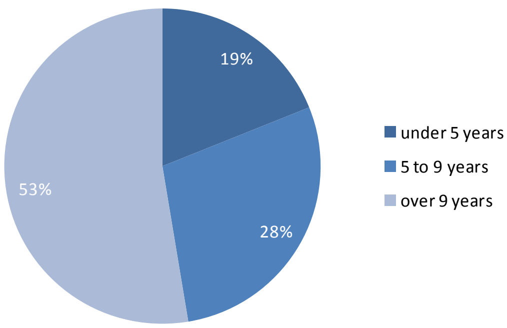
Director age



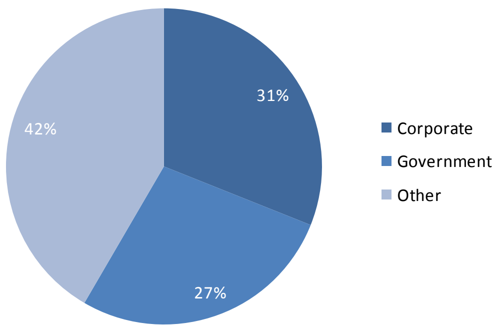
Director tenure



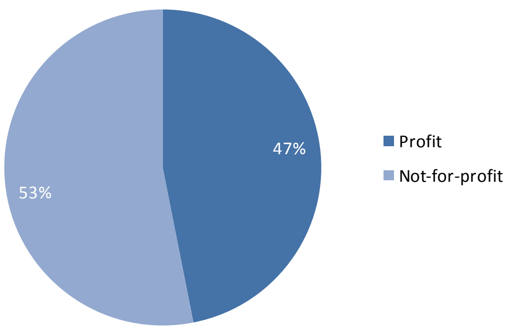
Director experience



Organisation type



Motive



Methodology

Data gathered from the self assessment of directors who completed Board Benchmarking's Board Effectiveness Survey have been used as a basis for this study. The survey is based on Board Benchmarking's unique WhatWhoHowDo™ Framework, as explained at www.boardbenchmarking.com. The Board Effectiveness Survey is used by organisations' boards to highlight areas of strength and areas where improvements can be made. It also acts as a yardstick against which to measure outcomes of improvement initiatives.

The survey has 120 statements measured on a seven point scale where "one" represents strongly disagree and "seven" represents strongly agree. The survey is unobtrusive and is designed to be completed by directors online within 30 minutes.

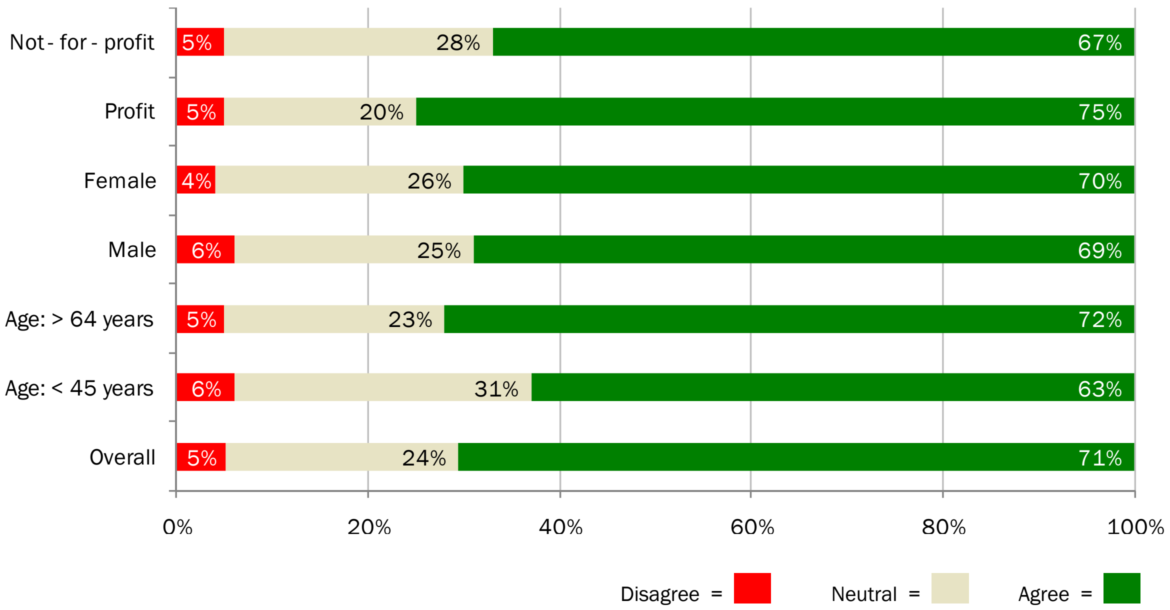
This study highlights differences among demographic groups. To do this, the seven rating options are aggregated under the titles of "disagree", "neutral" and "agree" as follows:

