GRG Remuneration Insight 44

Remuneration Profile Review

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Introduction

Remuneration profiles represent the way that the remuneration building blocks are put together for executive remuneration purposes. They also reflect the proportions of remuneration that are expected to arise for different elements of remuneration at different levels of performance. These proportions may vary for different categories of employees. This GRG Remuneration Insight canvasses the main types of Remuneration Profiles and discusses when they may be relevant.

Expression of Remuneration Profiles

In Remuneration Reports it is necessary, due to Corporations Act provisions, to disclose the remuneration profiles that emerged for executives during the year being reported and the prior year. The disclosure required is that each element of remuneration be expressed as a percentage of the total remuneration received by the executive for the year. Accordingly, a remuneration profile in a Remuneration Report may appear as follows:

Element of Remuneration	Amount	Actual Remuneration Profile (% of TRP)
Base Package	$200,000	60.6%
Short Term Incentive (STI)	$60,000	18.2%
Long Term Incentive (LTI)	$70,000	21.2%
Total Remuneration Package (TRP)	$330,000	100%

However, for remuneration planning and management purposes it is rare for remuneration profiles to be expressed as percentages of the TRP. This is because incentive award opportunities tend to be expressed as percentages of Base Packages. Expressed in this way the forgoing remuneration profile may be re-expressed as follows:

Element of Remuneration	Amount	Actual Remuneration Profile (% of Base Package)
Base Package	$200,000	100%
Short Term Incentive (STI)	$60,000	30%
Long Term Incentive (LTI)	$70,000	35%
Total Remuneration Package (TRP)	$330,000	165%

The foregoing two tables illustrate the communication differences between disclosures as required under the Corporations Act and disclosures as used by companies to communicate with executives. The Corporations Act disclosure simply reports the outcome for a year by combining accounting values – Base Package is what was actually paid in the year, STI is often what was earned in the prior year but paid in the current year and LTI is the value of grants over several years being partially amortised in the current year. Companies in communication with executives disclose the remuneration opportunity for the year even if it will not be paid or vest until subsequent years.

Remuneration Planning and Management

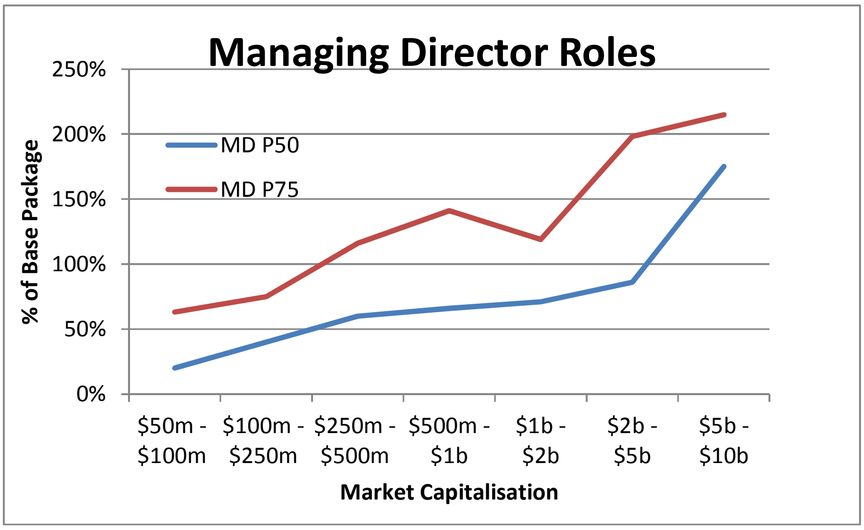
It is common market practice for Boards to set market based policies for Base Packages. STI and LTI award opportunity levels are expressed as percentages of Base Packages. Each year Base Packages tend to be reviewed and benchmarked against relevant market practice. Whereas the percentage award opportunity levels for STI and LTI tend to be reviewed and benchmarked less frequently and often only once every three years or more. Of course, the amounts of STI and LTI award opportunities increase in line with increases in Base Packages even if the STI and LTI percentages remain constant.

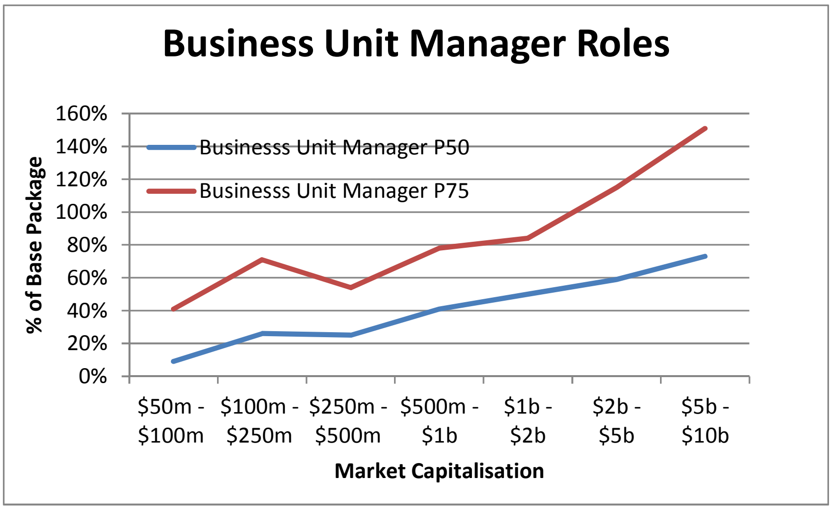
STI and LTI award opportunity levels are often set so that when added to Base Packages, they achieve desired market TRP positions. A typical policy is for Base Packages to be set by reference to median/P50 market practice for Base Packages and for the levels of STI and LTI at target performance to achieve TRPs of around the 75th percentile (Q3) of market practice.

In addition to opportunity remuneration profiles for target performance it is also usual for Boards to set opportunity remuneration profiles for stretch or outstanding performance. Often these incorporate STI and LTI award opportunities that are set at double the target levels. Following is an example of such a remuneration profile for an executive.

Element of Remuneration	**Opportunity Remuneration Profile (% of Base Package)**	
	Target Performance	**Stretch Performance**
Base Package	100%	100%
Short Term Incentive (STI)	30%	60%
Long Term Incentive (LTI)	30%	60%
Total Remuneration Package (TRP)	160%	220%

The following line charts show the uplift, expressed as a percentage of Base Package, required to achieve either P50 or P75 TRP when added to a P50 Base Package. The data was extracted from the 2012 GRG Industrial & Services KMP Remuneration Guide. One chart provides data for Managing Director roles and the other for Business Unit Manager roles. It should be noted that the uplift required for Managing Director roles is higher than for Business Unit Manager roles.





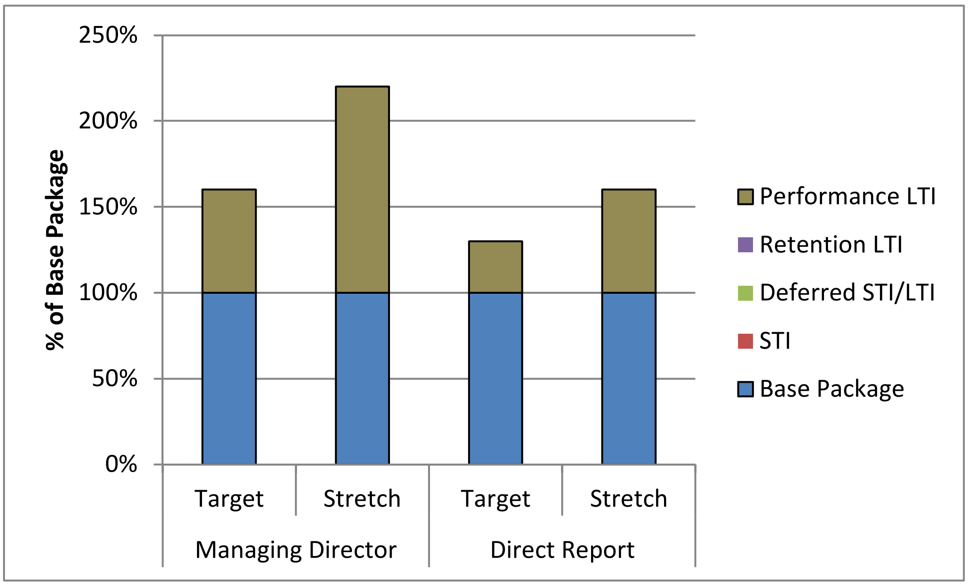
Alternative Remuneration Profiles

Following are examples of remuneration profiles with comments on when they may be appropriate.