Disagree =	Neutral =	Agree =
Strongly disagree (1) Disagree (2)	Slightly disagree (3) Neither agree nor disagree (4) Slightly agree (5)	Agree (6) Strongly agree (7)

Copyright warning

1. Driving highly effective CEOs

Response to the survey statement: “Our CEO is highly effective”



Positively, 71% of directors agree that their CEO is highly effective and only 5% of directors disagree with the above statement. The extent of agreement drops away with non-executive directors and directors aged under 45 years.

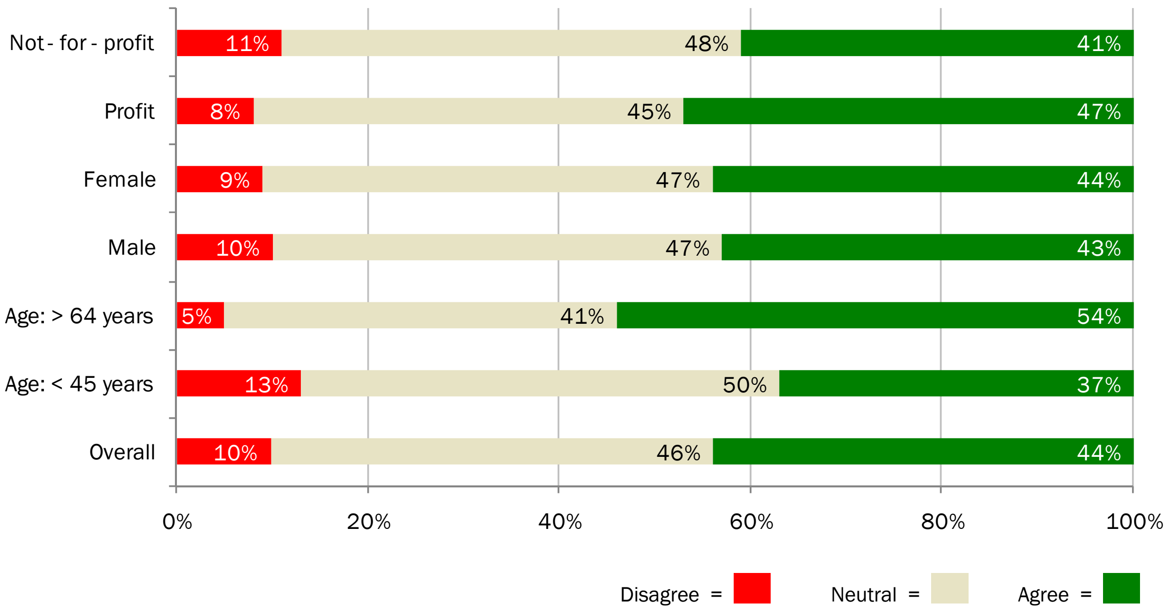
Most directors would agree that one of the single most important tasks of the board is to select, remunerate, develop, assess and where appropriate, replace the CEO.

The CEO’s role is a pivotal one in an organisation, which requires great leadership, vision and execution capability. Boards need to match the skills, experience and attributes of a potential CEO with the strategic needs of the organisation at the relevant time. A CEO who does an outstanding job during a period of high industry growth, won’t necessarily be the right CEO for a period of sustained industry contraction.

Directors who have a view that the organisation’s CEO is not effective, need to voice their concerns and ensure that appropriate action is taken. Many directors confide that in the small number of circumstances where their CEO was ineffective, their board probably acted too slowly to replace such person. Proactive succession planning can assist with this. Regular formal CEO appraisal is also critical (see the next research finding).

2. Addressing CEO performance appraisals

Response to the survey statement: “The performance appraisal of our CEO is handled well”



This is one of the more disappointing results in this study, with only 44% of directors agreeing that the performance appraisal of the CEO is handled well and 10% actually disagreeing. This is an area where significant benefit can be gained by boards appropriately addressing such deficiency, as most CEOs appreciate and benefit from a constructive, transparent and thorough performance appraisal process.

Only 37% of directors aged under 45 years agree that the CEO’s performance appraisal is handled well, whereas 54% of directors aged over 64 years have that view; again showing younger directors are more critical. A large number of directors, 13%, aged under 45 years disagree that the CEO’s performance is handled well, whereas only 5% of directors over 64 years have the same view. This could be partly explained by the fact that younger directors have grown up during a period of more rigorous performance appraisals not only of CEOs, but of senior management and all employees. It could also be the result of many CEO appraisals being undertaken exclusively by the chairman, the remuneration committee or sometimes by an “inner-cabinet” of the board, without appropriate feedback to the other directors.

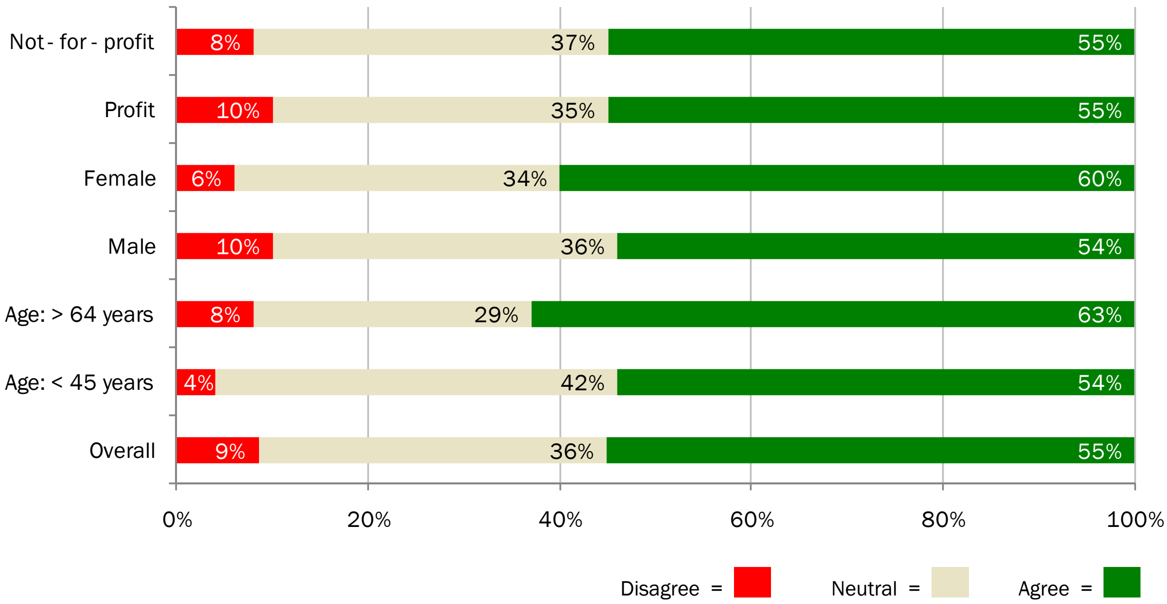
A CEO performance appraisal that is handled well will:

- be constructive with a view to the CEO’s ongoing development
- include an appropriate comparison of actual CEO and organisation performance against predetermined performance criteria
- be based on an agreed process and timing and be well documented
- include appropriate input from and feedback to all non-executive directors.

It is particularly important that an appropriate performance appraisal and an appropriate and transparent performance management process, with very clear and agreed accountabilities, be conducted of a poorly performing CEO.