Example A

Example A could be appropriate for a company that is exploring for natural resources and has fluid business plans as it may change priorities as new opportunities emerge. If an STI is used it will probably be a discretionary bonus as it will generally not be possible to select key performance indicators (KPIs) and set standards of performance for those KPIs that will remain appropriate for the full financial year. In these situations is it is often preferable to not use an STI so as to preserve cash and to provide all incentives via equity plans. The example uses low incentive award opportunities as these companies tend to be small in terms of market capitalisation.

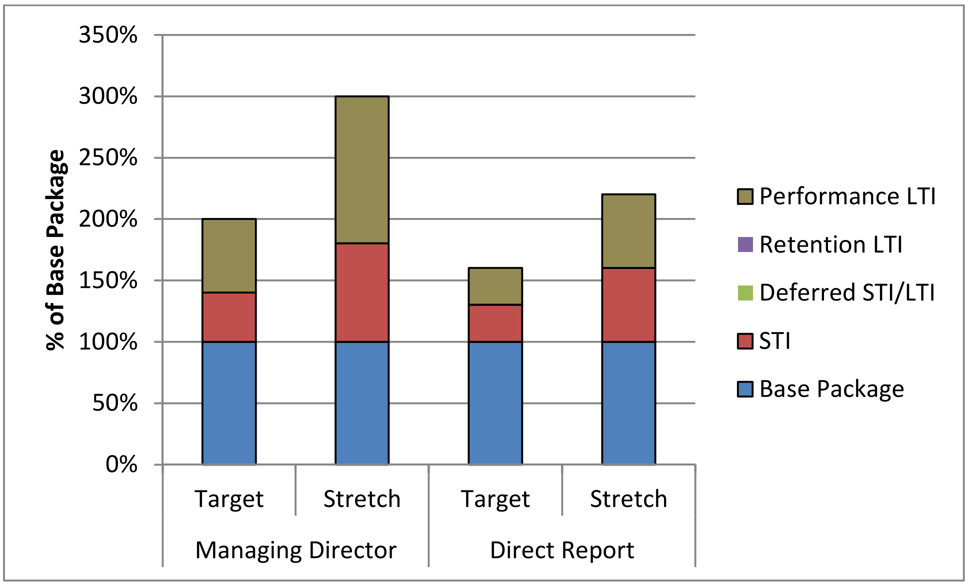
Example A



Example B

Example B is a typical illustration of an established company with a market capitalisation of around $100 million. Here separate STI and LTI plans are used with the Managing Director (MD) having higher total incentives than his Direct Reports and the MD's LTI has a heavier weighting than the STI.

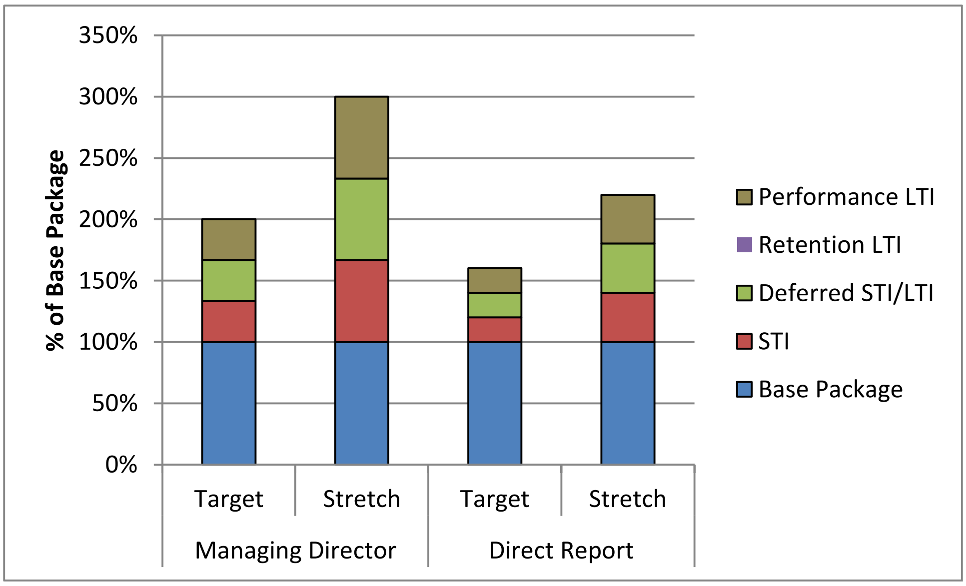
Example B



Example C

Example C is similar to Example B except that more emphasis is placed on the STI and retention. Under this remuneration profile the executives are advised that the target level of STI is double the target level of LTI. This places a strong emphasis on the STI and pressure on the Board to ensure that the budgeting process remains rigorous and the standards of performance in relation to the KPIs remain challenging and achievable. However, once an STI award is earned half of the amount is deferred into shares or rights that vest upon completion of another two years of service. The use of shares or rights continues to provide a company performance incentive as the value of the deferred amount will vary in line with share price movements. It also can produce a strong retention impact if the value deferred into shares or rights is significant. Of course, if the STI earned is small then the retention impact will be diminished.

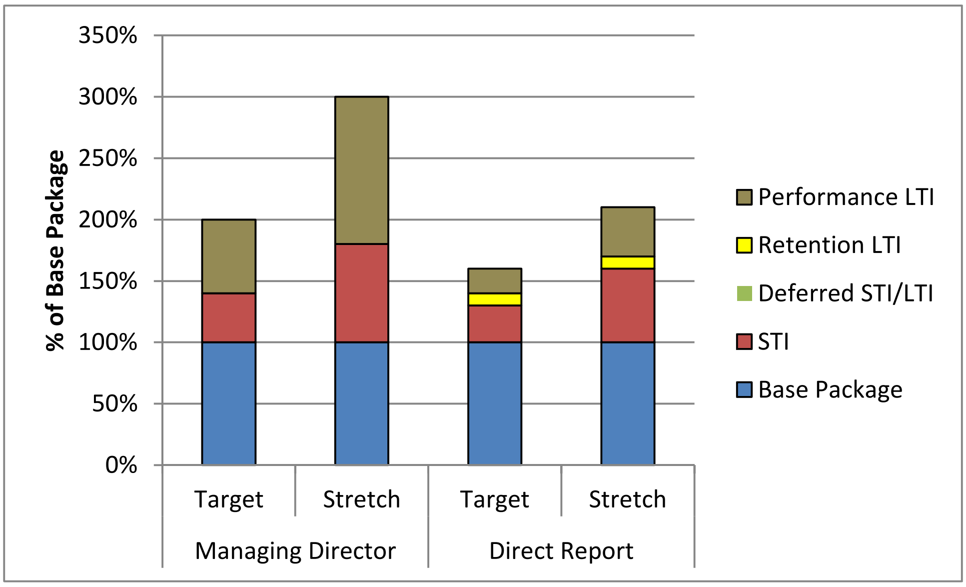
Example C



Example D

Example D is similar to Example C except that the value deferred into shares or rights is fixed ensuring that the retention element applies irrespective of outcomes under the STI plan. While the use of shares or rights which vest based on service is acceptable to shareholders for Direct Reports (provided that there are also performance vesting shares, rights or options) and lower level employees, shareholders often resist the grant of service vesting shares or rights to MDs are they prefer their incentive to be totally performance related.

Example D



Conclusions

The foregoing examples were chosen as a means of demonstrating several important points;

1. remuneration profiles need to be selected on the basis that they are most appropriate to the specific circumstances of the company,
2. remuneration profiles are a function of the Board's policy on market competitiveness of Base Packages and TRPs which gives rise to the amount to be offered as incentive award opportunities,
3. the relative weighting of LTIs and STIs, if any, need to recognise that different levels of employees are involved with different planning horizons, and
4. the difference between target and stretch remuneration profiles will be influenced by the degree to which Boards are prepared to offer an incentive to exceed planned/budgeted performance.