3. Appropriate CEO remuneration packages

Response to the survey statement: “Our CEO’s remuneration package is appropriate”



As boards are responsible for approving their CEO’s remuneration package (often based on a recommendation of a remuneration committee), it is of significant concern to note that only 55% of directors agree that their CEO’s remuneration package is appropriate, with 36% being neutral and 9% actually disagreeing.

The remuneration packages of CEOs and particularly the bonuses paid to CEOs of high profile organisations across the globe have been in the spotlight in recent times. There is a growing community and shareholder view that some CEO salaries, bonuses and termination payments are excessive.

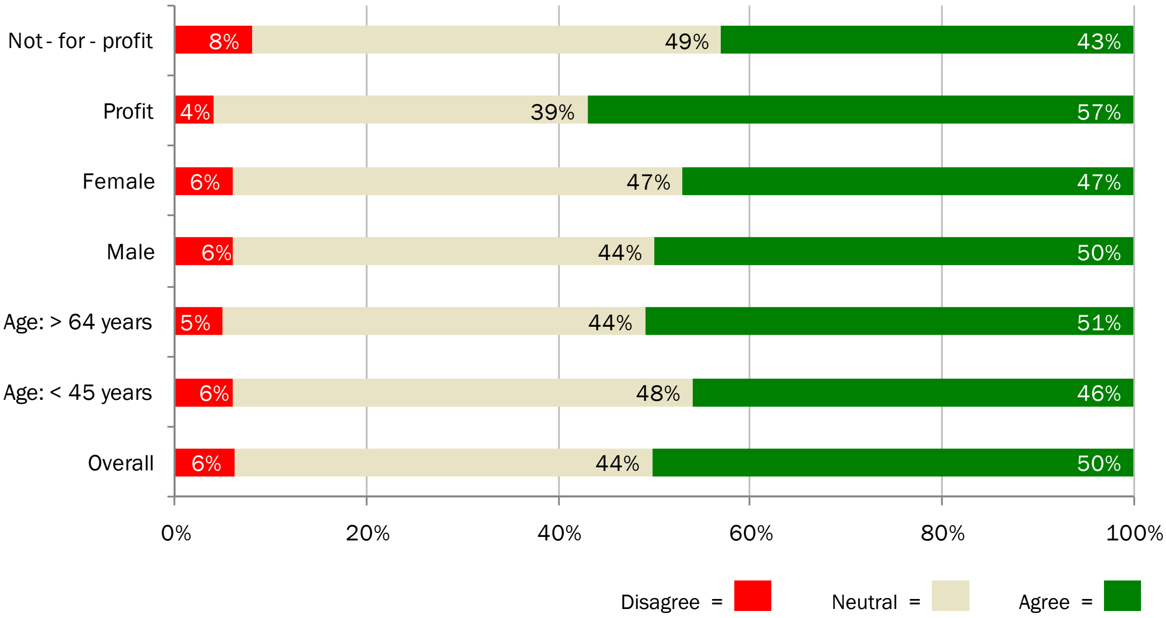
The Global Financial Crisis has also highlighted the fact that many organisations across the globe have had an excessive focus on the achievement of short term objectives and incentives with insufficient regard to long term risks and sustainable returns.

Governments and regulators across the globe have foreshadowed the possibility of limiting salary packages and termination payments and in some cases, tying such to an organisation’s risk profile and capital adequacy. The Australian Government has already moved to limit termination payments to executives to one year’s base remuneration without shareholder approval. There has also been considerable debate regarding the merits of the non-binding vote on the Remuneration Report versus a binding shareholder vote on executive remuneration.

The Australian Institute of Company Directors (“AICD”) called on boards in February, 2009 to critically assess their approach to executive remuneration. Directors are encouraged by the AICD to use the current changed market circumstances to rethink senior executive remuneration. This includes appropriately “stress testing” proposed incentive arrangements to ensure they work appropriately in different economic and market circumstances.

4. Appropriate remuneration packages for management

Response to the survey statement: “The remuneration packages of our management (other than our CEO) are appropriate”



As with section 3, there is a similar low level of agreement (50%) that the remuneration packages of management are appropriate, with 6% of directors having the view that such remuneration packages are not appropriate. This is another disappointing and contentious result.

Boards need to understand how the pay of their CEO and senior management team is linked to individual and organisation performance and ensure that total remuneration packages, including any performance bonuses, are appropriate in all possible circumstances, including in very high, medium and very low levels of organisation performance.

An appropriate balance also needs to be achieved between short and long term incentives, so that inappropriate risk-taking is discouraged and long term enhancement of shareholder value is appropriately considered.

It is the board, whether through a remuneration committee or otherwise, that is responsible for the pay levels and pay structures that apply to senior management. While the board will set the CEO’s salary package, the CEO will often set the salary packages of the organisation’s senior management within a framework of pay levels and structures that are agreed by the board.

The pay culture that built up in many organisations during the recent sustained period of economic growth often treated a performance bonus as a right and as a part of normal remuneration. The Global Financial Crisis has had a silver lining in terms of switching the focus from short-term returns to longer-term value creation. This has given organisations and boards the opportunity of recalibrating expectations of CEOs and senior management by ensuring bonuses are not seen as a right, but something that is earned as a result of outstanding performance that adds organisational value over the long term.

5. Board Effectiveness Review to increase performance

It is important that boards ensure they have an effective CEO, pay the CEO and senior management appropriately, encourage a strong culture of organisational performance and act appropriately when performance measures are not met.

The oversight of the CEO and organisational performance is a core board function – a function that periodically needs to be evaluated to ensure that the board is performing that, and other key functions, effectively.

Most people understand the importance of a regular health check to determine whether they have any risks to their health and if they are operating at their optimal capacity. Even if there are no obvious signs of ill-health, most people after a certain age ensure they have an annual check-up.

They do that check-up with a competent doctor who knows dozens of the most common areas of poor health and early warning signs of disease. Such doctors know what blood tests, scans and other tests to carry out. Occasionally, extra tests are needed if certain initial tests are not conclusive.

In a similar way, Insync Surveys recommends a regular check-up for boards and board and management committees to determine if there are any risks to their "health" and if they are operating at their maximum capacity or contrary to accepted practices.

Insync Surveys offers the following world class surveys that determine the extent to which boards, committees and directors are effective.

	Individual matters covered	Time to complete (mins)
Board Effectiveness Survey	120	30
Audit Committee Effectiveness Survey	120	30
Board Risk Survey	75	25
Board Risk Committee Survey	98	30
Management Risk Committee Survey	98	30
Director 360 Survey (of all directors)	24	30

Other surveys important to boards include:

Organisation Alignment Survey (for employees)	120	25
Employee Risk Culture Survey		
senior employees	56	15
all employees	27	7

Feedback from users of these surveys commonly include … "easy to complete"… "searching and comprehensive questions" … "focuses things quickly" … "hits the mark".

Further details are available at www.insyncsurveys.com.au and www.boardbenchmarking.com.

About Insync Surveys

Insync Surveys has one of the largest suites of leading edge integrated benchmarked stakeholder surveys in the world. Its surveys are distributed in over 30 countries and in more than 15 languages. Its surveys are for employees, customers, boards, community groups and many other organisation stakeholders.

Insync Surveys has carried out surveys for some of the largest public, private, government and not-for-profit organisations in Asia Pacific. It is based in Australia and has representatives in New Zealand, Asia, UK and North America. Insync Surveys' technology also powers the surveys of Board Benchmarking.

Visit: www.insyncsurveys.com.au
Contact us: info@insyncsurveys.com.au

About Boards Insync

Boards Insync is the specialist board survey division of Insync Surveys. It has one of the largest ranges of integrated board surveys in the world, including the Board Effectiveness Survey, Board Risk Survey, Audit Committee Effectiveness Survey, Risk Committee Effectiveness Survey and the Director-Peer Survey.

Its world class board surveys are available globally and have been carried out for numerous large public, private, government and not-for-profit organisations.

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